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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

TRANSCRIPT OF PROCEEDINGS

Order Consolidating Cases

March 4, 2004
Jefferson City, Missouri
Volume 15

In the Matter of Aquila, Inc., d/b/a Aquila)
Networks - L&P and Aquila Networks - MPS, to)Case No.
Implement a General Rate Increase in Electricity)ER-2004-0034

In the Matter of the Request of Aquila, Inc.,)
d/b/a Aquila Networks - L&P, to Implement a)Case No.
General Rate Increase in Steam Rates.)HR-2004-0024

KENNARD JONES, presiding,
Regulatory Law Judge

REPORTED BY:
Jennifer L. Leibach
ASSOCIATED COURT REPORTERS

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A P P E A R A N C E S

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FOR: Staff of the Public Service
Commission

PROCEEDINGS

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JUDGE JONES: Is there anything we need to discuss -- you can have a seat Mr. Oligschlaeger, you're still under oath. Is there anything we need to discuss before we deal with Mr. -- the questions from the bench and Recross and Redirect of Mr. Oligschlaeger?

MR. SWEARENGEN: I'm not aware of anything, Judge.

JUDGE JONES: Mr. Williams?

MR. WILLIAMS: Not at this stage, no.

MR. MICHEEL: Can I get some direction, Judge, are we going to then go to Mr. Featherstone after Mr. Oligschlaeger and finish this issue completely or are we going on to the depreciation issue after Mr. Oligschlaeger?

JUDGE JONES: I don't have any reason to think we would do anything other than follow the schedule and go on to Mr. Featherstone. I mean, is there an issue why we need to skip him and come back to this issue?

MR. SWEARENGEN: No, I think we need to finish this issue.

JUDGE JONES: Office of Public Counsel has filed a Motion to Strike Staff's Surrebuttal Testimony regarding the interim energy charges. Is Staff aware of that motion?

THE WITNESS: Yes.

01140

1 JUDGE JONES: Do you intend to respond or do
2 you all want to argue about it orally?

3 MR. MICHEEL: If we're going to argue about it
4 orally, I need to get the attorney down here that did that.
5 It wasn't me, and I've not read the Motion. I am aware that
6 we were going to do it.

7 MR. WILLIAMS: When did you file that?

8 JUDGE JONES: Yesterday, at a quarter to 5:00.

9 MR. WILLIAMS: I wasn't even aware of the
10 Motion until just now.

11 MR. SWEARENGEN: We've seen the Motion and
12 will have some comments, but we're not really ready to go
13 forward with that at this point.

14 JUDGE JONES: Okay.

15 MR. WILLIAMS: I'm sure Staff will have a
16 response, but we're not prepared at this point to go forward.

17 MR. SWEARENGEN: The issue is not up until
18 Friday anyway.

19 JUDGE JONES: What we'll do, then, is take it
20 up first thing in the morning tomorrow.

21 MR. SWEARENGEN: That will be fine, thank you.

22 JUDGE JONES: This is Thursday, right? All
23 right. Let's see. I have just a few questions for you, Mr.
24 Oligschlaeger.

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1 QUESTIONS BY JUDGE JONES:

2 Q. I was reading Mr. Featherstone's testimony
3 last night, and I noticed in some places where a dollar
4 figure would be, there was a blank, and I assume that means
5 it was highly confidential information. I don't know. But
6 my question for you is, and if I ask you something that would
7 be listed as a highly confidential answer, then let me know
8 that.

9 Staff's position -- I should back up and say
10 what -- how much does Staff think Aquila should be able to
11 pass on to rate payers with regards to this Aries issue?

12 A. The Staff's current position is still
13 reflected in a calculation that's contained on my Schedule 6
14 to my surrebuttal testimony.

15 Q. Okay.

16 A. That number is of the test year costs of the
17 Aries Purchase Power Agreement, the Staff is advocating that
18 \$22,010,290 be allowed in rates in total for the Aries
19 contract. Now, that amount needs to be allocated between the
20 Missouri Public Service and the L & P divisions,
21 unfortunately I don't have that information with me to divvy
22 up that number.

23 Q. Thank you. And having had discussions with
24 Aquila, do you understand the differences you all have? I
25 mean, other than the dollar amount, but is this a theoretical
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01142

1 difference that you all have? Is it a difference in how you
2 calculate numbers? Why aren't you all in agreement on that
3 number?

4 A. I would say it's largely a theoretical
5 difference. The company is advocating that the actual
6 contractual amount of MPS's Purchase Power payments related
7 to power taken from Aries be allowed in that -- in this case,
8 and I believe that's in the ballpark of \$27,600,000. The
9 Staff is advocating that, first of all, since this is an
10 affiliated transaction, that this transaction should be
11 valued on the actual cost of the transaction to MEPPH as
12 opposed to the market value of the transaction that was set
13 -- or was allegedly set through the bidding in RFP process
14 back in the late 1990's.

15 Now, having said that, obviously the company
16 disagrees that it should be set on a cost basis, but they
17 also disagree with how we advocate to set the costs in
18 various ways including how you recognize interest costs, how
19 you recognize return on equity costs, those are probably the
20 big differences.

21 Q. So then from what you said the actual contract
22 amount and what it has cost the company are different?

23 A. Well, no. MPS pays an amount to MEPPH based
24 upon a contract that was signed, I believe in 1999, and as I
25 stated, that amount is approximately 27,600,000. We believe

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1 that appropriate treatment of affiliated transactions for
2 rate purposes, you should take the lower of either the market
3 value of the transaction or the cost to the -- cost of the,
4 in this case, the cost of the power that is going to MPS, and
5 the cost is less than the market value.

6 Q. In your position, Staff seems to argue that
7 the contract price is too high, that what they're actually
8 paying MEPPH should be what it's worth. You're saying it's
9 not worth as much as Aquila has paid for it?

10 A. The way I would state it is that affiliated
11 transactions should be valued at cost. If they are not
12 valued at cost, for example, if MPS could have done --
13 entered into a similar set of transactions as MEPPH did at a
14 lower cost, there's no prudent reason why MPS shouldn't have
15 done so, but instead by not doing so, they allowed -- or it's
16 basically they're going to have to pay a higher cost because
17 there's some level of profit above the cost going to a
18 corporate affiliate.

19 Q. So the contract price is inflated to pay off a
20 buddy?

21 A. I'm not sure that's exactly how I would --

22 Q. I'm just trying to look at it as simply as
23 possible.

24 A. But that -- I think that's the general idea
25 that MPS is paying too much because they are basically paying

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1 a profit to a corporation, yes.

2 Q. I also noticed in looking at the schedules
3 that was compared to your Schedule 6 and the corrected
4 version that was supplied by Aquila yesterday, that in Aquila
5 version, this PILOT that's paid to Cass County was included,
6 but wasn't included in your Schedule 6.

7 A. Okay. In my surrebuttal testimony, we
8 indicated we were looking at the PILOT payments, and if they
9 were made within the update period for this case, we would
10 consider including them. We've since found out, from the
11 company, that these payments were made within the update
12 period; however, we've also since discovered that Mr. Sherman
13 recommended that a lower level of variable O & M should be
14 included in the company's calculation, and we actually have
15 reflected in our case.

16 Q. Okay. What's O & M?

17 A. Operation and maintenance expense.

18 Q. Okay.

19 A. Okay. And for that reason, we have more O & M
20 -- variable O & M in our case than what the company is
21 advocating, and that difference is greater than the amount of
22 the PILOT payments, so we believe that because of the excess
23 variable O & M in our case, we are effectively covering the
24 amount of the PILOT payments that the company is seeking.
25 Now, I would say that we don't agree with their calculation

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1 of the appropriate percentage of the PILOT payments that
2 should be allocated to MPS on what they have called corrected
3 Schedule 6 to my surrebuttal testimony.

4 JUDGE JONES: Commissioner Murray.

5 QUESTIONS BY COMMISSIONER MURRAY:

6 Q. Good morning, Mr. Oligschlaeger.

7 A. Good morning.

8 Q. I have just a few questions for you. The --
9 it's my understanding that Staff is alleging affiliate abuse;
10 is that correct?

11 A. That is correct.

12 Q. Now, in Staff's position, when did that
13 affiliate abuse begin?

14 A. I think affiliate abuse is how we would
15 characterize allowing in rates more than the costs associated
16 within an affiliated transaction, if the costs are less than
17 the alleged market value of the transaction. At the time we
18 were asked, the Staff was asked, and the Commission was asked
19 to look at the Aries purchase Power transaction in 1999, the
20 costs could not have been ascertainable at that time because
21 all of the financing agreements and all of the different
22 complexities of what actually has been set up for the Aries
23 unit and corporate structure were not in place and we could
24 not have analyzed that at that time.

25 Q. And the Purchase Power Agreement, Power Sales

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01146

1 Agreement did not provide that the cost would never be less
2 than the amount that we're attempting to be recovered; is
3 that right?

4 A. The Purchase Power Agreement set the cost to
5 MP -- to MPS or set the rate at which MPS would pay MEPPH for
6 the power. The Purchase Power Agreement itself does not
7 address the cost of that power.

8 Q. And it does not address rates?

9 A. No, it does not.

10 Q. Now, when Staff recommended in 1999 to the
11 Commission that the Power Sales Agreement was in the public
12 interest, what were the considerations at that time?

13 A. Well, Dr. Proctor's memorandum, he was the
14 Staff member who directly addressed that part of the
15 application. If you read his memorandum, he goes through a
16 process by which he explains that MPS did need power for the
17 period covered by the RFP, therefore the need for power was
18 there, and that the RFP process, as far as he could ascertain
19 was fair and that the selection of MEPPH among all those
20 entities that actually submitted bids appeared to be
21 reasonable, though his -- even his analysis did not go to the
22 point of stating he could determine necessarily what was the
23 least cost basis for MPS to be provided power for 2001 to
24 2005.

25 Q. Now, Staff's not taking the position at this

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01147

1 time that the Power Sales Agreement was imprudent, is it?

2 A. It's our position that MPS could have done
3 essentially what MEPPH has done.

4 Q. Is that a yes or a no?

5 A. That the Power Sales Agreement is imprudent?
6 I would state that to the degree MPS could have done the
7 transaction for less cost than MEPPH, that yes, it was
8 imprudent.

9 Q. Okay. So even though at the time a Staff rec
10 was that it was in the public interest based on the facts
11 that were known at the time, you're now saying that looking
12 at what has transpired since then, and the fact that power
13 could have been purchased more cheaply, but now you're saying
14 it was imprudent at the time? Is that an accurate portrayal
15 of your position?

16 A. Well, based upon only -- we can only base our
17 recommendation in that case on what we knew at the time, and
18 as I think we lay out in testimony, we had a very, very
19 limited amount of time to do any kind of review at all.

20 Q. And isn't prudence determined on what is known
21 at the time, not based on hindsight?

22 A. That is correct.

23 Q. So how is it that you're using things that
24 have since become known to make that determination now, that
25 at that time, it was imprudent?

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01148

1 A. Again, our position on this case is that the
2 cost -- the appropriate cost of this transaction is less than
3 the market value that was established in 1999, and for an
4 affiliate transaction, that's the proper basis, and in fact,
5 that concept or idea is somewhat imbedded in the Commission's
6 current rules on affiliated transactions. At the time in
7 1999, we could not do a cost versus market comparison because
8 the costs of that transaction were not known.

9 Q. Okay. Now, would the abuse that you allege
10 continue to exist even if the affiliate were sold?

11 A. The transaction itself, as long as it is in
12 effect, and that will be through May 2005, because it was
13 derived from an affiliated transaction will be an affiliate
14 transaction through May, 2005, regardless of the ownership of
15 Aries changes before that time.

16 Q. If there is this potential for Aquila to
17 profit from affiliate abuse, as the Staff seems to be
18 alleging, why would Aquila want to remove itself from that
19 situation and get rid of its affiliate?

20 A. I think their current financial condition, in
21 particular the financial burdens that the so-called tolls
22 associated with the Aries unit currently have on Aquila have
23 led them to seek to liquidate those tolls related to Aries,
24 as well as to other merchant generating units that it's
25 associated with.

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01149

1 Q. So you're basically saying they don't have a
2 choice?

3 A. I'm not -- I wouldn't say that. I think that
4 this is a fairly compelling rationale for the course of
5 action they're taking.

6 Q. I'm not sure I understand this question I
7 wrote down yesterday, but somewhere you were talking about
8 cost calculations, your cost calculations being based on
9 hypothetical lease payments. Is that what you're -- what you
10 based your cost calculations on?

11 A. Well, the cost calculation is based upon the
12 lease payments that would have been made if the permanent
13 financing that Aquila and Calpine had agreed to in regards to
14 the Aries unit had been consummated. It was not consummated.
15 Instead, the partners chose to go into default. It is our
16 basis or our contention that for a valid costing of the Aries
17 power that those lease payments still reflect an accurate
18 depiction of the actual debt service and depreciation
19 components of the Aries unit.

