Exhibit No.:	*1052*
Issues:	*Corporate History; Aquila's Organizational Structure in 2001; Aquila's Financial Problems; Current Corporate Structure; Corporate Allocation Adjustments; and Corporate Plant and Reserve Allocations*
Witness:	*Charles R. Hyneman*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Direct Testimony*
Case No:	*ER-2004-0034*
Date Testimony Prepared:	*December 9, 2003*
as Modified:	*February 27, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

CHARLES R. HYNEMAN

AQUILA, INC. d/b/a AQUILA NETWORKS-MPS (Electric)

CASE NO. ER-2004-0034

Jefferson City, Missouri
December 2003

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila Networks L&P and Aquila Networks MPS to implement a general rate increase in electricity.	)))	Case No. ER-2004-0034

AFFIDAVIT OF CHARLES R. HYNEMAN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Charles R. Hyneman, of lawful age, on his oath states: that he has participated in the preparation of the following direct testimony as modified on February 27, 2004, in question and answer form, consisting of 32 pages to be presented in the above case; that the answers in the following direct testimony as modified on February 27, 2004, were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Charles R. Hyneman
Charles R. Hyneman

Subscribed and sworn to before me this 26th day of Feburary 2004.

D SUZIE MANKIN
Notary Public - Notary Seal
STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. JUNE 21,2004

D Suzie Mankin

TABLE OF CONTENTS OF

DIRECT TESTIMONY OF

CHARLES R. HYNEMAN

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CASE NO. ER-2004-0034

DIRECT TESTIMONY

OF

CHARLES R. HYNEMAN

AQUILA, INC. d/b/a AQUILA NETWORKS-MPS (Electric)

CASE NO. ER-2004-0034

Q. Please state your name and business address.

A. Charles R. Hyneman, 3675 Noland Road, Suite 110, Independence, Missouri 64055.

Q. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor with the Missouri Public Service Commission (Commission).

Q. Please describe your educational background and work experience.

A. I have a Bachelor of Science degree in Accounting from Indiana State University and a MBA from University of Missouri at Columbia. I am a Certified Public Accountant (CPA) licensed in Missouri. I served twelve years on active duty in the U.S. Air Force and joined the Commission in 1993.

Q. Have you previously filed testimony before the Commission?

A. Yes. Schedule 1, attached to this testimony, lists the cases in which I have filed testimony before the Commission.

Q. With respect to Case Nos. ER-2004-0034, have you made an examination of the books and records of Aquila Inc. (Aquila or Company) and its Missouri Public Service (MPS) operating division?

A. Yes, with the assistance of other members of the Commission Staff (Staff).

Q. What is the purpose of your direct testimony?

A. The purpose of this testimony is to provide support and rationale for the Staff's proposed level of corporate costs allocated from Aquila's corporate overhead departments to the MPS utility division. In addition, in this testimony I will describe the history of Aquila, its acquisition growth strategy, its current financial difficulties and its corporate allocation structure.

Q. What knowledge, skill, experience, training or education do you have with regard to the areas you have been assigned?

A. I have acquired general knowledge of these topics through my experience in auditing corporate overhead costs in previous major rate cases filed with the Commission. I have also acquired knowledge of these topics through review of Staff workpapers and testimony from prior cases brought before this Commission relating to Aquila and other Missouri utility companies. I have also reviewed testimony and public utility commission orders on the issue of corporate allocations in other state utility regulatory proceedings. In addition, my college undergraduate and graduate coursework included accounting and auditing classes. Finally, I successfully passed the CPA exam, which included sections on accounting practice and theory, as well as auditing. I currently hold a license to practice as a CPA in Missouri.

Q. What Income Statement adjustments to the Staff Accounting Schedules are you sponsoring?

A. I am sponsoring numerous adjustments to Accounting Schedule 9, Income Statement, that are listed on Accounting Schedule 10, Adjustments to Income Statement. These adjustments are listed on schedules attached to this testimony. Schedule 2 lists MPS adjustments

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Corporate History

1917 to 1985

Q. Please provide a history of Aquila's corporate structure and operations.

A. Aquila was founded in 1917 as Green Light and Power Company. In 1922 the Company went public and changed it name to West Missouri Power Company. In 1927, West Missouri Power Company merged with and changed its name to Missouri Public Service Company (MPS). In 1954 MPS's revenue reached $10 million as it continued to grow through service expansion and utility acquisitions.

In 1985 Mr. Richard C. Green became Chairman, President and Chief Executive Officer (CEO) after being with the Company in various positions for several years. He held the position of CEO until it was assumed by his brother, Robert K. Green, in November 2001. In the same year as Richard Green became CEO, MPS changed its name to UtiliCorp United, Inc. (UtiliCorp) and began on its 17-year journey of rapid growth through acquisitions both in the domestic and international arena and its expansion into nonregulated operations.

1986 to 2000

In the first 10 years since UtiliCorp was formed from Missouri Public Service Company, it went from being a mostly electric utility in western Missouri to become a diversified, international energy provider. By 1995 it had facilities in 17 states, two provinces of Canada, the United Kingdom and New Zealand. Aquila's merchant business, which began as a small two-person natural gas merchant business acquired in the Peoples Natural Gas acquisition grew significantly over this time period. Over time this operation became Aquila Merchant Services and grew into one of the largest providers of wholesale energy and risk management services in North America. By 2000, Aquila Merchant Services had investments in electric generation assets, gas pipelines, gathering systems and gas storage facilities. It also traded commodities such as natural gas, electric power and weather derivatives.

It was also during this time period that Aquila entered into the telecommunications sector by investing in Everest Connections (Everest), a company that provides local and long distance telephone service, cable television, high-speed Internet and data services in the Kansas City area. Aquila also made a significant equity investment in Quanta Services Inc.

(Quanta), one of the largest specialized contractors in the nation, serving the utility, cable television and telecommunications industries.

The following is a list of companies acquired in whole or in part by UtiliCorp since 1986. Not included in this list are numerous partnerships and other investments too numerous to list here.