20 Q. And the reason the permanent financing
21 agreement was not consummated?

22 A. The partners went into default when it became
23 time to convert their construction financing into permanent
24 financing.

25 Q. And is that one of the disallowances you are
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01150

1 wanting to make based on shielding the rate payers from any
2 effects of Aquila's financial problems?

3 A. I believe that would fall into that category.
4 We do not believe that customers in Missouri should be asked
5 to pay any costs relating to a corporate decision to default
6 on a non-regulated project.

7 Q. Can you direct me to the Staff's accounting
8 schedule to this issue?

9 A. Unfortunately, I don't have the Staff's
10 accounting schedules with me.

11 Q. Does your counsel?

12 MR. WILLIAMS: I don't have those here. I
13 have those up in my office.

14 COMMISSIONER MURRAY: Okay.

15 Q. (By Commissioner Murray) I have a clean copy
16 here, I'll just hand it to the witness.

17 A. Do you have a particular question or?

18 Q. You're making an adjustment to the company's
19 calculations; is that correct?

20 A. I'm not actually sponsoring the adjustment, I
21 provided my Aries numbers to Staff witness for incorporation
22 into the Staff accounting schedules.

23 Q. So you're not totally familiar with where that
24 would show up in the accounting schedules?

25 A. Oh, I could probably find it if you give me
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01151

1 enough time to look through it.

2 Q. That's all right. If you're not the sponsor,
3 that's fine. Thank you. I want to try just a little bit
4 further to understand your position as to the Power Sales
5 Agreement, and your position as to the prudence that -- is
6 your position at this time that the company should not have
7 entered into that agreement?

8 A. No, I believe my testimony states that
9 entering into a contract for power with an affiliate can be a
10 prudent decision if the power is priced correctly and we
11 believe it should be priced in accordance with the cost --

12 Q. All right. When was it priced?

13 A. -- of the power. The price was set in early
14 1999.

15 Q. And that is the time that Staff reviewed the
16 agreement or recommendation to the Commission; is that
17 correct?

18 A. Again, we had less than a month to actually
19 review the application.

20 Q. I didn't ask you how long you had. I asked is
21 that when you recommended?

22 A. That we approve the agreement with all rate
23 findings for further proceedings.

24 Q. Okay. Go ahead.

25 A. And okay, and I was just going to note, we had

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01152

1 actually had approximately one month to look at this
2 application.

3 Q. I understand that.

4 A. Yes, so it -- any kind of detailed review was
5 not possible.

6 Q. Did you file your recommendation with
7 reservations?

8 A. We filed it with conditions, which I think
9 would meet the definition of reservations, including the
10 overage that we want to look at this for rate purposes later.

11 Q. Okay. Go ahead. Were you finished with your
12 answer?

13 A. Yes, I was.

14 Q. Okay. So based on -- I'm not -- I need to
15 think about what you just said, because I'm not sure if you
16 answered my question. I asked you, if you were saying that,
17 at this time, you think that the company should not have
18 entered into the agreement, and I don't know that you
19 answered that.

20 A. It's -- the company entered into an agreement
21 at a certain rate, and the 27 million I was talking about
22 with Mr. Jones earlier, at that time, the application was
23 made, we would not have had an ability to look at the cost of
24 the power to see whether that market rate was reasonable or
25 not, and amongst other reasons, that's why that needed that

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01153

1 kind of review, needed to wait until later. In other words,
2 if he remembers of the rate-making aspects of it and how
3 prudence fits into that, we -- that couldn't have entirely
4 been done in early 1999.

5 Q. I guess what I'm -- what I'm struggling with
6 here is why does prudence come into it at all? It appears to
7 me that no one would have known what the cost would have been
8 at that time?

9 A. And the company would take the risk of being
10 able to justify that rate through a comparison of the actual
11 cost of the power.

12 Q. Right, and that's related to rates, it's not
13 related to the prudence of entering into the agreement, is
14 it?

15 A. Well, and not to make this even more
16 complicated, we are alleging other aspects of imprudence of
17 the company including their -- the fact that they just did
18 not look at the option at all of building and constructing
19 and generating a regulated generating unit at the time.

20 Q. Do you dispute the company's position that the
21 atmosphere within the industry, at the time, and the
22 deregulatory movement at that time was accepted by Staff as
23 being more conducive to purchasing power than to owning
24 generators?

25 A. I would not disagree at all that in this -- in
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01154

1 the atmosphere that existed in the late 1990's, companies
2 would have been very prudent to look at the point of stranded
3 cost and whether those decisions might serve to aggravate a
4 potential cost down the road. Where I would part with the
5 company is I don't think it's reasonable at all to say just
6 throw up your hands and say we're not going to build any
7 regulated generating unit at all. The other Missouri
8 utilities did not follow that path, and I don't think it was
9 reasonable for Aquila to do so.

10 Q. Did you state that to Aquila or the Commission
11 at the time?

12 A. I was not involved in those discussions with
13 Aquila at the time. I cannot tell you that.

14 Q. You don't know whether any Staff made that
15 position known to Aquila or the Commission at the time?

16 A. No, I do not.

17 Q. Okay. Would you be surprised if Staff had
18 supported that position that the company had taken?

19 A. I would be surprised if the Staff would have
20 taken the position that it would be prudent for a company not
21 to even consider the option of building regulated generating
22 units to meet customer needs down the road.

23 Q. Okay. So back to the position where you are
24 alleging that it was imprudent that the Power Sales Agreement
25 was an imprudent act of the company. Can you itemize how
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01155

1 you're supporting that?

2 A. Well, any time you, in this case, now, I'll
3 put it in the context of a Purchase Power Agreement. Anytime
4 you enter into an agreement to purchase power from an
5 affiliate, and the regulated entity could have entered into
6 the same arrangements to obtain the power at a lower overall
7 cost than, I think it's, per se, imprudent to choose to enter
8 into the affiliated transaction, and the Commission's rules
9 reflect that.

10 Q. And when is that known at? When is that
11 evaluated as to the ability to enter into a contract with a
12 non-affiliate versus an affiliate?

13 A. That would be known when you can make a full
14 comparison of the market rate of the affiliate transaction
15 and the underlying cost of the affiliate transaction.
16 Traditionally, the Commission and the Staff has waited until
17 rate proceedings to look at those kinds of prudence issues.

18 Q. So are you stating that traditionally prudence
19 is challenged looking backward rather than at the facts known
20 at the time?

21 A. It's challenged at a point in time, after the
22 events take place. As I think you indicated earlier, it is
23 -- it should be based upon the facts known at the time that
24 the decision was made, not in a hindsight perspective.

25 Q. What was the facts known at the time this
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01156

1 decision was made?

2 A. The company's decision?

3 Q. Yes.

4 A. To enter into the PSA.

5 Q. And Staff's recommendation that the Commission
6 approve it?

7 A. The facts that was known, that was the details
8 of the bidding process, the RFP process that went on in 1999,
9 and the rate that had been determined through that RFP
10 process that MPS would pay to MEPPH for the power.

11 Q. Okay. So now is it your position that based
12 upon facts that were not known at the time, the company's
13 decision may be challenged as imprudent?

14 A. I don't know what knowledge the company had at
15 that time of the likely cost of the power that would be
16 provided to MPS. I know the Staff did not have that
17 knowledge.

18 Q. So looking backward, do you just make an
19 assumption that the company knew what Staff didn't know at
20 the time? I'm just trying to figure out how in the world
21 you're getting it challenging the prudence of something where
22 the facts known at the time indicated to Staff that it was in
23 the public interest?

24 A. Okay. The -- let me try it this way. The way
25 it has been traditionally set up in Missouri regulation has

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01157

1 been companies are free to enter into these types of
2 transaction with the knowledge that they will be looked at in
3 reviewing subsequent rate proceedings for their prudence,
4 reasonableness, et cetera, and this was the way this was set
5 up as well.

6 Q. Well, let me stop you there, because I -- and
7 maybe it's just a lack -- or a misunderstanding on my part,
8 but I thought that the, and maybe I need to reread how the
9 Commission actually approved this PSA, but I thought that the
10 Commission had approved it reserving any effect on rates for
11 a later case, but I did not think that that meant that the
12 Commission was going to go back and relook at whether or not
13 entering into the agreement was prudent, but merely whether
14 and how anything that resulted from the agreement would be
15 recoverable in rates. Am I -- is that a matter of semantics
16 or?

17 A. Well, the Commission was asked to make various
18 findings regarding the approval of this transaction and Aries
19 being EM-99-369. Okay. The Staff did what review it could,
20 that review did not enter into the kind of detail and time
21 that would be necessary to do a full review for rate purposes
22 of that, and I think Dr. Proctor's recommendation clearly
23 sets out the premise on which he based that, and that it was
24 not a kind of rate-making review. That's what we were asked
25 to do, and that's what we did.

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01158

1 COMMISSIONER MURRAY: Okay. I think I'm going
2 to pass to Chairman Gaw.

3 QUESTIONS BY CHAIRMAN GAW:

4 Q. Good morning.

5 A. Good morning.

6 Q. Let me see if I can get a big picture view of
7 what the adjustments are regarding the Aries plan. Can you
8 tell me, in general, what basic adjustments that you made in
9 regard to -- to -- to the Aries plant that impact the case,
10 just a very -- just the big picture of changes that were
11 done?

12 A. Okay. Certainly. The companies advocating
13 that the contractual pavement to MEPPH for power within the
14 test year of approximately 27,600,000 be included in the
15 case. The Staff is advocating that as an affiliated
16 transaction, the rules should be that the lower of the cost
17 of that power or the market value of that power should be
18 used for rate purposes.

19 Q. That's the same position that Staff has taken
20 for quite some time with regard to affiliated transaction,
21 isn't it?

22 A. I believe so, yes.

23 Q. Okay. Go ahead.

24 A. We believe that properly calculated, the cost
25 of Aries power is less than the market value established in
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01159

1 the MEPPH, MPS contract, and we're proposing that that amount
2 be reduced to an amount of approximately \$22 million.

3 Q. Okay. What was the original amount?

4 A. Approximately 27,600,000.

5 Q. Twenty-seven six. Okay. So 5,600,000
6 difference?

7 A. Approximately, yes.

8 Q. Okay. Now, and I'm not, right now, wanting to
9 know why. I know there's been quite a bit of discussion
10 about that, but I want to ask you how is that -- how does
11 that impact the -- how does that -- when you translate that
12 down the line into what that -- that will be due to -- to the
13 rate base, what does that do to rate base and what's it
14 likely to do, how much approximately is that worth in rates,
15 if you know, in revenues?

16 A. As an expense adjustment, it's actually stated
17 basically at its face value. It would mean approximately
18 \$5.6 million in rates. This is not a rate base adjustment.

19 Q. It is not? Right. It's directly in the
20 rates?

21 A. Right.

22 Q. Okay. Thank you for clarifying that for me.
23 Okay. So what other adjustments were made? Is that it with
24 regard to the Aries plan?

25 A. That is it -- that is a dispute, yes.

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01160

1 Q. All right. Any other disputes about Aries
2 that produced a change in -- in rate base or in rates?

3 A. I would clarify we are also alleging
4 imprudence in terms of their generation resource planning.

5 Q. I'm aware of that, and what I need to know, I
6 guess, is whether or not that does anything in regard to this
7 case, and if so, how?

8 A. Well, I mean, we have made, first of all, some
9 recommendations that the Commission Order the company to do
10 what we would consider appropriate resource planning in the
11 future. In terms of rates, and its costing Aries power, we
12 are proposing that no return on equity component be granted
13 to the company as part of that overall costing in order to
14 recognize what we allege to be the imprudence in the
15 generation resource planning side.

16 Q. Okay. Has Staff ever made that kind of an
17 adjustment before in your tenure?

18 A. That kind, you mean in terms of the return on
19 equity?

20 Q. Yes, and in regard to return on equity as it
21 relates to a concern about -- about generation or plant?

22 A. I know that we have proposed prudence
23 adjustment notices in the past associated with generating
24 assets and what comes particularly to mind are the nuclear
25 plants at Callaway and Wolf Creek. I think we focused at
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01161

1 that time in terms of trying to identify specific costs that
2 were incurred imprudently or excessively in proportioning
3 that the ultimate plant cost, not recognize -- or not reflect
4 those imprudent amounts, so in terms of adjusting return on
5 equity or that kind of adjustment, I don't recall such an
6 instance, but that's not to say it has not happened.

7 Q. Can you translate that -- that into dollars
8 for me on the -- on that -- the position that no return on
9 equity be granted?

10 A. Well --

11 Q. And in -- just in the very general -- I'm not
12 looking for down to the penny, I just want to know generally
13 how that impacts your calculations.

14 A. Well, it gets a little bit complicated.

15 Q. I figured that.

16 A. If you were in the hearing room yesterday,
17 it's apparent that the company's equity investment, so to
18 speak, and Aries, drastically increased as a result of and
19 after the default of the unit for various reasons, and it's
20 our position, certainly, that none of that should be
21 recognized for rate purposes. If you look at the equity
22 levels that were in place prior to the default and value
23 those to reflect, again, the net depreciated value of the
24 Aries unit, we believe that the dollar impact of that
25 disallowance would be less than \$3 million.

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01162

1 Q. Are we talking rate base or rate sound?

2 A. We're talking rate base.

3 Q. Three million. Okay. Give me the rationale
4 again for that.

5 A. Well, in my testimony, actually, there are
6 three different rationales for not allowing a return on
7 equity component to cost. The one we've talked about is
8 because we believe that there has been imprudence in the way
9 Aquila has planned its generating resource planning additions
10 since at least the mid-to-late 1990's.

11 The other rationales are that a large part of
12 that equity that they have in the plants are associated with
13 the default, which is the kind of extraordinary and unusual
14 occurrence that shouldn't be recognized for rates,
15 particularly as it pertains to non-regulated operations, and
16 lastly, we also know that it's not the company's intention to
17 maintain any kind of implicit ownership of the Aries unit on
18 an ongoing basis, and it would be inappropriate to recognize
19 equity cost for that reason as well.

20 Q. In the third category, is that -- is that --
21 is that rationale one that the Staff has employed rigidly?

22 A. I'm not sure we've ever been in this kind of
23 exact situation before --

24 Q. Okay.

25 A. -- in regards to a generating unit.

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01163

1 Q. Can you give me any authority for that kind of
2 an adjustment?

3 A. As it pertains to the ongoing -- well, in
4 general, the Commission sets rates, it's my understanding,
5 based on what's expected to happen on an ongoing basis, not
6 what has happened in the past, and I would just state in
7 general, that that's the rationale for this.

8 Q. In general, though, during the test year,
9 we've got -- we've got this plant in effect under a contract,
10 and what I'm trying to understand is is there some -- some
11 authority in rate-making process or in accounting standards
12 that would say we know this is not going to be a part of the
13 -- of the accessible generation under the terms of the
14 contract that now exists beyond 2005, so therefore, we can
15 make this adjustment? I'm just trying -- just give me some
16 of the rationale besides the just we know this, what
17 authority is, or what's the rationale in accounting standards
18 or in rate-making standards that you say not to do this?

19 A. Well, of course, the contract payments will
20 continue regardless of whether the ownership changes, in
21 terms of the costing, which is how we recommend it be valued
22 for rates.

23 Q. Okay.

24 A. One thing I would just note is the company's
25 proposal to sell the Aries unit, and I may be getting into
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01164

1 highly confidential information, so perhaps we should --
2 (REPORTER'S NOTE: At this point, an in camera
3 session was held, which is contained in Volume 15, pages 1165
4 through 1231.)
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1 JUDGE JONES: I'm not sure how -- well, if we
2 hadn't been thrown off course procedurally, tomorrow would be
3 the last day for these hearings. I know we've reserved some
4 time in the future if need be, but my intention is to stay on
5 course, which means today, we will be moving on to
6 depreciation and cost of removal if we have to stay past
7 5:00. I don't know how you all feel about that, but you can
8 tell me off-the-record on our personal time if you would like
9 to.

10 The next witness on this issue is Cary
11 Featherstone. Mr. Featherstone, are you ready to step
12 forward?

13 Would you please raise your right hand when
14 you get a moment.

15 (THE WITNESS WAS SWORN.)

16 JUDGE JONES: Thank you, you may be seated.

17 DIRECT EXAMINATION

18 QUESTIONS BY MR. WILLIAMS:

19 Q. Mr. Featherstone, did you prepare and prefile
20 direct testimony on December 9th -- prepared direct testimony
21 on December 9th, 2003, for purposes of this case on the
22 issues of cost removal and salvage in the Aries unit, which
23 has been marked for identification as Exhibit No. 67, both HC
24 and MP, and then submit an errata sheet, which has been
25 marked as Exhibit No. 145 reflecting some modifications to
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01233

1 that testimony?

2 A. I did.

3 Q. And did you also file redacted, which has been
4 marked as corrected direct testimony of Cary Featherstone on
5 February 27th of this year, which has been marked as Exhibit
6 Nos. 1067 and 1165, both HC and NP on those same issues, and
7 which is the same as Exhibit 67 and Exhibits 145 with changes
8 to remove matters pertaining to Aquila Network, LLP?

9 A. Yes.

10 MR. WILLIAMS: I'd offer Exhibit No. 67 HC NP,
11 Exhibit No. 145, Exhibit Nos. 1067 and 1145, Exhibit No. 1067
12 and 11 -- HC NP, I'm sorry.

13 JUDGE JONES: Exhibit Nos. 67, 1067, 145, and
14 1145 are admitted into the record.

15 (EXHIBIT NOS. 67, 1067, 145, 1145 WERE
16 RECEIVED INTO EVIDENCE BY THE JUDGE.)

17 Q. (By Mr. Williams) I should ask do you have any
18 further revision to any of those exhibits?

19 A. I do. The company and the Staff is still
20 looking at a question on what portions of my direct testimony
21 can be declassified from HC.

22 Q. Do you have any other revisions besides that?

23 A. I have some others. On Page 12, Line 6.

24 Q. Of?

25 A. Of my direct testimony.

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01234

1 Q. This will pertain to both exhibits?

2 A. Yes. There's a word up that should have been
3 have.

4 Q. Where is that again?

5 A. Line 6, Page 12. It should read Aquila and
6 Calpine have an arrangement. On Page 20, Line 7, where it
7 says MPS had anything, it should say MPS had nothing to do
8 with the terms. On that same page, Line 21, where it says
9 July, 2003, it should be June 26, 2003. Those are all the
10 changes that I'm aware of at this time in my direct
11 testimony.

12 Q. And with those changes, is that your direct
13 testimony in this case?

14 A. It is.

15 Q. Did you also prepare rebuttal testimony on
16 January 26th, 2004, both HC and NP versions that's been
17 marked for identification as Exhibit No. 68HC and Exhibit No.
18 68NP, on the issues of savings in the Aries unit and redacted
19 version to remove materials pertaining to L&P, if any, that's
20 been marked as Exhibit No. 1068?

21 A. Yes.

22 Q. Do you have any changes to those exhibits?

23 A. I don't believe so.

24 MR. WILLIAMS: I offer Exhibit Nos. 68 and
25 1068.

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1 JUDGE JONES: Exhibit Nos. 68 and 1068 are
2 admitted into the record.

3 (EXHIBIT NOS. 68 AND 1068 WERE RECEIVED INTO
4 EVIDENCE BY THE JUDGE.)

5 Q. (By Mr. Williams) Did you also prepare
6 surrebuttal testimony on the issue of Aries cost removal
7 salvage that's been marked as Exhibit No. 69HC and that
8 testimony was prepared on February 13th, 2004, in the
9 surrebuttal testimony?

10 A. Yes.

11 Q. And that both has HC and nonproprietary
12 versions?

13 A. It does.

14 Q. Do you have any changes to that exhibit?

15 A. Other than my caveat earlier about that we're
16 discussing declassifying some of the information, there are
17 some additional changes.

18 Q. Would you please provide those revisions?

19 A. Page 6, Line 11, where it says exempt whole
20 generator should be exempt wholesale generator. On Page 23
21 of the Surrebuttal, Line 7, where \$7.50 per kw month, that
22 should be \$5.90 per kw month. Line 8, where it says 590 --
23 \$5.90 per kw month should be \$7.50 and per kw month. That's
24 what I'm aware of at this time.

25 Q. And did you also cause to be filed modified
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01236

1 surrebuttal testimony to remove references to Light & Power
2 on February 27th, 2004, that's been marked as Exhibit No.
3 1069?

4 A. Yes.

5 Q. And those changes you just gave us, would
6 those changes also should be reflected in Exhibit No. 109?

7 A. They would.

8 Q. I offer Exhibits No. 69 and 1069.

9 JUDGE JONES: Exhibits Nos. 69 and 1069 are
10 admitted into the record.

11 (EXHIBIT NOS. 69 AND 1069 WERE RECEIVED INTO
12 EVIDENCE BY THE JUDGE.)

13 MR. WILLIAMS: Tender the witness.

14 JUDGE JONES: Is there any cross-examination
15 from the Federal Executive Agency?

16 MR. PAULSON: No, your Honor.

17 JUDGE JONES: Any cross-examination in the
18 Office of Public Counsel?

19 MR. MICHEEL: No.

20 JUDGE JONES: Any cross-examination from
21 Aquila?

22 MR. SWEARENGEN: Not at this time, your Honor,
23 thank you.

24 JUDGE JONES: Any questions from the bench?
25 Commissioner Gaw.

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01237

1 CHAIRMAN GAW: Thank you, Judge.

2 QUESTIONS BY CHAIRMAN GAW:

3 Q. Mr. Featherstone, what is Staff's position in
4 regard to what Aquila should do to meet its resource needs in
5 the next few years from a generation standpoint?

6 A. Sir, my answers would probably be highly
7 confidential.

8 Q. I can't believe you'd say that.

9 A. Yes, sir.

10 JUDGE JONES: We'll go off camera.

11 (REPORTER'S NOTE: At this point, an in camera
12 session was held, which is contained in Volume 15, pages 1238
13 through 1266.)

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1 JUDGE JONES: Okay. We'll adjourn for lunch
2 now and come back at 1:30.

3 (A BREAK WAS HAD.)

4 JUDGE JONES: Let's go ahead and get started.

5 MR. WILLIAMS: We're not in camera currently.

6 JUDGE JONES: No, we aren't, I've just changed
7 that. We finished questions from the bench, now we move on
8 to Recross. Does the Department of Natural Resources have
9 any Recross?

10 MS. WOODS: No, your Honor, thank you.

11 JUDGE JONES: The Office of Public Counsel.

12 MR. MICHEEL: No.

13 JUDGE JONES: Aquila?

14 MR. SWEARENGEN: Yes, your Honor, if you just
15 give me a minute. I need to look something up. Thank you for
16 bearing with me, Judge.

17 RE-CROSS-EXAMINATION

18 QUESTIONS BY MR. SWEARENGEN:

19 Q. Good afternoon, Mr. Featherstone.

20 A. Good afternoon, Mr. Swearengen.

21 MR. SWEARENGEN: We may need to be in camera,
22 Judge, and the reason I say that is my first line of
23 questions is going to concern some of the questions that
24 Commissioner Gaw asked the witness about resource planning
25 and in future years.

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JUDGE JONES: Okay. Go in camera.

(REPORTER'S NOTE: At this point, an in camera session was held, which is contained in Volume 15, pages 1269 through 1294.)

REDIRECT EXAMINATION

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QUESTIONS BY MR. WILLIAMS:

Q. Well, if it deals with an item such as whether a -- well, first of all, has Staff dealt with Aquila regarding construction of power generating plants prior to the Aries plant?

A. That information -- I guess the company informed the Staff through its two times a year meetings during the initial stages of Aries project through the IRP meetings.

Q. Have there been generating projects that Aquila has been involved with prior to the Aries project and the IRP meetings pertaining to what became the Aries project?

A. Yes.

Q. And did Staff provide any input to Aquila regarding any of those projects?

A. The company hasn't built any generating assets since 1983, and since I've been with the Commission, I'm not certain what input was provided or was even sought by the company regarding, like the Sibley units, when they were built in the 60's, 1969, or the Jeffrey units when they were built in the 70's, and 80's, so I'm not certain I would know that.

Q. Were you present in the hearing room when Dr. Proctor testified in this proceeding?

01296

1 A. I was.

2 Q. And, if you recall, didn't Dr. Proctor testify
3 that the Staff did not conduct a prudence review whenever it
4 was reviewing Aquila's Public Utility Holding Company Act
5 application before this Commission?

6 A. He did.

7 Q. Mr. Swearingen just had you read into the
8 record a portion of the Staff's report on electric
9 restructuring that was dated in June of 1998. Do you recall
10 that?

11 A. I do.

12 Q. And is it your understanding that all of the
13 Staff's suggestions in that report were dependant upon the
14 state legislation first passing the law enabling electric
15 restructuring?

16 A. Excuse me. I believe so. I think Mr.
17 Oligschlaeger testified that the Commission, I guess, asked
18 the Staff to do some preliminary review of what might take
19 place if legislation was passed to destructure or deregulate
20 the electric retail competition in the state.

21 Q. Do you still have JRE-1 in front of you?

22 A. Yes, I do.

23 Q. Would you read the first two lines of that
24 report right at the very beginning, first two sentences?

25 A. Are you -- the title page or?

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1 Q. Page 1. It would be Page 4 of 37 of Schedule
2 JRE-1.