1986 - Northern Minnesota Utilities and Peoples Natural Gas
1987 - West Kootenay Power in British Columbia, Canada
1987 - West Virginia Power
1989 - Michigan Gas Utilities
1990 - WestPlains Energy
1990 - West Virginia Power Gas Service
1991 - Acquired Clajon Holding L.P. and formed Aquila Gas Pipeline Corp.
1993 - Acquired 39.6 percent of WEL Energy Group in New Zealand
1993 - Acquired Nebraska gas distribution and transmission assets of Arkla
1994 - Acquired Kansas gas distribution and transmission assets of Arkla
1995 - Acquired 49.9 percent ownership of United Energy in Melbourne, Australia
1995 - Tristar Gas Company
1996 - Acquired 40 percent of Oasis Pipeline
1998 - Acquired transmission assets of TransAlta in New Zealand
1998 - Acquired 78.6 percent of Power New Zealand
1999 - Acquired 27.2 billion cubic foot gas storage facility in Katy, Texas
1999 - Acquired 26 percent interest in Quanta Services
1999 - Acquired a 40-acre coal handling facility in West Virginia
1999 - Acquired a 25 percent interest in Multinet/Ikon in Victoria, Australia
1999 - TrustPower assets in New Zealand
2000 - GPU International

2002 - Acquired $220 million natural gas storage facility in Lodi, California
2002 - Midlands Electricity in United Kingdom

As of December 31, 2001, Aquila had total assets of $12 billion and annual sales of $40 billion. The chart below shows the growth in Aquila's assets and sales over the period 1991 through 2001 in billions of dollars.

	Assets	Sales
1991	$2.4	$1.7
1992	$2.5	$2.3
1993	$2.8	$2.7
1994	$3.1	$2.4
1995	$3.9	$2.8
1996	$4.7	$4.3
1997	$5.1	$8.9
1998	$6.1	$12.5
1999	$7.5	$18.6
2000	$14.1	$29.0
2001	$12.0	$40.0

Aquila's Organizational Structure in 2001

In 2001, Aquila was at its peak both in size and financial performance. At this time, shortly before the collapse of Enron and the beginning of its own financial problems, Aquila was organized and managed as four business segments. These business segments were: 1) Energy Merchant, 2) U.S. Networks, 3) International Networks, and 4) Services.

Energy Merchant Business Segment

Aquila's Energy Merchant business segment provided risk management products and services, traded energy-related and other commodities, and marketed natural gas and electricity to industrial and wholesale customers in the United States and Canada. Merchant Services also marketed energy in Europe through its offices in the United Kingdom, Germany and Norway. In 2001, Aquila's merchant services business had $37.7 billion in sales, which accounted for 94% of Aquila's total sales, and contributed 65% of Aquila's earnings before interest and taxes (EBIT). At December 31, 2001, Merchant Services had $6.2 billion in assets, or 52% of Aquila's total assets. The energy-trading component of Aquila Merchant Services (the business exited by Aquila in August 2002) alone accounted for 90% of total company revenue, which made it one of the top trading companies in the United States.

U.S. Networks Business Segment

As a component of its Global Networks Group, Aquila's U.S. Networks' operating divisions in the U.S. served approximately 438,000 electric distribution customers in three states: Missouri, Kansas and Colorado; and 891,000 natural gas distribution customers in seven states: Missouri, Kansas, Colorado, Nebraska, Iowa, Michigan and Minnesota. Its domestic utility divisions are the same as today. They are Aquila Networks-MPS, Kansas Public Service, Peoples Natural Gas, WestPlains Energy, Northern Minnesota Utilities and Michigan Gas Utilities.

In 2001, U.S. Networks had approximately \$2.3 billion in sales, which accounted for 5.6% of total company sales, and contributed 16.7% of total company EBIT. At December 31, 2001, U.S. Networks had \$3.5 billion in assets, or 29.4% of total company assets.

International Networks Business Segment

The second component of Aquila's Global Networks Group, Aquila's International Networks operated electric and gas utility networks in Australia, New Zealand and Canada. Aquila managed and was 34% owner of United Energy in the Australian State of Victoria. United Energy has four business units: Distribution, Energy Merchant, Utili-Mode and UeComm. The Distribution unit served 1.1 million electricity and gas customers in Melbourne and the Mornington Peninsula. UeComm, a telecommunications business, has developed networks in Sydney, Melbourne and Brisbane. Utili-Mode offers energy-related "back office" services including call center, billing, metering and account collection functions. The Energy Merchant business buys and sells electricity in the wholesale market, trades related commodities, and sells risk management products.

Aquila and United Energy jointly own 45% of AlintaGas Limited, a natural gas distributor in the state of Western Australia. AlintaGas is based in the city of Perth and has more than 430,000 customers.

Aquila owned 55% of UnitedNetworks Limited (UnitedNetworks), a company that serves approximately 600,000 customers, mostly in the Auckland and Wellington areas. UnitedNetworks is one of New Zealand's largest network infrastructure companies, distributing energy to about 30% of the country's electricity consumers and more than half of New Zealand's natural gas consumers. It also owns and manages a telecommunications networks business. Aquila created UnitedNetworks in 1998 by combining the electrical distribution operations it acquired from three different New Zealand utilities, and later a natural gas network.

Aquila has been operating in Canada since its acquisition of West Kootenay Power in 1987. In February 2000, Aquila acquired TransAlta Corporation's distribution and retail operations in Alberta for $480 million. Aquila operated this business as Aquila Networks Canada (Alberta), Ltd.

In 2001, Aquila's International Networks unit had approximately $354 million in sales, which accounted for less than 1% of Aquila's total sales, and contributed 17% of Aquila's EBIT. At December 31, 2001, International Networks had $1.9 billion in assets, or 16% of total Company assets.

Services Business Segment

In 2001, this segment primarily consisted of Quanta and Everest. During 2001, Aquila held a 38.5% equity interest in Quanta, a Houston-based firm that builds and maintains networks carrying energy and telecommunications. In 2001 and the beginning of 2002, Aquila spent considerable time and resources trying, unsuccessfully, to achieve control over Quanta's operations.

Formed in early 2000, Aquila Communication Services provided a range of broadband services including local and long-distance voice, high-speed Internet access and digital television.

Aquila's Financial Problems

The financial collapse of Enron saw the beginning of significant negative impacts on the utility industry, specifically highly-diversified energy trading companies such as Aquila. Enron formalized its financial collapse by filing for bankruptcy on December 2, 2001. The impacts upon Aquila of the Enron financial collapse can be illustrated by the change in Aquila's debt credit ratings.