3 A. Chapter 1, Electric Restructuring Plant
4 Introduction. One of the primary reasons for the creation of
5 the Missouri Public Service Commission's parenthesis
6 Commissions close parenthesis task force on retail electric
7 competition was to compile a comprehensive plan for
8 implementation of retail electric competition in the state of
9 Missouri in the event legislation is enacted, which
10 authorizes or mandates the competitive supply of generation
11 to retail electric consumers. The task force report provides
12 the information necessary for developing such a comprehensive
13 plan, but a comprehensive plan could not be developed which
14 would have obtained a consensus of the task force.

15 Q. And I also wanted to direct your attention to
16 a footnote that appears No. 1 at the bottom of that page.
17 Would you please read that footnote? How about if I read it
18 and you tell me if I'm correct.

19 A. Well, I have a copy here that is not a very
20 good one, and I'm having a tough time reading the footnote.
21 If you could give me your copy.

22 Q. We can try that.

23 A. If circumstances change or information
24 currently available to the Staff changes, the Staff reserves
25 the right to modify this plan.

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01298

1 Q. At what sentence does that footnote appear, at
2 the end of which sentence? Just read that sentence.

3 A. The Staff of the Commission parenthesis Staff
4 close parenthesis having participated fully in the working
5 groups and the task force will make this opportunity to
6 present a comprehensive plan for restructuring in Missouri
7 based upon the information currently available, and that
8 footnote one, then, that I just read, applied to that
9 sentence.

10 Q. Did the legislature ever pass a law that
11 permitted electric restructuring in the state of Missouri?

12 A. No, it did not.

13 Q. Did the Staff, in its report, advocate the
14 passage of such a law?

15 A. No.

16 Q. Had the Commission approved the EWG
17 application in Case No. EO-97-395, would the EWG proposal
18 have gone into effect regardless of whether the Missouri
19 legislature passed a law allowing electric restructuring in
20 the state of Missouri?

21 A. It was my understanding that the application
22 requested the Commission to transfer all of its generation
23 and capacity contracts to the EWG, regardless of whether a
24 law was passed.

25 MR. WILLIAMS: No further questions.

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01299

1 JUDGE JONES: Thank you, Mr. Featherstone.

2 At this time, we will move on to depreciation
3 cost of removal. Does anyone need time to resituate
4 themselves or can we go right into it?

5 MR. SWEARENGEN: I think we would appreciate a
6 minute or two.

7 JUDGE JONES: We'll take a five minute break,
8 well, actually, let's reconvene at 2:30.

9 MR. SWEARENGEN: Thank you very much.

10 (A BREAK WAS HAD.)

11 (EXHIBIT NO. 179 WAS MARKED FOR IDENTIFICATION
12 BY THE COURT REPORTER.)

13 JUDGE JONES: Okay. Let's go live. We're
14 back on the record with Case No. ER-2004-0034. Moving on to
15 the issue of depreciation. At this time, will company please
16 call its first witness?

17 MR. ENGLAND: Thank you, your Honor. If I
18 haven't -- well, I know I haven't. Let the record reflect
19 the appearance of W.R. England on behalf of the company for
20 this issue, and I would like to call Dr. White as our first
21 witness, please.

22 JUDGE JONES: Thank you, Mr. White. Would you
23 come forward, please? And will you raise your right hand.

24 (THE WITNESS WAS SWORN.)

25 JUDGE JONES: Thank you. You may be seated.

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01300

1 JUDGE JONES: You may proceed, Mr. England.

2 MR. ENGLAND: Thank you, Judge.

3 DIRECT EXAMINATION

4 QUESTIONS BY MR. ENGLAND:

5 Q. Would you please state your full name for the
6 record, please?

7 A. My name is Ronald E. White, spelled W-H-I-T-E.

8 Q. And by whom are you employed and in what
9 capacity?

10 A. I'm Executive Vice President of Foster
11 Associates, Incorporated.

12 Q. And what is your business address, Dr. White?

13 A. My business address is 16989 -- excuse me,
14 17595 South Tamiami Trail, and that's spelled T-A-M-I-A-M-I,
15 Tamiami Trail, Suite 212, Fort Myers, Florida.

16 Q. Thank you. And on whose behalf are you
17 appearing today?

18 A. I'm appearing on behalf of Aquila.

19 Q. Thank you. In that capacity, have you caused
20 to be prepared and filed certain direct testimony that I
21 believe has been marked for purposes of identification as
22 Exhibit 98, which I believe had an HR designation and the
23 case number, and then another piece of direct testimony
24 marked for purposes of identification as Exhibit No. 99,
25 which has an ER in the case number designation?

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01301

1 A. Yes, I did.

2 MR. ENGLAND: Your Honor, I apologize, but I'm
3 not sure if we're going through the general litany with these
4 witnesses or just going right to having them identify
5 corrections and moving on from there.

6 JUDGE JONES: The latter of your concern.

7 MR. ENGLAND: Okay.

8 Q. (By Mr. England) With respect to those two
9 pieces of direct testimony, do you have any corrections at
10 this time?

11 A. Not that I'm aware of.

12 Q. Okay. Did you also cause to be prepared and
13 filed -- prepared rebuttal testimony, which has been marked
14 for purposes of identification as Exhibit No. 100?

15 A. Yes, I did.

16 Q. Okay. And are there corrections to that?

17 A. There are, Mr. England, and I believe that
18 those were prepared as supplemental pages --

19 Q. Okay.

20 A. -- replacement pages to the testimony.

21 Q. And I believe they've been premarked as well
22 as Exhibit No. 179, I believe a seven-page exhibit, which
23 revises certain pages of your rebuttal testimony; is that
24 correct?

25 A. That is correct.

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01302

1 Q. Okay. Are there any other corrections that
2 you're aware of that need to be made at this time?

3 A. Not that I'm aware of.

4 Q. Okay. Thank you, sir.

5 MR. ENGLAND: Again, your Honor, since I'm new
6 to this proceeding, my understanding is there also was some
7 redacted testimony that was filed with a 1000 lead number, if
8 you will.

9 JUDGE JONES: That's correct.

10 MR. ENGLAND: And my understanding is this
11 witness' redacted comparable redacted testimony, if that's
12 the proper term, would be 1098, 1099, 1100.

13 JUDGE JONES: That's correct.

14 MR. ENGLAND: Okay. I have no other questions
15 of the witness at this time. I would offer Exhibits 98, 99,
16 100, 179, 1098, 1099, and 1100 and tender the witness for
17 cross-examination.

18 JUDGE JONES: Thank you. Exhibits 98 --

19 MR. SCHWARZ: Staff has an objection.

20 JUDGE JONES: To what?

21 MR. SCHWARZ: To the exhibits.

22 JUDGE JONES: All of them?

23 MR. SCHWARZ: Yes, sir.

24 JUDGE JONES: Well, as to 98, 1098, 1099,
25 1100, all the parties have agreed that there is no need for

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01303

1 foundation. I assume your objection is otherwise.

2 MR. SCHWARZ: I understand. Yes.

3 JUDGE JONES: What is your objection?

4 MR. SCHWARZ: The objection goes to
5 admissibility of the testimony. Admissibility of expert
6 witness testimony is controlled by Section 490.065, and I
7 have distributed a copy of that statute for the convenience
8 of the Commission and Counsel, and has been explicated
9 recently by the Missouri Supreme Court in the Case of State
10 Board of Registration for the Healing Arts versus McDye, and
11 I have distributed copies of that as well.

12 The key problem with the testimony that's
13 offered comes with respect to Subsection 3 of the Statute,
14 which requires that the data, in a particular case, must be
15 otherwise reasonably reliable, and I believe there are some
16 shortcomings with that.

17 The Supreme Court in the referenced case has
18 made clear that these shortcomings go to admissibility and
19 not to weight of the evidence. On Page 6 of the slip
20 opinion, the Court said about two-thirds of the way down,
21 after discussing earlier precedence on admissibility to
22 clarify, however, the Court says, this court expressly holds
23 that to the extent that cases since Laskey have suggested
24 that the standard of admissibility of expert testimony in
25 civil cases is that set forth in Frye or some other standard,

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01304

1 they are no longer to be followed. The relevant standard is
2 that set out in Section 490.065.

3 JUDGE JONES: I'm sorry, I didn't follow where
4 you started reading.

5 MR. SCHWARZ: It is just above -- I guess just
6 above Section 490.065.

7 JUDGE JONES: Okay.

8 MR. SCHWARZ: Okay. So it is -- it is
9 controlling of admissability not just weight. Then on Page 8
10 of 18 and in the second paragraph really goes to the crux of
11 the matter, but Section 490.065.3 goes on to require that the
12 facts or data on which an expert bases on opinion or
13 inference quote must be of a type reasonably relied upon by
14 experts in the field in forming opinions or inferences upon
15 the subject close quote, and that the facts and data, quote,
16 must otherwise be reasonably reliable with emphasis on
17 reliable close quote.

18 Section 490.065.3, thus, comma, Section
19 490.065.3 expressly requires a showing that the facts and
20 data are of a type reasonably relied on by experts in the
21 field in forming opinions or inferences upon the subject of
22 the expert's testimony. The Court must also independently
23 assess their reliability, and that, I think, is the basis of
24 the objection with particularity in two regards.

25 First, the cost of removal of life span of the

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01305

1 property. If you -- Mr. White states in his direct testimony
2 on Page 11, Line 9, quote while Foster Associates does not
3 claim expertise in developing demolition cost estimates, \$50
4 per kilowatt is well within the range of estimates reported
5 in industry surveys and in testimony presented by independent
6 demolition experts. It is also consistent with cost incurred
7 by Aquila in dismantling other generating facilities. There
8 is an expressed disclaimer of expertise on the cost of
9 dismantling, and there is certainly, in the testimony, no
10 analysis of specific costs that were analyzed, what a
11 reasonable range might be, how that range would have to be
12 modified to apply to Jeffrey, certainly, Iotan, Lake Road,
13 the specific properties here at issue.

14 Again, in Schedule REW-5, at Page 10, it is
15 stated this cost estimate is intended to serve as a
16 placeholder pending completion of a detailed dismantling cost
17 study. The company is prepared to under take a dismantling
18 cost study upon receipt of authorization by the Commission to
19 include removal expense in the accrual for depreciation.

20 Thus, the witness is admitting that there is
21 no present dismantling cost study upon which this Commission
22 can rely, and further, indicates that the company would be
23 undertaking this as a hindsight process once they know what
24 the amount is that's been authorized by the Commission that
25 they need to justify.

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01306

1 Hardly meets the standard of reliable, and the
2 Commission needs to keep in mind that while the Staff is
3 proposing a reduction in overall depreciation expense in this
4 case, if something on the order of \$1 to \$2 million, the
5 company's proposing an increase in depreciation expense in
6 this case of something in excess of \$12 million. The issue
7 -- the issue is framed on cost of removal, simply doesn't
8 meet the reliability that this Commission needs and is
9 entitled to in making a decision of that magnitude.

10 I think that the -- a similar problem of
11 reliability is encountered in the matter, the data of exactly
12 when these plants will retire. It seems to be a will of the
13 wisp. I would ask the Commission to note its decision in
14 ER-97-394, the previous rate case with this company, reported
15 at 7 MO PSC 3rd and the particular table I'm referring to is
16 at Page 190 on that, and that case, it -- the Commission
17 notes that MPS was proposing a retirement date of 2010, for
18 Sibley units 1, 2, and 3, 2013, 15, and 18, for Jeffrey
19 Units, 1, 2, and 3, and 2004 for Greenwood Units 1 to 4.

20 Certainly like a will of the wisp, those
21 numbers have receded in the present case. Jeffrey is
22 estimated at 2022, Sibley at 2014 to 2015, and various others
23 have moved back to 2017 to 2024, and it's not surprising, and
24 is one of the major reasons, major concerns that Staff has
25 with application of life span techniques to these properties,
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1 that is the current conditions in the natural gas market
2 vis-a-vis coal prices, the technological improvements in
3 generation, the availability of in-place transmission and
4 generating facilities, rail facilities, transportation
5 facilities, are certainly economic art conditions that have
6 to be analyzed, and until the company actually makes a
7 decision, and in the end, commits that it's going to replace
8 a generation, it's not reliable to base those decisions on
9 certainly what's here in the record.

10 JUDGE JONES: Well, I understand your argument
11 with regard to salvage cost. It seems to go to the issue of
12 Section 490.065. I don't understand your argument, however,
13 with retirement dates. You seem to have a problem with the
14 span of time that they're suggesting rather than whether or
15 not it's reasonable.

16 MR. SCHWARZ: The question is whether it's
17 reliable, and I mean, my understanding is, and I haven't sat
18 in on all the proceedings, but my understanding is that a
19 major issue here is that the company is uncertain as to what
20 its future generation needs are and how those needs are going
21 to be met. It is --

22 JUDGE JONES: Who is certain?

23 MR. SCHWARZ: Well, if no one is certain, then
24 the dates and the ultimate treatment of generation capacity
25 is not reliable. That's the whole point.

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1 JUDGE JONES: But --

2 MR. SCHWARZ: No one is certain, so that the
3 reliability of picking specific dates for purposes of
4 depreciation without a cognizant decision for purposes of
5 generation and capital needs is unwarranted. That is, the
6 two are not separate and independent. The two are
7 interrelated, and if it's not reliable over on the generation
8 side, on the actual provision of service, it cannot be
9 reliable on the depreciation side.

10 JUDGE JONES: So I take it, then, you're
11 insinuating Staff's witnesses have testified reliably as to
12 life spans of essence.

13 MR. SCHWARZ: Staff doesn't use the life span
14 approach.

15 JUDGE JONES: How do you calculate
16 depreciation without considering the life span of asset.

17 MR. SCHWARZ: Until such time as there is a
18 decision on the operating side, if you will, you don't
19 reflect those in the depreciation, and that's the major issue
20 between the company and the Staff.

21 JUDGE JONES: Okay. And does your objection
22 go to both direct testimonies and rebuttal?

23 MR. SCHWARZ: And rebuttal, and I think the
24 company's -- the company's position and approach is the same
25 in both, as I understand it.

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1 JUDGE JONES: It seems as though rebuttal
2 testimony would go to some other party's direct testimony,
3 wouldn't it?

4 MR. SCHWARZ: Yes, it does, and the point of
5 the objection is that the data that goes into the company's
6 life span approach is not reliable because the date of final
7 retirement of, you know, 50 percent or so of the company's
8 generating facilities is simply not known at this time, not
9 by Staff, not by the company, and if it's not known for
10 purposes of how are you going to generate electricity and
11 meet demand, how can it be known for purposes of
12 depreciation?

13 JUDGE JONES: That means we shouldn't talk at
14 all about depreciation under 490.065.

15 MR. SCHWARZ: No, Staff's approach does not --

16 JUDGE JONES: How does Staff approach
17 depreciation without talking what will happen in the future?

18 MR. SCHWARZ: Staff's position is that when
19 the date of final retirements are known with certainty, then
20 you go ahead and make the depreciation analysis, you allocate
21 costs, which by that time are known and measurable on the --
22 in the rate case that the time.

23 It's similar to what happened in the
24 Missouri-American case or the Saint Joe Water Case when the
25 old plant was retired. At the time it was retired, there was

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1 unamortized, unrecovered plant costs, and when the plant was
2 actually retired and the new plant went online, Staff's
3 recommendation and the company's recommendation was that
4 those costs be amortized. Public Counsel opposed it, but the
5 Commission decided that now that those costs were known, they
6 could be recovered.

7 JUDGE JONES: Okay. Mr. England. I'll give
8 you an opportunity to respond in just a moment, but I have
9 one more point I'd like to make. The Court opinion that you
10 provided to me, and correct me if I'm wrong, basically says
11 490.065 applies. Period. And on top of that, it applies it
12 in the context of is it a medical malpractice case?

13 MR. SCHWARZ: No, it's a Board of Registration
14 for the Healing Arts. It dealt with what is -- how does the
15 Board determine what's appropriate treatment and is a
16 physician providing treatment that's inappropriate.

17 JUDGE JONES: Which means one can look at what
18 all other physicians do on that day, right? There's no
19 forecasting involved in that.

20 MR. SCHWARZ: The -- the Court clearly
21 indicated that, as the statute does, that the -- in that
22 case, the practice of other physicians wasn't an important
23 factor, and that the physician was arguing you have to look
24 at the physicians who treat patients with vascular disease
25 the same way I do, and the Court said no, that's not the
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1 right standard, you have to look at physicians who treat --
2 all physicians who treat vascular problems, but the
3 requirement for the underlying data is a separate and
4 distinct standard.

5 JUDGE JONES: Well, like I said, I understand
6 your salvage cost issue. It seems like there needs to be
7 some information out there that leads an expert to come to a
8 conclusion. I don't know how an expert can come to a
9 conclusion without looking at something else that's out
10 there, but regard to the retirement dates, let me ask you
11 this. Does Staff have an opinion on what depreciation cost
12 there should be?

13 MR. SCHWARZ: Yes.

14 JUDGE JONES: Well, how did you arrive at
15 that?

16 MR. SCHWARZ: We -- the Staff uses interim
17 retirements on these facilities. For instance, boiler tubes
18 wear out with some -- I say some regularity, you may go
19 through boiler tubes in 15 years or 20 years, depending on --

20 JUDGE JONES: Well, that's not reliable
21 though.

22 MR. SCHWARZ: It's -- it's interim and -- and
23 reasonably reliable. A building will go through several
24 roofs during its lifetime. Those can all -- and I think that
25 all parties depreciate those separately, those component

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1 parts separately as interim retirements. The roof, perhaps
2 transformers, turbine blades, things of that nature, that
3 will be needed to be replaced prior to the time when the
4 entire facility is retired, and Staff -- Staff's position is
5 that until the date of final retirement is known, that
6 interim retirements --

7 JUDGE JONES: You mean portions of an asset?

8 MR. SCHWARZ: Yeah, well, yes, component parts
9 of a unit, of the Sibley generating plant has coal handlers
10 and railroad tracks and --

11 JUDGE JONES: Okay. If I own a home and if my
12 house has a life of -- I mean, my roof has a life of 10 years
13 and I replace it in 10 years, and then my plumbing has a life
14 of 20, and I replace it in 20, my house never -- never goes
15 to salvage, I just keep replacing component parts, right?

16 MR. SCHWARZ: That's correct.

17 JUDGE JONES: So there is no life of the asset
18 in total according to Staff's theory, as you put it across.

19 MR. SCHWARZ: Well, there will be economic
20 factor -- there are other factors simply besides age and wear
21 and tear that might for instance operate on an electric
22 generation plant that wouldn't necessarily operate on your
23 home, but Paul Revere's house is still standing in Boston,
24 Notre Dame Cathedral is still standing in Paris. They can
25 last very long periods of time.

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1 JUDGE JONES: Okay. Mr. England.

2 MR. ENGLAND: If I may inquire of Counsel, I
3 was -- I wasn't quite sure the precise aspects of the
4 testimony or study that was problematic for him. I heard him
5 mention cost of removal.

6 MR. SCHWARZ: Uh-huh.

7 MR. ENGLAND: Is that as it applies to the
8 generating plans that you were talking about or cost of
9 removal generally?

10 MR. SCHWARZ: Well, I think it certainly
11 applies specifically to the cost of removal of the generating
12 plants. I'm not sure that the data itself that Mr. White
13 uses for the other non-life span property is -- is not
14 otherwise reasonably reliable. I think that as far as that
15 goes --

16 MR. ENGLAND: Okay.

17 MR. SCHWARZ: -- it is his use of them that we
18 take problems with. On the other hand, I don't know how you
19 -- how you separate them.

20 MR. ENGLAND: I'll take a crack at responding,
21 your Honor, but I think I'm kind of where you are in that
22 depreciation, generally speaking, is sort of a science of
23 trying to predict what's going to happen in the future, and
24 nobody has a clear crystal ball in that regard. It also
25 strikes me that Counsel has objected to all testimony, and

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1 we're dealing with a very small piece here, that's the cost
2 of removal related to finite pieces of equipment, in this
3 case, generating plant, seems a little bit like throwing the
4 baby out with the bath water.

5 The standard, as I understand, for admitting
6 expert testimony, I believe was accurately stated by Mr.
7 Schwarz, simply because he quoted it from the statute. At
8 least he quoted correctly. And I think the reliability
9 question is ultimately one for you all to determine. In
10 reading the passage that Mr. Schwarz specifically cited,
11 direct Page 11, Line 9, or beginning on Line 9, while this
12 witness doesn't claim expertise in developing demolition cost
13 estimates, we're not offering him as a demolition cost
14 expert.

15 What Dr. White is, and being offered for, is
16 an expert in the area of depreciation, and as an expert, he's
17 allowed to rely on studies and information that he gathers in
18 the course of his employment and in his work. The
19 information that he relies upon for purposes of determining
20 cost of removal for power plants is a study performed by
21 others, which he's perfectly entitled to rely upon, whether
22 that is a study that is accepted within the community, I
23 think that's something for Counsel to inquire upon, if he
24 wants to, through cross-examination, but just because Counsel
25 says he doesn't think it's reliable doesn't make it

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1 unreliable.

2 I think it's something to be tested, as I
3 said, through cross-examination. In looking at the case that
4 Mr. Schwarz has cited you to, and I'm not sure, at least on
5 the handout it's Page 9 of 18, if I may quote, the Court
6 there said quote that therefore the admissibility of an
7 expert's opinion depends not on some immutable external
8 standard, hyphen, such as the presence of controlled studies,
9 hyphen, but on whether experts in the particular field in
10 reasonably relying on other types of data in forming their
11 opinions or whether in the field controlled studies are
12 required, and I think Counsel's challenging whether or not
13 the study is relied upon by this witness for that portion of
14 his study that deals with cost of removal of large power
15 plants as based upon studies that can be reasonably relied
16 upon, and that's something that this witness, I'm sure, will
17 tell you you can, and something for Counsel to try to prove
18 otherwise, so I don't think the objection is proper or
19 appropriate insofar as it seeks to prevent the admissibility
20 of all of this evidence.

21 JUDGE JONES: Mr. Schwarz, do you want to
22 respond?

23 MR. SCHWARZ: If I might, briefly. I think
24 that while it may not be Mr. White's responsibility to
25 provide a dismantling cost, it is the company's or its
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1 consultants. That was the practice in the AmerenUE complaint
2 case. I believe it was the practice in the Empire District
3 Electric case. I don't have those citations, but I think
4 that -- that it is conceded in the schedule where the company
5 acknowledges that this study will need to be provided at a
6 later date, and the whole point is that the standard is that
7 the reliable data upon which the expert basis his opinion be
8 provided at the time that the expert provides his opinion.

9 JUDGE JONES: That's not what the statute
10 says. It says his opinion must be based on that study, but
11 it doesn't -- now it sounds like now you're saying you wanted
12 that information before today.

13 MR. SCHWARZ: No.

14 JUDGE JONES: Okay.

15 MR. SCHWARZ: That's not what the statute
16 says. The statute says that the facts or data in a
17 particular case can be gleaned elsewhere, but must be
18 otherwise reasonably reliable, and the Court specifically
19 said, the Court must also independently assess their
20 reliability, that is n--

21 JUDGE JONES: That's what Mr. England's
22 saying.

23 MR. SCHWARZ: Well, but the company itself has
24 said that they have no expert on this necessary data in this
25 case, and they concede that they can provide the necessarily
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1 reliable data at some point in time in the future. The point
2 is that to support the expert's opinion, the data upon which
3 he relies, the \$50 an hour in this case, the Court, in this
4 case, the Commission, must independently assess its
5 reliability, and they have conceded that there is no basis,
6 they have provided no basis in this case in this record for
7 the Commission to do so.

8 JUDGE JONES: So Mr. White is saying that
9 salvage cost is \$50 an hour and you don't know where he got
10 that figure.

11 MR. SCHWARZ: No, and he's not -- he's
12 concededly not an expert to tell us that he independently
13 analyzed the data.

14 JUDGE JONES: Well, and in light of 490, it
15 would be irrelevant whether he could independently tell us
16 because he has to base it on something anyway, right?

17 MR. SCHWARZ: But, I mean, he could
18 conceivably have expertise in more than one area.

19 JUDGE JONES: Well, he would still have to
20 base his opinion on something else.

21 MR. SCHWARZ: Yes.

22 JUDGE JONES: Okay. Well, what I'm going to
23 do is allow you to voir dire the witness on his expertise in
24 that area and where he got that information. Do you want to
25 do that?

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1 MR. SCHWARZ: Sure.

2 JUDGE JONES: Okay. Go right ahead.

3 MR. ENGLAND: May I make a suggestion? I was
4 done with what truncated direct, if you'll pardon the use of
5 that word in this context, that we do in this proceeding.
6 I'm prepared to put the witness up for cross-examination,
7 would suggest that Mr. Schwarz include his voir dire along
8 with the rest of his cross-examination and at the end, the
9 Commission can determine what they want to do with the motion
10 to -- or I guess the objection to the testimony, and at that
11 point in time, and just proceed forward.

12 JUDGE JONES: Well, I want to make clear
13 whether or not this evidence is going to be part of the
14 record before we move on with cross-examination, questions
15 from the bench, and I think the best way to do that is for
16 Mr. Schwarz to make his challenge now.

17 MR. ENGLAND: Okay. Fair enough.

18 JUDGE JONES: Or I could have you all write
19 motions and reply motions and brief the issue for me, if you
20 want to.