On May 21, 2002, Moody's Investors Services placed Aquila under review for possible downgrade. In a press release issued on that date, Robert K. Green, Aquila's then President and Chief Executive Officer stated, "We've maintained an open dialogue with Moody's and made them aware of our plans to improve cash flow. We've already identified approximately $96 million in savings as a result of staff reductions, elimination of executive incentives and a tightening on all expenditures. We expect to make significant progress in short order."

The next day, May 22, 2002, Aquila announced that it was eliminating approximately 200 positions from its merchant services and corporate staffs. This staff reduction was in addition to the elimination of 500 positions upon completion of the previously announced restructuring of its networks business.

On June 17, 2002, Aquila announced a new three-part plan including: (1) a significant reduction and downsizing of its wholesale energy services business in response to the increased cost of capital for that business; (2) an anticipated \$.50 per share reduction in the annual common dividend to a new rate of \$.70 per share; and (3) the issuance of \$900 million of new equity and debt securities in order to balance the capital structure and satisfy Aquila's remaining 2002 liquidity needs, including the funding of previously announced acquisitions.

On August 5, 2002, Standard and Poor's reaffirmed Aquila's credit rating of BBB with CreditWatch Negative, following Aquila's cancellation of the proposed acquisition of Cogentrix Energy, Inc. Standard and Poor's cited the cancellation as positive for the credit quality of Aquila, but it would not immediately affect the current rating or outlook for Aquila. Aquila had been placed on CreditWatch with negative implications when the Cogentrix transaction was announced.

On August 6, 2002, less than a month after it announced that it would restructure the wholesale energy marketing and trading business of its Merchant Services segment, Aquila announced that it was totally eliminating all wholesale energy marketing and trading.

On August 16, 2002, Aquila released information outlining initiatives taken in the past six months that had favorable implications for its risk profile, cash flows and credit ratings. These actions included:

- Terminating the Cogentrix acquisition
- Reducing its dividend by 42%

- Exiting from the wholesale energy trading business
- Completing equity and debt offerings totaling $764 million in proceeds
- Identifying over $100 million in cost reductions
- Targeting over $1 billion in asset sales

On August 19, 2002, FitchRatings revised Aquila's Rating Outlook to Negative from Stable based on its ongoing review of Aquila's liquidity and financial flexibility at a time when Aquila was shedding business lines and assets.

On September 3, 2002, Moody's downgraded Aquila to Ba2 with a Stable outlook. According to Aquila, Moody's cited execution risk respecting Aquila's asset divestiture program as a major concern. Earlier in the year, Moody's had considered downgrading Aquila's credit rating due to its deteriorating financial situation. Moody's rating of Ba2 is considered non-investment grade or "junk." Moody's downgrade meant that Aquila had to pay $192 million in obligations within 60 days to cover financial triggers tied to its credit ratings.

On September 4, 2002, Standard and Poor's downgraded Aquila's credit rating to BBB- with Outlook Negative. According to Aquila, Standard and Poor's acknowledged execution risk related to the asset divestiture program but was willing to give management more time to implement its plan. Standard and Poor's action confirmed Aquila's investment grade credit rating and removed Aquila from credit watch. This action by Standard and Poor's moved Aquila's credit rating to BBB- from BBB and placed Aquila on negative outlook. As a part of its credit assessment, Standard and Poor's stated that to maintain credit quality in the triple-B range, Aquila must complete asset sales, further reduce business risk and improve utility operations.

With Aquila's financial position worsening, in October 2002, Aquila's President and CEO Robert Green resigned from all executive officer positions with Aquila and from its board of directors. Robert Green's separation package had a value of approximately $7.6 million. The board reassigned Robert Green's CEO responsibilities to longtime Chairman, Richard C. Green, Jr.

On October 16, 2002, Aquila reported additional asset sales under its previously announced restructuring program, bringing the current total of assets it had sold or agreed to sell to $976.6 million. Aquila's stated goal was to sell at least $1 billion in assets to strengthen its balance sheet and credit. Aquila's Chairman, President and Chief Executive Officer Richard C. Green, Jr. stated that: "We are continuing to focus on our transition back to our roots as a regulated utility company and our exit from the elements of our previous energy merchant strategy that are not consistent with our current business model."

In early November 2002, Aquila announced it had wrapped up the first phase of bidding for sale of Midlands. Aquila expected the next phase, binding offers, to be completed in November. Aquila stated that Midlands was the last asset it would have for sale and that it would not sell it at a loss or have a "fire sale." Aquila also stated it did not need the sale of Midlands to meet its goal of selling $1 billion in assets.

On November 13, 2002, as part of its ongoing transition plan, Aquila announced that its Board of Directors has suspended the quarterly cash dividend on Aquila common stock for an undetermined period. The Board reached this decision after the new management team completed a detailed analysis of Aquila's current financial condition. Suspension of the dividend was part of Aquila's strategy to achieve its goal of strengthening its credit profile. In the press release, Richard C. Green, Jr., stated that Aquila planned to do more than simply survive, and that "Aquila's liquidity is sufficient to ensure that Aquila can continue to operate safe and reliable utility networks and maintain quality customer service. This remains a healthy core business."

Also on November 13, 2002, Aquila reported a Third Quarter loss. Aquila also announced that as a result of its operating performance, the winding down of merchant energy businesses and the asset sales program, that it did not expect to be in compliance with an interest coverage requirement contained in certain financial arrangements until December 31, 2003. According to Aquila's Form 10-Q filing with the Securities and Exchange Commission (SEC), as of September 2002, Aquila's revolving credit agreement was the only obligation on its balance sheet that contained these interest coverage ratio provisions.

Aquila obtained a waiver from this requirement that expired on April 12, 2003. Aquila agreed to make certain payments to the financial institutions, to limit its dividends, to have lower borrowing capacity under its revolving credit agreements, and to use reasonable efforts to obtain approvals from regulators that would allow it to pledge its domestic regulated assets as collateral. Aquila agreed to renegotiate its bank financing arrangements prior to the waiver's expiration. In Aquila's September 30, 2002, Form 10-Q filing Aquila noted that, because of the downgrade in its credit rating to Ba2 by Moody's, the interest rate on \$500 million of senior notes due 2012 increased from 11.875% to 13.125% and the interest rate on \$250 million senior notes due 2011 increased from 7.95% to 8.70%.

On November 13, 2002, the prior ratings actions had resulted in the following credit ratings for Aquila:

- Fitch — BBB-, Negative Watch
- Standard and Poor's — BBB-, Negative Outlook
- Moody's — Ba2, Stable Outlook

Both Fitch's and Standard and Poor's ratings were still considered investment grade. Aquila expected no additional ratings actions from either Standard and Poor's or Moody's until early 2003, when Aquila completed its asset divestiture program and finalized its 2002 financial results.

Aquila asserted that its lowered credit ratings were not unique, stating that Moody's currently rated over 20 U.S. utilities as sub-investment grade and those utilities were continuing to provide safe and reliable service. Lower credit ratings can impact a company's cost of capital, and Aquila admitted that its marginal cost of capital had increased. Deterioration of credit quality for diversified energy companies and events, such as the Enron collapse, had made access to capital markets more difficult. It had also made what access is available more expensive.

Additional credit rating actions took place in 2002. On November 15, 2002, Fitch announced the downgrade of Aquila's senior unsecured rating to BB from BBB- and placed Aquila on Rating Watch Negative. This action was taken pending a comprehensive review of the outlook for the remaining core business and the refinancing of credit facilities then set to come due on April 12, 2003. Subsequent to the downgrade, Aquila announced that with liquidity at close to $900 million, it was prepared to respond to the potential effects resulting from the downgrade.

On November 19, 2002, Standard and Poor's downgraded Aquila to BB from BBB-. The outlook remained negative. The downgrade reflected the slower-than-expected recovery of Aquila's credit quality as it exited the merchant energy business, and recent financial results that revealed lower than anticipated operating cash flows and higher debt leverage numbers. Standard and Poor's stated that the numbers were weaker than expected and that

Aquila's financial plan had not provided the level of sustainable cash flow necessary for investment-grade status. Aquila responded to the downgrade with an announcement that its liquidity was sufficient to meet the cash needs resulting from the downgrade without affecting its operations. According to Aquila's September 30, 2002, Form 10-Q, because of the downgrade of Aquila's credit rating to BB by Standard and Poor's, the interest rate on $500 million of senior notes due 2012 increased from 13.125% to 14.375% and the interest rate on $250 million senior notes due 2011 increased from 8.70% to 9.45%. Aquila stated that the downgrade could potentially trigger approximately $238 million in additional demands for cash.

There were several factors creating demands for cash after the Standard and Poor's downgrade. Aquila stated that $84 million in four series of Australian denominated bonds guaranteed by Aquila had provisions that could require Aquila to repurchase the bonds if the bondholders choose to exercise that option in the next 30 to 60 days. Aquila also had a tolling agreement that could require Aquila to post $37 million in additional collateral within 70 days to eight months of a Standard and Poor's downgrade. Tolling agreements allow Aquila to generate power at plants owned by others in exchange for the natural gas that fuels the plants. Another approximately $23 million would need to be posted to cover standard margining agreements remaining from Aquila's discontinued wholesale energy merchant business. There was also the potential that Aquila might be required to post additional collateral of up to $94 million related to certain commodity contracts.

After the Standard and Poor's announcement, Aquila's credit ratings were as follows:

- Fitch — BB, Negative Watch
- Standard and Poor's — BB, Negative Outlook
- Moody's — Ba2, Stable Outlook

Aquila no longer had an investment grade rating from any rating agency.

Further downgrades by Moody's below Ba3 or by Standard and Poor's below BB-, may require Aquila to post an additional $73 million in collateral. Any downgrade below Moody's current rating of Ba2 results in a .25% increase in interest on both sets of notes previously mentioned. Any downgrade below Standard and Poor's current rating of BB results in a 1.50% increase in interest on the $500 million, 2012 notes, and a 1.00% increase in interest on the $250 million, 2011 notes.

During this time frame Aquila was experiencing significant corporate restructuring costs, or costs related to Aquila's attempt to improve its liquidity, sell non-core assets and restore its financial health to investment grade. These restructuring costs ranged from higher interest costs for a non-investment grade utility to legal, accounting, financial advisors and other consultant services. The cost to Aquila of the restructuring actions was approximately $188 million for the nine months ended September 30, 2002. These restructuring charges included $54.1 million in severance costs related to the elimination of approximately 1,630 employees (including employees transferred with the sale of businesses). Approximately 1,120 Merchant Service employees, 80 corporate employees and 430 Domestic Networks employees were terminated.

Also included in the $188 million restructuring charges were $28.9 million in employee retention payments, $36.7 million in abandoned lease agreements, $59.2 million in the write-down of leasehold improvements and equipment previously used in the wholesale energy trading business and $7.1 million loss on sale of Aquila's corporate aircraft.

Aquila reduced its ownership interest in Quanta from a high of 38% to 14% as of October 2002. Quanta's stock price decreased significantly from Aquila's cost basis of

$26.69 to less than $3 per share. This reduction in Quanta's stock price caused Aquila to write down its investment in Quanta by $698.1 million in the nine months ended September 30, 2002. In the 4th quarter 2002, Aquila expected to dispose of its remaining Quanta shares prior to December 31, 2002. As of end of 2002, the Company reduced its ownership share to 10%. During 2002, Aquila sold approximately 17.6 million shares of Quanta. Aquila sold the remaining 11.6 million shares during the first quarter 2003.

The financial effects of Aquila's operating performance, the winding down of its wholesale energy trading business and its asset sales program have caused Aquila to not be in compliance with certain debt agreements with its lenders. These debt agreements require that Aquila's earnings before interest, taxes, depreciation and amortization (EBITDA) during the previous four quarters must be at least 2.25 times its interest expense during this period. This is referred to as an interest coverage ratio. Aquila does not expect to be in compliance with these debt agreements until at least December 31, 2003.