21 MR. ENGLAND: I'd like for Mr. Schwarz to do
22 the voir dire. Don't make me do that, your Honor.

23 JUDGE JONES: Go right ahead, Mr. Schwarz.

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VOIR DIRE EXAMINATION

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2 QUESTIONS BY MR. SCHWARZ:

3 Q. Mr. White, in your direct testimony on Page
4 11, you -- well, Foster and Associates disclaims expertise in
5 developing demolition costs. Does that include you along
6 with the balance of Foster and Associates?

7 A. It certainly does.

8 Q. Let me ask you this. Are you aware of any
9 coal fired electric generation plants, say, more than 400
10 megawatts that have been retired in the last 20 years?

11 A. I wouldn't have that at my fingertips. I'm
12 certainly aware of studies that have been done on
13 dismantlement. I'm aware of the general cost range per kw of
14 those dismantlement studies. What is important here, Mr.
15 Schwarz, is not the focus on the \$50 per kw, but the reason
16 that I put that in, as I described it in my testimony, as a
17 place holder, was because the issue of accruing for ultimate
18 dismantlement, let alone net salvage has been an issue before
19 this Commission, and in discussing this matter with the
20 company, the company --

21 MR. SCHWARZ: Judge, I don't think this is
22 responsive at this stage to my question, which is --

23 JUDGE JONES: I'm going to let him finish what
24 he's trying to say here.

25 THE WITNESS: The company indicated that we
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1 certainly wanted to, again, have a Commission view on the
2 propriety of accruing for dismantlement cost, and so that
3 number, which was considered to be conservative in my
4 judgment and from my knowledge and experience, as I indicated
5 in my testimony, is a place holder.

6 It's a placeholder for the Commission to,
7 again, decide whether or not it is appropriate to accrue for
8 ultimate dismantlement. If the Commission makes that
9 determination, then the company has indicated that it will
10 proceed with a formal dismantlement study and retain somebody
11 to do that that has expertise in that field.

12 Q. (By Mr. Schwarz) But I take it from your
13 answer that you're not aware of any power coal fire plants
14 that have -- of greater than 400 megawatts that have retired
15 in the last 15, 20 years.

16 A. I can't sit here today and tell you that I can
17 cite plants for you.

18 Q. Okay. So you certainly don't know the actual
19 cost of dismantling, say, a 400 megawatt?

20 A. As I say, there's dismantlement studies out
21 there that indicate --

22 MR. SCHWARZ: Judge, I'd like my question
23 answered. My question is are you familiar with the actual
24 cost to dismantle a 400-megawatt coal fired generating plant.

25 MR. ENGLAND: And your Honor, excuse me, Dr.

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1 White, I believe he was answering that question.

2 MR. SCHWARZ: I don't believe his answer was
3 responsive, and I'm entitled a yes or no, at least as an
4 introductory.

5 JUDGE JONES: Due to the fact that this isn't
6 a cross examination, and quite frankly, you're asking the
7 Doctor, why did you say what you said, I think he should be
8 given some latitude in defending his testimony, don't you
9 think so, Mr. Schwarz?

10 MR. SCHWARZ: I think that I'm entitled to
11 answers to the question that I ask, and I am perfectly
12 willing for him to explain something beyond yes or no, but I
13 asked a very specific question.

14 JUDGE JONES: Some questions can't be answered
15 yes or no, you and I both know that.

16 MR. SCHWARZ: I understand, but my question
17 was do you know the cost to actually dismantle a 400-megawatt
18 power plant, and that, and he can explain that, but he either
19 knows or he doesn't know.

20 JUDGE JONES: Go ahead, Mr. White.

21 THE WITNESS: Well, I thought I already
22 answered that question. No, I do not know.

23 Q. (By Mr. Schwarz) Okay. And if you want to, I
24 mean I'm really not -- I just want an answer to my question
25 before.

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1 JUDGE JONES: Okay. You have that, move on.

2 Q. (By Mr. Schwarz) So the studies that you refer
3 to in your testimony are estimates that have not necessarily
4 been tested by being compared to the actual cost to demolish
5 the particular plant?

6 A. I don't know the answer to that. I know that
7 these -- that numbers within the range of what I'm talking
8 about, \$50 per kw, are used for dismantlement cost estimates
9 in setting depreciation rates. Not being an expert in
10 dismantlement, I don't know how that compares to actuals, and
11 again, Mr. Schwarz, I want to emphasize that the significance
12 of this was to establish the principal for accruing for it.

13 Q. Well, the -- let me ask you this. I thought
14 the -- at least a major purpose of your testimony was to have
15 the Commission provide actual dollars based on cost to
16 dismantle. Is that not correct? I mean, it's a placeholder,
17 but the rate payers are expected to pay while the place is
18 being held; isn't that correct?

19 A. That is quite correct. It is part of the
20 calculation of the depreciation expense. Now, should the
21 Commission decide that that number is too low or too high,
22 and adjust it, the Commission can certainly do that. What it
23 will have decided, however, is the principal of accruing, and
24 once that determination is made, then to undertake a
25 comprehensive dismantlement study and quantify that amount

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1 seems to me to be a sensible thing to do. To do that prior,
2 undertake the cost and the efforts for dismantlement study
3 and not have established the propriety of accruing for that
4 is, in my view, would be an imprudent cost to incur.

5 Q. What's the value of the issue?

6 A. Excuse me, I don't understand the question.

7 Q. Is the dismantlement of these plants, several
8 million dollars?

9 A. I'm not sure I understand the question, Mr.
10 Schwarz.

11 Q. How much does it cost to dismantle these
12 plants at -- well, excuse me, you indicated \$50 a megawatt it
13 will be \$25,600,000 for Sibley's 512.2 megawatts; is that
14 correct?

15 A. I believe that's correct.

16 Q. And you don't think that it's reasonable and
17 reliable to obtain a study to establish those facts prior to
18 asking the Commission to make rate payers pay for it?

19 A. Well, Mr. Schwarz, my understanding is that
20 this Commission has decided in a prior cases that
21 dismantlement cost was too uncertain to be included in
22 depreciation rates. That question, that issue, is being
23 revisited here, and if it is established that it is
24 appropriate, it's proper rate-making to accrue for that, then
25 to undertake a study to quantify that with some greater
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1 degree of certainty seems to me to be appropriate.

2 Q. And would the Commission keep the record open
3 until such time as that study is done?

4 A. I don't know how they would handle that. The
5 reasonableness of \$50 per kw as a threshold seems to me to be
6 quite sensible.

7 JUDGE JONES: Okay. Let me interrupt you
8 here. From where did you perceive \$50? What made you come
9 up with that number?

10 THE WITNESS: That, Judge, is largely based on
11 my experience and knowledge of what other cost estimates have
12 been. There are published studies out there of the average
13 cost of plants that have been retired and studies of actual
14 dismantlement costs before dismantlement estimates before the
15 plant has been retired. That's my general knowledge.

16 JUDGE JONES: Now, Mr. Schwarz, you do realize
17 that his knowledge, apparently is something he perceives,
18 right?

19 MR. SCHWARZ: Yes, Judge.

20 JUDGE JONES: That's allowed for in the
21 statute.

22 MR. SCHWARZ: That is one element of the
23 statute, that's correct.

24 JUDGE JONES: Okay. Well, it's his
25 perception, and you want me to exclude all of his testimony
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1 based on -- let me -- let me tell you this.

2 First of all, I think the testimony should be
3 in. I'm not convinced that it shouldn't be, so you know
4 where I'm going with this, and secondly, even if I agree with
5 you, I strongly disagree with you wanting to exclude all of
6 his testimony, particularly now.

7 MR. SCHWARZ: Well, I will amend it to simply
8 apply to the life span property, then, that I have
9 specifically pointed out the shortcomings in the reliability
10 of the data upon which he bases his estimate and I'd be
11 curious, I mean, the Commission needs to ask itself, what
12 evidence do we have to make a positive finding of fact that
13 the studies that Dr. White may or may not have reviewed are
14 themselves reliable, and I would suggest to you that there is
15 no evidence whatsoever.

16 JUDGE JONES: So you're saying he hasn't
17 backed up his expert opinion?

18 MR. SCHWARZ: The Court has indicated and the
19 statute requires that the forum, that the Court --

20 JUDGE JONES: I also don't agree with you that
21 this case properly and squarely interprets this fact pattern.
22 It's completely different. I mean, it does say 490.065 is
23 the law, but the applicability of this to a rate case is far
24 removed, I think. I think the Supreme Court of Missouri
25 would probably agree with me.

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1 MR. SCHWARZ: Well, the heading of the Court's
2 opinion on Page 6 is Standard for Admissibility of Expert
3 Testimony. I think Doctor -- I don't have any qualms with
4 Dr. White's qualifications as an expert, but we're talking
5 about the admissibility of his testimony.

6 JUDGE JONES: I understand that, Mr. Schwarz,
7 but you do have to consider the fact pattern in which a law
8 is made, don't you? Isn't that relevant?

9 MR. SCHWARZ: The Court has instructed that
10 the Court must also independently assess the reliability of
11 the facts upon which the expert's testimony is made, and I'm
12 not aware of anything in the record or anything that Dr.
13 White has said here that will establish or makes a record
14 that some demolition cost estimates are reliable, and having
15 said that I don't know, I mean, we can banter -- I don't
16 think there's any point.

17 JUDGE JONES: There's another reading of the
18 statute that I'm not sure you considered. It says the facts
19 or data that he relies on must be reasonably reliable or
20 something like that, right? So if there are no facts or
21 data, then this section doesn't even apply. Could the
22 section be read that way, Mr. Schwarz?

23 MR. SCHWARZ: I don't think that --

24 JUDGE JONES: It doesn't say that his opinion
25 necessarily be made on facts or data, he just says that such

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1 facts or data must be reasonable.

2 MR. SCHWARZ: I think that in -- I think that
3 Mr. -- or Dr. White has in fact, relied on these -- or based
4 his work on these studies, and there is no independent
5 showing of reliability of those studies for this Commission
6 to make a finding that they are reliable.

7 JUDGE JONES: I don't think he's referred to
8 any studies in particular. He's saying in his experience,
9 this amount is what he believes is reasonable.

10 MR. SCHWARZ: Judge, I think that those facts,
11 the statute and the Court, required that this Commission find
12 those -- those facts to be reliable, and I can't say anymore.
13 I mean, it seems I've read it, I think, two or three times.
14 The Court must also independently assess their, meaning the
15 facts, reliability.

16 JUDGE JONES: Assuming there are facts.

17 MR. SCHWARZ: Well, I mean, I'm certainly not
18 going to say that Dr. White states that he looked at
19 demolition studies when he really didn't. That's a
20 possibility, but I think that would undermine his credibility
21 as well.

22 JUDGE JONES: Well, I'll tell what you we'll
23 do. I'm going to admit the testimony of Dr. White, and it
24 can be stricken later if you -- if you all brief the issue
25 and convince me otherwise.

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1 MR. SCHWARZ: Well, I've made my objection, I
2 think that we've discussed it adequately, and it's, I think,
3 the independent duty of the Commission to apply the law to
4 the cases before it, and I've --

5 JUDGE JONES: Well, that's what we'll do.
6 With that, the objection is overruled, and we'll move -- oh,
7 let me do this. So Exhibits No. 98, 99, 100, 1098, 1099, and
8 1100 are admitted into the record.

9 Will there be cross-examination -- did you
10 want to tender your witness Mr. England or did you have more
11 to add?

12 (EXHIBIT NOS. 98, 99, 100, 1098, 1099, AND
13 1100 WAS RECEIVED INTO EVIDENCE BY THE JUDGE.)

14 MR. SCHWARZ: I think he tried.

15 MR. ENGLAND: Yes, sir, I would like to tender
16 the witness, but I think you still need to rule on the
17 corrected rebuttal, which was Exhibit No. 179.

18 JUDGE JONES: Is there any objection to
19 Exhibit 179?

20 MR. SCHWARZ: Not other than I've already
21 noted.

22 JUDGE JONES: Okay. Mr. Micheel?

23 MR. MICHEEL: No, your Honor.

24 JUDGE JONES: Exhibit No. 179 is admitted into
25 the record, and will there be cross-examination from Office
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1 of the Public Counsel?

2 (EXHIBIT NO. 179 WAS RECEIVED INTO EVIDENCE BY
3 THE JUDGE.)

4 MR. MICHEEL: No, your Honor.

5 JUDGE JONES: We'll move on to
6 cross-examination from Staff of the Commission.

7 CROSS-EXAMINATION

8 QUESTIONS BY MR. SCHWARZ:

9 Q. Good afternoon again.

10 A. Good afternoon, Mr. Schwarz.

11 Q. Let's try to get off on a different foot. In
12 any number of places in your testimony, you talk about
13 something that you called the forces of retirement that act
14 upon plant. Can you tell me what you mean by that?