However, Aquila obtained waivers from the affected lenders from the requirement to comply with this interest coverage ratio from September 30, 2002, until April 12, 2003. In exchange for this waiver, Aquila paid down approximately $158.6 million in debt. Aquila further agreed that 50% of any net cash proceeds it receives from the sales of assets under $1 billion and 100% of any net cash proceeds from any further sales of its North American assets above $1 billion dollars received prior to April 12, 2003, would be used to reduce its obligations to these lenders on a pro rata basis. Aquila agreed to make reasonable efforts to obtain approvals from regulators to allow it to use certain of its regulated assets as security for the benefit of its lenders. In addition, Aquila was required to pay fees of approximately $2.4 million to the lenders in connection with these waivers. Should the waiver obtained by

Aquila not be extended beyond April 12, 2003, and the affected lenders demand payment in full, substantially all of Aquila's remaining debt would become due and payable. Aquila would not have the liquidity to meet these obligations as they become due and will be in default. Aquila met this agreement and negotiated with lenders a $430 million Term Loan agreement on April 11, 2003.

On May 13, 2003, Aquila announced that it had terminated the 20-year tolling agreement for Acadia Power Partners, LLC. Under the toll, Aquila supplied the natural gas to a combined cycle plant in Eunice, Louisiana, and paid fixed capacity payments for the right to sell into the wholesale market 580 megawatts of power generated by the plant. Under the termination agreement, Aquila paid Acadia $105.5 million to release Aquila from the agreement. The transaction returned $45 million to Aquila in posted collateral and eliminated $843 million in payments due Acadia over the remainder of the 20-year term. Aquila entered into the contract with Acadia in 2000.

Aquila's financial status during the first quarter of 2003 continued to reflect the costs of winding down its wholesale energy trading business, while also seeing improved results from its domestic utility networks. On May 15, 2003 Aquila reported a fully diluted loss of $.27 per share for the first quarter of 2003, or a net loss of $51.9 million on sales of $579.3 million. The loss was attributed to: 1) trading and contract losses related to last year's decision to exit the energy trading business; 2) an increase in fixed capacity payments for merchant generation capacity; 3) mark-to-market losses on certain long-dated forward contracts; and 4) higher interest cost reflecting additional borrowings and higher interest rates due to the Company's non-investment grade credit rating. The Company also reported

$6.3 million in restructuring charges primarily connected with unfavorable interest rate swaps.

On May 22, 2003, Aquila announced that, along with its partner, FirstEnergy Corp., it had reached an agreement to sell their respective shares of Sterling Limited for 43 million pounds. Aquila owned 79.9% of the joint venture.

On July 10, 2003, an agreement reached between Aquila and the Colorado Public Utility Commission Staff became effective. This agreement allowed Aquila to pledge Colorado's regulated utility assets as collateral to the three-year Term Loan.

On July 24, 2003, Aquila sold its Australian properties. The Company announced that it would receive approximately US $477 million from the sale or about US $32 million higher than originally anticipated. This increase was mainly attributed to the stronger Australian dollar.

On August 12, 2003, the Company reported net losses for the second quarter 2003 of $80.6 million or $.41 per fully diluted share. Mr. Richard C. Green, Aquila's Chairman and CEO, stated: "We will continue our restructuring through this year and next, especially our work to address our remaining long-term gas contracts and fixed capacity payments for merchant power plants." The second quarter loss is considered to be due primarily to restructuring and impairment charges related to last year's decision to reshape the business to a regulated utility. Both operating cost and interest expense were said to be higher in 2003 due to the Company's non-investment grade credit.

The Company is presently in the process of seeking and evaluating proposals with regard to the sale of its Canadian properties.

Current Corporate Structure

Q. Describe how Aquila is currently structured including a description of recent major asset sales.

A. Aquila's businesses are structured as follows:

1. Global Networks Group - consists of two segments, (i) Domestic Networks, the electric and gas utilities in seven mid-continent states, which also includes its communications business and its former investment in Quanta (sold in late 2002 and early 2003), and (ii) International Networks, investments in Australian electric and gas utilities (sold in the second and third quarters of 2003), United Kingdom investment in an electric utility business (in the process of being sold), an investment in New Zealand electric and gas utility businesses (sold in the fourth quarter of 2002) and the Canadian electric utility businesses (in the process of being sold).

2. Merchant Services, consisting of two segments, (i) Capacity Services - power generation operations, investments in independent power plants (in the process of being sold), natural gas gathering and processing operations (sold in 2002 and classified as discontinued operations for all periods presented), and (ii) Wholesale Services, the North American and European commodity and client service businesses (including Aquila's capital business which was also sold in 2002).

Q. Please describe the process Aquila uses to allocate costs to its business units.

A. Aquila's corporate allocations consist of two groups, both organized in specialized departments. The first group provides the traditional "shared service" or pure corporate overhead costs. Aquila refers to these departments as the enterprise support functions (ESFs). ESF department costs are allocated to all of Aquila's domestic regulated and nonregulated business units. At December 31, 2002, Aquila had approximately 75 corporate ESF departments with 224 employees. These employees provide general corporate services to all of Aquila's regulated and nonregulated business units. The primary ESF departments include Executive Offices, Investor Relations, Human Resources, Finance, Accounting, and Information Technology.

The other component of corporate allocations are groups that provide services solely to Aquila's regulated utilities. Aquila refers to these departments as intra-business units (IBUs). IBU department costs (both payroll and nonpayroll) are allocated only to Aquila's regulated utilities. At December 31, 2002, Aquila had approximately 150 corporate IBU departments with 680 employees.

Aquila has developed a comprehensive corporate overhead allocation procedure to allocate costs to its domestic business units. Aquila's primary method of allocating ESF and IBU costs is a three-factor formula referred to as the "Massachusetts Formula." Aquila uses the factors of gross profit (margin), net plant in service and payroll to calculate the relative allocation percentage for each business unit to apply to allocable corporate pool dollars under the Massachusetts Formula.

In addition to the Massachusetts Formula, Aquila uses other allocation factors to allocate ESF and IBU department costs to its business units. For example, the costs charged to ESF departments of 4220 (Compensation Administration) and 4223 (Human Resource Executive) are allocated based on the ratio of the number of employees in that business unit to the total number of all business unit employees. For additional information about Aquila's corporate allocation process refer to Aquila witness Beverlee R. Agut's direct testimony in this case, pages 2 through 6.

Q. Does Aquila allocate all corporate costs incurred to its operating companies like MPS?

A. No. Aquila has created departments where certain costs are accumulated but not allocated to the regulated business units. These are referred to as corporate retained departments.

Corporate Allocation Adjustments

Q. What adjustments to MPS's test year corporate allocated costs is the Staff proposing in this case?

A. The Staff's adjustments can be classified into five categories of adjustments to MPS's per book corporate allocated costs. These adjustments are included in Accounting Schedule 10, Adjustments to Income Statement:

1. Adjust test year costs to reflect Aquila's corporate allocation adjustment;
2. Remove severance and severance-related expenses.
3. Remove Supplemental Executive Retirement Program costs;
4. Allocate certain corporate departments to restructuring operations;
5. Include adjustments proposed by Aquila.

Q. Please explain the Staff's first proposed adjustment to MPS's test year per books corporate allocated costs.

A. This Staff adjustment updates MPS's corporate allocated costs in 2002 using the updated August 2003 allocation factors provided by Aquila. This adjustment is simply the difference between the level of MPS's per books net residual allocated corporate costs and the annualized level of net residual corporate costs proposed by Aquila in its updated filing in this case. In addition, this adjustment incorporates certain corporate department eliminations and adjustments to remove certain costs that Aquila determined were not appropriate to include in this rate case. The basis of the corporate department eliminations and allocated cost adjustments is included in Aquila adjustment CS-16A discussed at pages 7 and 8 of Aquila witness Agut's direct testimony.

Q. Please explain what you mean by "net residual" corporate costs.

A. Net residual corporate costs simply means total corporate costs less the corporate costs that are being annualized and adjusted by other witnesses. For example, both Aquila and the Staff have witnesses that are sponsoring corporate payroll and benefits, pensions, insurance, dues and donations, advertising and property taxes. These witnesses are sponsoring adjustments to MPS's direct costs as well as the related corporate costs. These corporate costs have been removed from the total corporate pool of expense dollars subject to allocation to the business units. The remaining costs left in the corporate pool is what is referred to as net residual corporate costs.

Severance Costs

Q. Please explain the Staff's second adjustment to remove severance and severance-related expenses from MPS's per book allocated costs.

A. This adjustment removes severance payments, payroll taxes and other severance-related costs. Aquila proposed a 3-year amortization of these costs and refers to these costs as "restructuring costs." Aquila's proposed recovery of restructuring costs in included in Aquila's adjustment CS-10 and is addressed on pages 9 through 11 of Aquila witness Ronald A. Klote's direct testimony.

Q. Is Aquila's definition of restructuring in its CS-10 adjustment separate and distinct from Aquila's current ongoing restructuring activities that include the sale of a significant portion of its business operations?

A. Yes. Adjustment CS-10 is more appropriately referred to as Aquila's state-based reorganization severance adjustment. The term "restructuring operations" used throughout the remainder of this testimony refers to Aquila's current financial difficulties and the actions taken by Aquila to get back to financial stability.

Q. Why didn't the Staff include Aquila's Adjustment CS-10 amortization in this case?

A. The Staff has historically excluded severance payments from cost of service. One primary reason for this position is that severance payments are non-recurring expenditures which are not normally included in cost of service for a regulated utility. An exception to this is when a cost is determined to be extraordinary in nature and it meets the Commission's requirement for deferral and recovery under the accounting authority order (AAO) process. Aquila has not made the case that these costs are extraordinary and the Staff is of the opinion that a reasonable justification for recovery of these severance payments under the AAO process cannot be made.

In addition to being nonrecurring, the costs that Aquila seeks to recover have already, at least to a significant extent, been recovered in rates. The rates for Aquila's last rate case, Case No. ER-2001-672 went into effect in March 2002 as a result of the Commission accepting a settlement of that case and a Staff excess earnings complaint case. Since that date, and continuing until rates are changed from the resolution of this case in June 2004, Aquila has been recovering and will continue to recover payroll, payroll taxes and other benefit costs in current rates for substantially all of the employees that received severance payments that are included in Aquila's proposed adjustment CS-10. This situation is known as "regulatory lag" and is created by the delays inherent in the ratemaking process.

Regulatory lag can at times be financially beneficial to a utility and at times can have a negative financial impact on a utility. In this case, while Aquila did experience significant severance costs, it has recovered and is currently recovering these costs in rates. This situation occurs because Aquila is no longer required to pay the salary and benefits of these employees, whose continued employment compensation was built into rates in Aquila's last rate case.

For example, assume an employee with an annual salary of $60,000 ($5,000 per month) was severed on May 31, 2002 and received a severance payment of $100,000 on that date. Aquila is continuing to receive this employee's salary in rates from June 2002, the month after the employee was severed until June 2004, when rates from this rate case will go into effect. This is an amount of $120,000 ($5,000 times 24 months). In effect, in this example, Aquila will collect $120,000 from its ratepayers yet only pay $100,000 in severance costs. This is an example where regulatory lag is beneficial to Aquila.

Supplemental Executive Retirement Plan (SERP)

Q. Please explain the Staff's adjustment to remove the costs of Aquila's SERP.

A. The SERP is a supplemental executive retirement plan, which provides significant additional benefits to a select group of current Aquila employees. Aquila's SERP, as amended and restated effective January 1, 2001 can be found at Aquila's website, Aquila.com, as an attachment to its June 30, 2001, Securities and Exchange Commission (SEC) Form 10-Q.

The Staff opposes cost of service recovery for MPS's share of Aquila's SERP for several reasons. First, Aquila's SERP includes a "Change in Control" provision. This provision requires a funding of the plan in the event of a change in ownership as defined in the "Change in Control" provision of the plan. This provision acts as deterrence for another company to acquire Aquila and thus acts as employment security protection for Aquila's top executives and highly compensated employees. These employees are the employees who are at a high risk of not being retained by a company that successfully merges with or acquires Aquila. While this protection may be beneficial to Aquila's executives and highly compensated employees, it is not a cost that could reasonably be considered necessary to operate a utility company.

Second, Aquila's SERP was significantly modified on January 1, 2001 to add additional SERP benefits. The modifications increase the benefits to SERP participants by adding a Bonus SERP Benefit (designed to provide executives an additional retirement benefit based on the executives' annual bonus pay) as well as a Supplemental SERP Benefit (designed to provide executives an additional market-based retirement benefit). Given Aquila's current financial difficulties, the Staff does not believe it is an appropriate time to reward Aquila's top executives by providing them with additional retirement benefits. While it is up to Aquila's Board of Directors whether or not to rescind this increase in retirement benefits for Aquila's senior executives, it is up to this Commission whether or not to allow the costs of Aquila's SERP in rates. The Staff recommends that the Commission not include the costs of Aquila's SERP in rates in this case.