15 A. When we're talking about life expectancies and
16 mortality characteristics of plant categories, we're
17 describing these characteristics in terms of probability
18 distributions, and the shape of those probability
19 distributions, whether retirements are clustered early in
20 life or clustered later in the profile of retirement pattern,
21 that's created by the forces of mortality, and there's --
22 there's economic forces, there's physical forces, there's
23 functional forces, in its simplest example, things wear out.
24 That is a force of retirement.

25 Because we're working with group plant

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1 accounts, we have more than one asset classified in the
2 group. Some of those assets are going to remain in service
3 longer than others. Those characteristics, that timing
4 pattern of retirement, is what's dictated by the forces of
5 mortality.

6 Q. Well, I'm -- do you have your testimony there
7 with you?

8 A. I do.

9 Q. Your direct, on Page 5, you say that's about,
10 beginning on Page 18 that the life analysis is undertaken to
11 obtain a mathematical description of the forces retirement of
12 retirement acting upon a plant category.

13 A. Yes.

14 Q. But isn't it true that what you get is a
15 mathematical statistical branch of mathematical, a
16 description of mathematic placements in retirement patterns
17 over time? I mean --

18 A. I'm not sure I understand your question, so if
19 I'm not addressing it.

20 Q. Let me rephrase it.

21 A. Okay.

22 Q. Let me rephrase it. There's nothing in -- in
23 the depreciation that will say you need a 1 percent rate to
24 account for economic obsolescence or you need a 1.5 percent
25 depreciation rate to account for the effects of wear and tear

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1 caused by weather. What you really get is a mathematical
2 representation of patterns of placement and retirement of
3 property in the account, isn't that -- and I don't mean to
4 quibble too much.

5 A. No, I understand -- I understand your
6 question. There's two ways to view the way we use statistics
7 in estimating service life. One might describe it as
8 descriptive statistics and the other is inferential
9 statistics. If you're using descriptive statistics, all
10 we're doing is fitting a survivor curve or some other defined
11 curve function to data, and we're just trying to find a curve
12 that fits that data.

13 Another approach to the application of
14 statistics is the use of what we call inferential statistics,
15 that is from an analysis of data, we try to draw inferences
16 about the parent population from which the data we're
17 studying is a random sample. Now, the characteristics of
18 those -- that mortality experience is what's driven by the
19 forces of mortality.

20 Let me give you an example. If I study a
21 plant account and I find that forces of retirement are
22 largely chance, things don't wear out, the probability that
23 plant units can be retired from service next year versus this
24 year given it that survive is the same. That's pure chance
25 force of retirement.

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1 Now, when I fit probability distributions, be
2 it Iowa Curves or some other function of that data, if I know
3 in a general sense the nature of the force that's retirement
4 that's acting on the plant, that gives me some knowledge
5 about the shape of the probability distribution that's going
6 to describe that data. That's inferential statistics, and
7 that's what I have done here, and that's why those
8 probability distributions can capture those forces of
9 retirement. We have a variety of different curve shapes that
10 capture different types of forces of retirement.

11 Q. Really. Did you label any of your curves
12 economic obsolescence? Can you direct me in your study to an
13 economic obsolescence curve?

14 A. Well, economic obsolescence doesn't affect a
15 group plant account. An economic obsolescence dictates the
16 time period over which an asset is going to generate net
17 revenue.

18 Q. Can you direct me to a curve that describes
19 the effects of weather?

20 A. I think you're mischaracterizing my testimony,
21 Mr. Schwarz. I'm telling you that these probability
22 distributions capture as a function of time the aggregate of
23 these forces of retirement acting upon them. As a function
24 of time. As an asset ages, these forces may become more or
25 less pervasive depending upon the nature of the force.

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01333

1 Q. Let me ask you this, and I'm not as familiar
2 with remaining life techniques as I am with other -- I don't
3 -- I may come off as a little more -- I want to say -- well,
4 never mind.

5 Let me ask you this then. You did random
6 samples of the company's data in preparing your study.

7 A. No.

8 Q. You didn't do random. Okay. Why didn't you?
9 I'll bite. I'll bite.

10 A. Let me return to what I said before with
11 respect to the application of inferential statistics. The
12 objective of conducting a statistical life analysis is to
13 identify the characteristics of the parent population from
14 which our observed mortality experience is a random sample.
15 It's no different than if I had a hat with marbles in it, and
16 I reach in and I grab a sample of those marbles and they all
17 have a different number on it, and from that handful of
18 marbles, I might calculate the average of the numbers on that
19 marble.

20 Now, what I'm trying to do is estimate the
21 mean of all of the numbers that were in the hat. What I have
22 is a sample in my hand. That's exactly what we've doing in
23 life analysis. If I take a pole line account, I have a
24 sample of retirements from some parent population, and it's
25 the parameters of that parent population that I'm trying to

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1 estimate.

2 Q. Well, let me ask you this. In the analysis
3 that you did for this case, did you not have, with respect to
4 poles, the entire -- I mean, you know how many poles were
5 installed in a particular vintage year, do you not?

6 A. I know how many marbles I'm holding in my
7 hand. Those poles are a sample from a parent population from
8 which we're going to continue to have additions and
9 retirements of poles. I have no idea how large that parent
10 population is, but I'm trying to predict the future based
11 upon my expectations of what that parent population looks
12 like.

13 Q. Well, but in your analyses of particular
14 vintages, you know the entire population of each vintage, do
15 you not?

16 A. No, that is a sample, that is a sample from a
17 larger population. What you're saying is when I reached into
18 the hat, I know that I've got six red marbles, that's a
19 vintage, and that's what I'm holding in my hand, but to take
20 the -- estimated the service life of those six marbles and
21 draw inferences that that's the mean that's in the hat is a
22 different question.

23 Q. All right. We're not -- we're speaking to
24 cross purposes here. If you are examining the 1980 -- the
25 1980 vintage of poles is all the poles that let's use the MPS

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01335

1 division, that's all the poles that they installed in 1980.
2 Is that correct?

3 A. That's correct.

4 Q. Okay. And from the company records, you know
5 how many 1980 vintage poles have been retired and how many
6 survive; is that correct?

7 A. That is correct. I know the age of the
8 deaths. What I don't know is the age at which those units
9 that are still in service are going to be when they are
10 retired from service, so that's why I have to use statistics
11 to try to forecast what that probable life and life
12 expectancy is going to be of those units that are remaining
13 in service.

14 Q. And you -- as a statistician, a depreciation
15 person can also establish parameters for the entire vintage,
16 can they not?

17 A. Not until that vintage is fully retired from
18 service. I can only estimate what I think is going to happen
19 in the future.

20 Q. Correct. But both the whole life technique
21 and the remaining life technique are estimating from known
22 parameters the expected life of either the survivors or of
23 the entire account population. Is that safe to say?

24 A. No, we've confused two distinct concepts now.
25 On the one hand, we have the question of life analysis. What

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1 are the mortality characteristics of a plant account. Once
2 we describe those statistically with probability
3 distributions and associated statistics, averages, means,
4 expectancies, probable lives, how we take those statistics
5 and use them in developing a depreciation rate is another
6 question, and when you introduce the notion of whole life
7 versus remaining life, that's a component of the depreciation
8 system in which those statistics are applied. It's only one
9 component. So we don't want to confuse the application of
10 the statistics with how those statistics are estimated.

11 Q. Let me ask you this with respect to net
12 salvage, if you would. For any vintage of any plant account
13 for Aquila, did you examine the amount of net salvage that
14 has been collected over time by Aquila with the actual amount
15 that was expended to actually retire the plant in that
16 vintage?

17 A. That's impossible to do.

18 Q. Why?

19 A. Well, for a couple of reasons. First of all,
20 we don't maintain net salvage by vintage. All we know is
21 total dollars of salvage received or removal expense
22 incurred, it's not vintage.

23 Secondly, we're working with -- we're dealing
24 with group plant accounts here, and the accrual for cost of
25 removal and salvage is no different than the allocation of

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01337

1 the cost of the asset, that is to say plant that is retired
2 in an age less than the average service life is going to be
3 underaccrued for cost of removal. Similarly, plant that
4 remains in service beyond the average is going to have to be
5 overaccrued to compensate for the underaccrual on your early
6 retirements, so I can't match dollars received with my
7 accrual because I'm always accruing for plant that hasn't
8 been retired from service. I can't match the two.

9 Q. If you cannot match the two, how do you check
10 in the real world the hypothesis that historical -- the
11 historical cost of removal divided by the original cost of
12 the plant removed is a predictor?

13 A. In the same way that I can check whether or
14 not the average service life that I estimated is correct.
15 We'll never know until that plant account is fully retired
16 from service. As long as we're adding vintages and replacing
17 and retiring plant equipment, we won't know, and that's why
18 we conduct periodic depreciation studies.

19 Q. Can you tell me the amount of the reserve for
20 depreciation balance for any of Aquila's plant that
21 represents the accrual for cost of removal?

22 A. The answer to that is more complicated than
23 the question, and the reason I say that is because we have
24 the imbalances that are being created by using group
25 accounts, and so while one can simply -- if one were

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1 continuing to use a whole life rate, for example, one can
2 take the estimated average net salvage rate and divide it by
3 the average service life and count the number of years that
4 that rate has been applied and say that's what I've been a
5 accruing.

6 Unfortunately, in the depreciation reserve,
7 there's going to be a difference between the realized salvage
8 and removal expense and what we actually accrued over that
9 period of years. Now, that imbalance attributable to simply
10 the difference between the realized and the estimated in the
11 accrual is associated with removal expense, and associated
12 with that component of the depreciation reserve, so to
13 segregate that reserve into two pieces, one has to consider
14 not only what's been accrued but the reserve imbalances
15 associated with removal expense.

16 Q. Well, is that yes or no?

17 A. I think I prefaced it by saying the answer was
18 more complex than the question.

19 Q. Well, it wasn't an answer to the question.
20 That is the --

21 A. Can I estimate it? Yes.

22 Q. I didn't ask if you could estimate it. I
23 asked do you know. There -- is it -- can you tell me over
24 the years, plant has been added, plant has been retired, the
25 additions and retirements are marked -- the additions go into
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01339

1 the plant balance, the retirements go -- are marked against
2 the reserve for depreciation, reduce the reserve for
3 depreciation.

4 Can you tell me for any Aquila plant account
5 the amount in the reserve for depreciation that is -- has
6 been collected for cost of removal, net salvage, and the
7 amount that has been collected in rates to recover the -- or
8 make the return of the original cost of the plant?

9 A. Perhaps I misunderstood your question at the
10 onset. That's a matter of record. Those are debits and
11 credits. Of course those dollar amounts are known.

12 Q. So for instance, and I'm looking at just
13 because I happen to have it here, Ms. -- do you have Ms.
14 Shad's direct testimony?

15 MR. SCHWARZ: May I approach?

16 JUDGE JONES: Yes, you may.

17 Q. (By Mr. Schwarz) I'm looking at Schedule 31.
18 If I look with my glasses on, I can't see anything. Her
19 schedule 3.1, the Jeffrey Energy Center Account 311,
20 indicates the accrued reserve at 12/31/01 is \$12,035,615.

21 A. That would be the recorded depreciation
22 reserve.

23 Q. Correct. And do the records reflect how much
24 of that is for the recovery of their initial investment in
25 that and how much is for cost of removal?

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1 A. If your question goes to what has been posted
2 to that depreciation reserve for salvage and removal expense
3 realized, yes, that would be a debits and credits to the
4 depreciation reserve.

5 Q. Is --

6 A. Knowing that --

7 Q. Can you tell me how much of the depreciation
8 reserve was accrued for cost of removal and how much was
9 accrued for return of the accounts origin investment?

10 A. Well, as I said earlier, as long as we're
11 using a whole life rate, which the company has been, then the
12 company knows what net salvage rate has been used in the
13 formulation of that whole life rate. The ratio of that net
14 salvage rate to the average service life that's being used is
15 the component of the accrual that was identified for net
16 salvage, and yes, one can look at how much of that was posted
17 to the depreciation reserve.

18 Now, to split that into salvage and removal
19 expense is another issue, but the net salvage, yes, they can
20 make that calculation.

21 Q. To your -- can you tell me what the amount for
22 each -- to your knowledge, does the company have that
23 recorded separately?

24 A. I believe that Mr. Rooney, in his testimony,
25 has quantified those amounts. I didn't, but I believe Mr.

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01341

1 Rooney quantified those amounts.

2 Q. In a number of places in your testimony, you
3 talk about a permanent reserve imbalance, and I'm not quite
4 sure what that is. Could you explain -- explain that for me.

5 A. Sure. That goes to the application of a whole
6 life rate versus a remaining life rate. A whole life rate,
7 as we've been talking all along, is a numerator composed of
8 one minus net salvage rate and a denominator is the net
9 service life. A remaining life rate, as I've described in my
10 testimony, can be broken down into two pieces. The whole
11 life rate plus an amortization of the difference between the
12 computered or theoretical reserve and the recorded reserve
13 allocated over the composite weighted average remaining life
14 of a plant category.