Third, the individuals in Aquila's SERP are or have been participants in all of Aquila's other benefit plans, including Aquila's regular pension plan and 401(K) plan. In the Staff's view, these plans provide sufficient retirement benefits for all of Aquila's employees and the addition of another retirement plan is excessive.

Finally, Aquila's SERP has in the past been accounted for on a cash, or pay-as-you-go basis. Aquila recently decided to change to an accrual method of accounting for the SERP, which significantly increased the current costs of the plan. In the Staff's view, the accounting for the SERP on a cash basis, which Aquila did for many years, was appropriate. Aquila was not required by any accounting regulatory body to change the method of accounting for the SERP, but it decided to do so on its own.

Restructuring Operations

Q. Please describe the Staff's third adjustment to Aquila corporate allocations.

A. This adjustment allocates a portion of selected corporate departments to Aquila's restructuring operations.

Q. Please explain what you mean by Aquila's restructuring operations?

A. In March 2002, Aquila launched an initiative, known internally as Project BBB+/Baa1, to reduce costs by $100 million and sell $500 million in non-core, non-strategic assets in an effort to improve its credit standing. While this project was not successful, Aquila continued to sell off major portions of its nonregulated and international operations in an attempt to return the Company to financial stability. These activities have continued through 2002 and 2003 and are expected to continue into 2004.

In a press release dated November 6, 2003, Aquila announced that it is continuing to execute its restructuring plan, which to date has generated $1.9 billion from asset sales. Mr. Richard C. Green is quoted in the Aquila press release as saying "Aquila still has significant work ahead to ensure a firm foundation for the company. Our focus in the coming months will be finalizing our pending U.K. and Canadian asset sales and continuing to pursue much-needed rate relief. At the same time, we are committed to further improving our financial condition by selling our investment in independent power plants, and by exiting our remaining tolling agreements."

Q. In its direct filing, did Aquila allocate any corporate costs to restructuring operations?

A. Yes. In its direct filing, Aquila made an attempt to identify and eliminate nonpayroll restructuring-related costs. Aquila's adjustment, however, eliminates the salary and benefits of only one corporate ESF department. This department, 4035 Chief Financial Officer (CFO), includes Aquila's CFO Rick Dobson and three other employees.

Q. Does the Staff consider Aquila's attempt to quantify, capture and eliminate costs related to its restructuring operations from this rate case to be sufficient?

A. No. Except for its CFO department, Aquila allocated no payroll or benefit cost of any corporate employee to Aquila's restructuring operations. At page 8 of her direct testimony, Aquila witness Agut states that "in 2002, the Chief Financial Officers, Messrs. Dan Streek and Rick Dobson, extensively focused on maintaining the solvency of Aquila. It is anticipated this focus will continue for at least a couple of years."

Q. What should Aquila have done to adequately protect its customers from absorbing the cost of Aquila's restructuring operations?

A. If Aquila was serious about capturing costs related to its restructuring operations it should have set up a restructuring account to capture these costs similar to what it did with its severance and other costs that it is seeking recovery of in this case. Such an account is routinely set up and used in any major restructuring or acquisition project. Under this type of project accounting, project costs are deferred until the appropriate accounting treatment is determined. If Aquila followed this procedure and required its employees to account for their labor hours and non-labor costs accordingly, the Staff would not have to propose this adjustment in this case.

In addition to this accounting for its restructuring activities, Aquila should have made a very aggressive effort to analyze the corporate assets that are now being allocated to its regulated division solely as a result of its exit from nonregulated operations.

Q. Did Aquila make a commitment that its ratepayers would not be negatively impacted by its current financial difficulties?

A. Yes. At page 7 of his direct testimony, in Case No. EF-2003-0465 dated April 30, 2003, Mr. Jon Empson, Aquila's Senior Vice President, Regulatory, Legislative, and Gas Supply Services stated "...while Aquila accepts full responsibility for its past strategy, Aquila is also taking full responsibility for restoring financial stability without adversely impacting the customer."

Also, at page 15 of his direct testimony in this case, Mr. Keith Stamm, Aquila's Chief Operating Officer, referring to costs included in this rate case stated, "we have not included costs associated with exiting or winding down our non-regulated businesses and investments."

Q. Does the Staff believe that Aquila's failure to capture all the costs of its restructuring operations (i.e., exiting or winding down its non-regulated businesses and investments) and excluding them from this rate case has the potential to adversely affect its customers?

A. Yes. While the Staff made an attempt to quantify what it believes to be a reasonable level of costs to allocate to restructuring operations, there is the likelihood that these costs are, in fact, much higher. Therefore, even if the Commission accepts the Staff's proposed allocation of corporate costs to Aquila's restructuring operations, there is still a risk of an adverse impact on Aquila's customers. The only way to avoid this risk and ensure that the customers are protected is if Aquila's management had created and enforced an aggressive project-accounting system to ensure that all costs incurred and all employee labor (employees working on restructuring operations) were appropriately accounted for and charged to the restructuring account. Proper accounting would be to defer all payroll and nonpayroll costs to a deferred account and exclude this account from ratemaking consideration in this case.

Q. Which ESF departments did the Staff determine should be allocated restructuring operations?

A. The Staff determined that 75 percent of departments 4035, CFO, and 4040, Chairman, should be allocated to Aquila's restructuring operations. In addition, the Staff is proposing an allocation of 50 percent of departments 4030, Chief Operating Officer; 4031, General Counsel; and 4043, Board of Directors Management. Finally, the Staff is proposing a 25 percent allocation of departments 4183, Corporate Financial Reporting; 4194, Tax-Income Team; and 6131, President Global Networks Group to restructuring operations.

Q. Please provide a description of each of the corporate departments in the Staff's restructuring adjustment.

A. The following department descriptions are included in Aquila's 2003 Cost Allocation Manual (CAM), which is attached to Aquila witness Agut's direct testimony:

> Dept 4030 Chief Operating Officer - Management costs incurred for day-to-day supervision of the entire company operations including international operations.

> Dept 4031 General Counsel - Overall responsibility for all matters of a legal nature including mergers, acquisitions, joint ventures and divestitures.

Dept 4040 Chairman and CEO - Makes Executive decisions for the corporation. Performs services for all divisions as well as overseas operations.

Dept 4043 Board of Directors Management - Oversees the coordination of issues surrounding the board of directors.

Dept 4183 Corporate Financial Reporting- Perform external reporting for consolidated Aquila, Inc. Also includes external audit fees.

Dept 4194 Tax-Income Team - Responsible for all income tax compliance including the preparation of tax returns, tax accounting, and audit administration.

Dept 6131 President-Global Networks Group - Provide financial support, financial analysis, and business counsel for global networks operations, which includes both international and domestic networks. Time incurred with respect to international units and the cable/communication business will be direct charged to the respective unit.

Q. How did the Staff select the corporate departments to be allocated to restructuring operations?

A. I reviewed Aquila's Board of Director minutes, annual reports, SEC filings, press releases, outside auditor workpapers, responses to Staff data requests, testimony filed in past Aquila regulatory proceedings and payments to outside contractors. In addition, I used experience gained in auditing Aquila's corporate allocations process in its last rate case to develop a general understanding of the extent of Aquila's corporate departments' involvement in Aquila's restructuring operations.

Q. Does the Staff's proposal to allocate 75, 50 and 25 percent of selected corporate departments purport to capture the exact amount of corporate costs that should be allocated to Aquila's restructuring operations?

A. No. There is no way for the Staff to capture the exact dollar amount that should be charged to restructuring operations. However, the Staff's proposal is a reasonable and conservative estimate of the time and resources that Aquila has devoted to its restructuring operations and will devote to it into the foreseeable future.

Q. Please explain the fifth category adjustments to MPS's corporate allocated costs?

A. These adjustments, listed on Schedules 2, as CS-56, CS-83, and Interest, simply include the adjustments to corporate costs that were proposed by Aquila in its direct filing. CS-56 removes the cost of Aquila's corporate aircraft, CS-83 removes costs that are related to a transaction that occurred prior to the test year, and the Interest adjustment removes interest charge that should not be included in the income statement.

Corporate Plant and Reserve Allocations

Q. Please describe how the Staff arrived at its proposed level of corporate plant, depreciation reserve and accumulated deferred taxes to allocate to MPS.

A. Aquila allocates corporate plant and depreciation reserve to its business units using the same allocation method that it uses to allocate ESF and IBU department costs to its business units. The Staff made no adjustments to Aquila's September 30, 2003 level of corporate allocated plant in service to MPS. Aquila's corporate allocated depreciation reserve is addressed in the direct testimony of Staff witness Steve M. Traxler.

Q. How did the Staff calculate the amount of corporate allocated deferred income taxes that is shown on Accounting Schedule 1, Rate Base?

A. Aquila allocates its corporate accumulated deferred income taxes to its business units based on the relative level of plant in service. The Staff accepted Aquila's September 30, 2003 level of accumulated deferred income taxes for MPS.

Q. Does this conclude your direct testimony?

A. Yes.

Charles R. Hyneman
Schedule of Testimony Filings

Case No.	Company
TR-93-181	United Telephone Company of Missouri
ER-94-163	St. Joseph Light & Power Company
HR-94-177	St. Joseph Light & Power Company
GR-95-160	United Cities Gas Company
EM-96-149	Union Electric Merger with CIPSCO, Inc.
GR-96-285	Missouri Gas Energy
GR-97-272	Associated Natural Gas Company
ER-97-394	UtiliCorp United, Inc.
GR-98-140	Missouri Gas Energy
EM-97-515	Western Resources, Inc. Acquisition of Kansas City Power & Light Co.
GM-2000-312	Atmos Energy Corporation Acquisition of Associated Natural Gas Company
EM-2000-292	UtiliCorp United Inc. Acquisition of St. Joseph Light & Power Company
GO-99-258	Missouri Gas Energy
EM-2000-369	UtiliCorp United Inc. Acquisition of Empire District Electric Company
GR-2001-292	Missouri Gas Energy
ER-2001-672	UtiliCorp United, Inc. d/b/a Missouri Public Service
GO-2002-175	Aquila, Inc. d/b/a Aquila-MPS
ER-2003-424	Empire District Electric Company

Hyneman Adjustments-MPS

	1	2	3	4	5a	5b	5c
Acct	CS-16A	CS-10	SERP	Restructure	CS-56	CS-63	Interest
408	94.8	94.9		94.1			
500	9.2			9.5			
506	13.2						
509	15.1			15.2			
511	17.2			17.6			
546	21.2			21.5			
548	23.2			23.4			
549	24.2	24.3		24.5			
556	33.2			33.5			
557	34.2			34.5			34.4
560	35.2			35.4			
561	36.2	36.3		36.5			
563	38.2			38.4			
566	40.2			40.4			
567	41.1			41.2			
570	44.2			44.5			
571	45.2			45.5			
573	47.2			47.5			
580	48.2			48.5			
581	49.2			49.4			
583	51.2			51.4			
584	52.2			52.4			
586	54.2	54.3		54.5			
587	55.2			55.4			
588	56.2			56.4			
589	57.1			57.2			
592	60.2			60.5			
593	61.2			61.5			
594	62.2						
597	65.2			65.5			
598	66.2			66.5			
901	67.2			67.5			
902	68.2			68.4			
903	69.2			69.7			
904	70.1			70.2			
905	71.1						
907	72.2			72.4			
909	73.2			73.5			
910	74.2			74.4			
911	75.2			75.4			
912	76.2			76.4			
913	77.2	77.3		77.6			
916	78.2	78.3		78.5			
920	79.2	79.3		79.5			
921	80.1			80.7	80.2	80.3	80.6
922	81.2	81.3		81.5			
922.1	81.2			81.5			
923	82.1	82.2		82.3			
925	84.1			84.4			
926	85.2	85.3	85.11	85.12			
928	86.1			86.4			
930.2	88.2			88.6			
931	89.1	89.2		89.3			
935	90.2			90.4			

Schedule 2

Schedule 3

Schedule 4