15 If that second term, the allocation of the
16 reserve imbalance is not part of the depreciation rate, then
17 the reserve imbalance that I described is the difference
18 between the theoretical reserve and the recorded reserve is
19 not being addressed in a depreciation rate. Unless some
20 deliberate action is taken to adjust the depreciation rate to
21 eliminate that reserve imbalance, be it excess or deficient,
22 you're going to have a -- or reserve -- a reserve imbalance.

23 Q. Are you aware that this Commission has on any
24 number of occasions ordered an amortization of reserve
25 imbalances?

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1 A. I don't have any direct knowledge that they
2 may have ordered an amortization. I have no problem with an
3 amortization. There's a great deal of sensibility for an
4 open-ended plant category to use a composite remaining life.
5 There may be reasons why a more rapid amortization is
6 appropriate, for telephones, for example, that was a
7 telephone practice to amortize that reserve imbalance more
8 rapidly because of the emergence of competition.

9 Q. So that there are ways other than using the
10 remaining life technique to address reserve imbalances?

11 A. No question about it. However, a whole life
12 rate standing alone will not.

13 Q. And it would be a regulatory failure on both
14 the part of the Staff and the Commission to permit that to be
15 permanent, is that not correct?

16 A. I don't know if I would say it's a failure.
17 What one is not going to be able to do is achieve the goals
18 and objectives of the depreciation accounting. One can have
19 a permanent reserve imbalance and present value of the
20 revenue requirements of recovery are identical. You can
21 leave it there forever, but that's abandoning the
22 depreciation for accounting.

23 Q. If I suggested to you that Staff would view it
24 as regulatory failure to have a permanent imbalance, that is
25 one that's never corrected, would you have any problem with
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1 that?

2 A. I can't speak for Staff.

3 Q. In your rebuttal testimony, and it's on
4 Exhibit 179, which is I think convenient, Table 1, you have a
5 comparison between the company's proposals and the Staff's
6 proposals; is that correct?

7 A. That is correct.

8 Q. But I notice that you don't have any
9 comparison to the currently ordered rates and annualizations.
10 Do you know what those are?

11 A. I guess there's two parts to that. The
12 comparison of the company to the present is in the
13 depreciation studies and in my direct testimony, and I think
14 you will see narrative throughout the rebuttal testimony, for
15 example, on Lines 10 to 12 on the page that you just
16 referenced, refers to the reduction relative to currently
17 approved.

18 Q. Okay.

19 A. Now, Mr. Schwarz, I also want to make sure
20 that I don't misrepresent this. My comparison of Staff to
21 company is based upon December 31, 2001, plant. It's at the
22 date at which I conducted the study.

23 Q. Right.

24 A. And I just want to make certain that there's
25 no confusion that these differences are not representative of

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1 test year, for example, differences.

2 Q. Well, if there's no confusion on that issue,
3 it will be the only one in this case for which that can be
4 said, I'm afraid. So the company is seeking a -- an increase
5 in depreciation expense in excess of \$10 million. Is that
6 safe to say?

7 A. Relative to the point in time at which I did
8 my study. Now, I'm not sure, again, whether you're referring
9 to my differences or those that are identified in the rate
10 case.

11 Q. I'm just -- if you use the same basis as is
12 used in Table 1 --

13 A. Yes.

14 Q. -- the company is seeking more than \$10
15 million, how is that?

16 A. That is true, but again, I've got to qualify
17 that. For example, corporate has not been allocated between
18 gas and electric. I have all of corporate sitting in
19 electric. Common plant has not been allocated between gas
20 and electric, all of common is sitting in my study. In other
21 words, I estimated depreciation rates for those plant
22 categories.

23 What I have provided is an annualized
24 calculation of the expense resulting from an application of
25 those rates, so I want to be careful when someone looks at my
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01345

1 numbers and says this is the increase that the company is
2 requesting. Mr. Rooney has quantified those in his work, and
3 I think perhaps using his numbers as a basis for comparison
4 is probably better than mine.

5 Q. Would you agree that at the time that property
6 is placed in or a vintage of property is placed in service
7 that its remaining life is equal to its average service life?

8 A. I would fully agree.

9 Q. Let me ask you this. Is the unit Gammet
10 Fleming system widely used in depreciation?

11 A. I don't know. I know my system is.

12 Q. Did you obtain your -- any of your data from
13 FERC Form-1's?

14 A. I want to say no, I believe that the
15 reconciliation was to FERC Form-1, but there was no data
16 specifically from that form.

17 Q. And I'm looking at REW-5, Page 12.

18 A. For some reason, I only have through REW-4.
19 Perhaps you can help me. What is 5?

20 Q. Well, it is the 2002 depreciation rate study.

21 A. For which entity, which business?

22 Q. Aquila Networks MPS.

23 A. Very good. I have it.

24 Q. Okay. Development of accrual rates?

25 A. Yes.

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01346

1 Q. In that first paragraph, you state that the
2 service --

3 A. I'm sorry, Mr. Schwarz, what page are we on?

4 Q. Page 12, I thought. I'm sorry.

5 A. Yes.

6 Q. You say that the service potential of an asset
7 is the present value of future net revenue or cash inflows
8 attributable to the use of that asset alone.

9 A. I'm fully prepared to discuss that, I just
10 don't happen to have located it with you.

11 MR. ENGLAND: Your Honor, may I show the
12 witness?

13 JUDGE JONES: Yes, you may.

14 THE WITNESS: I'm with you.

15 Q. (By Mr. Schwarz) Service potential is the
16 present value of future net revenue or cash inflows
17 attributable to the use of that asset.

18 A. That's correct.

19 Q. Did you do a present value of future revenue
20 streams for any of the property in this case?

21 A. No, I did not, and we're going to spend a lot
22 of time talking about this, if you'd like to.

23 Q. No, I just asked if you did.

24 A. Okay. Let me only quantify that -- qualify
25 that by saying what I'm addressing in that paragraph is goals

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01347

1 and objectives of depreciation accounting, and I tend to be
2 rather dogmatic about what it is we're trying to achieve in
3 setting depreciation rates, and I've established for you
4 there exactly what depreciation is and what our objective is.

5 Q. Now, is White German, is it as dogmatic as
6 Schwarz?

7 A. As a matter of fact, it is. My name was
8 originally Veese (ph. sp).

9 Q. Okay. And that's an economic concept, is it
10 not?

11 A. It's a cost allocation accounting theory
12 concept, yes.

13 Q. But it's a concept in the field of economics
14 as well as --

15 A. And accounting, and accounting both.

16 Q. Thank you.

17 MR. SCHWARZ: I think that concludes.

18 JUDGE JONES: Thank you, Mr. Schwarz.

19 Commissioner Murray, do you have questions?

20 COMMISSIONER MURRAY: Yes, I do.

21 QUESTIONS BY COMMISSIONER MURRAY:

22 Q. Good afternoon, Dr. White?

23 A. Good afternoon, Commissioner.

24 Q. I want to start out by telling you that this
25 issue of net salvage cost of removal is of great concern to
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01348

1 me, and I was pleased to read your testimony and to see your
2 expertise, and I'm -- I want to explain, first, why I am
3 concerned about the issue.

4 And that is because I have seen -- I've
5 observed that there has been a position consistently taken by
6 Staff, for some time, that net salvage cost of removal should
7 not be accrued but rather expensed, and then that position
8 seemed to somewhat morph into a position that net salvage
9 cost of removal should not only be accrued, but it should
10 also not be posted to the depreciation, and that has resulted
11 in some very large adjustments -- recommended adjustments,
12 very large, and the Commission itself has been less
13 consistent.

14 There have been a couple of isolated cases in
15 which, at least part of what Staff's position has been
16 adopted, and there have been a lot of stipulations and
17 agreements that have been entered into, and in those
18 stipulations and agreements, many of the companies have
19 agreed to Staff's treatment of net salvage cost of removal
20 establishing no policy of the Commission on that issue, but I
21 really have a concern about this because I think it's an
22 extremely complex issue, and I think the Commission itself
23 has not been clear, and I think the Commission itself, even
24 those of us who have been around for a long time, quite
25 awhile, find it a very difficult issue in trying to determine

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1 what is the actual policy of the Commission.

2 Your testimony has some discussion about the
3 evolution of the changes here at the Commission, and I
4 appreciated that, but I want to take this opportunity to see
5 if I can help you clarify for me some of the things that I
6 still don't understand about this specific aspect of this
7 issue.

8 And one of which would be can you explain the
9 difference between recorded reserve and computed reserve?

10 I'll stop there for now.

11 A. Sure, Commissioner. The recorded reserve is
12 the dollar amount that's sitting on the asset side of the
13 balance sheet, a contra-account to the plant account. That
14 represents the actual recording of depreciation expense,
15 accruals into that reserve, retirements are removed from that
16 reserve, and gross salvage and cost of removal are posted to
17 that depreciation reserve, when it's realized. So that's a
18 record of what's actually occurred in the plant accounting
19 records.

20 Now, the computed reserve is a measurement of
21 what the reserve should be today, if our expectations about
22 the future, in fact, occur as we predict them to be. Now,
23 think about it in the following way. If I know my plant
24 investment and I can estimate how long I think that plant is
25 going to remain in service, and what I believe my best

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1 estimate is of the cost of removal of that plant, by taking
2 the difference between my cost of plant in service today and
3 the sum of all the future accruals for both cost and removal
4 expense, if I take the difference between those two numbers,
5 that's a measurement of what my reserve should be today, and
6 that's what's called a computed or theoretical reserve.

7 That number will change every time we conduct
8 a depreciation study. When we change our estimate of service
9 lives. It will change when we change our curve shapes and
10 our net salvage rates, but that the difference between a
11 recorded reserve and a computed reserve.

12 Q. And if the -- on Page 12 of your direct
13 testimony, at the top of the page, the first answer there,
14 you talk about the measured reserve imbalance.

15 A. Yes.

16 Q. And can you define that?

17 A. That's the difference between the two numbers
18 that we just talked about.

19 Q. Okay.

20 A. The difference between the recorded reserve
21 and the computed reserve.

22 Q. All right. And that is what, then, would be
23 amortized over the composite weighted average life of each
24 category you say.

25 A. Commissioner, if I could direct you to Page 14

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01351

1 of my direct testimony.

2 Q. Yes, uh-huh.

3 A. On Line 10, there's a formula there that shows
4 two pieces.

5 Q. Yes.

6 A. That second piece, where it shows the computed
7 reserve minus the recorded reserve, that's that difference
8 that we were just talking about, divided by the estimated
9 remaining life, that's the amortization of the reserve
10 imbalance. Staff would exclude that term from their
11 depreciation rates. Staff's rates are just that first term,
12 one minus the average net salvage rate divided by the average
13 service life.

14 Now, in the case of MPS, we have a slight
15 reserve excess. In other words, if you look at the numerator
16 of that second term, our recorded reserve is a little bit
17 larger than our computed reserve, so we're reducing the
18 depreciation expense by amortizing that slight measured
19 reserve excess. When we conduct another depreciation study,
20 that number could change, it could become a deficiency again.

21 Q. And because the depreciation studies are done
22 periodically and those numbers are adjusted from time to
23 time, it's your position, as I understand it, that the entire
24 value of the cost of the asset including the cost of removal
25 is recovered over time?

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1 A. Yes, I'm not sure I would link that to the
2 fact that we do periodic depreciation studies. We refine our
3 estimates, of course, as time passes. The principle
4 involved, though, in accruing for cost of removal is a
5 recognition that that revenue requirement for removing plant
6 is incurred when the plant is placed in service.

7 Now, I don't know its dollar amount any more
8 so than I know how long the plant is going to remain in
9 service, but I've created an obligation, someone has to pay
10 for that, and the question is should that be -- that cost be
11 allocated over the service life and paid for by customers
12 receiving service from it, or should it be delayed until the
13 end and passed on to the next generation of customers?
14 That's the real issue.

15 Q. Yes, the generational inequity issue, correct?

16 A. It is, and Commissioner, if I might, it's even
17 complicated a little more by the fact that we're using group
18 accounting.

19 Q. Yes.

20 A. And when you start to talk about
21 intergenerational, then you also have to talk about
22 short-livers and long-livers and the whole nation of
23 intergenerational inequities that becomes a bit complicated
24 when we have group plant accounting.

25 Q. And there is nothing that can be 100 percent

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1 accurate in allocating all of the cost to the cost causers,
2 I'm sure.

3 A. I fully agree with that. And -- and what's
4 also important to understand is that all we're doing is
5 shifting the timing. The present value of those revenue
6 requirements are going to be identical, no matter how we
7 estimate them and what time we report them. The issue is
8 when do we report them and who pays for them, when do we
9 enter it into the revenue requirement equation.

10 Q. And if it is not entered until in the manner
11 that Staff is proposing here, which would be entered at the
12 time that the expense is incurred, and entered only as an
13 expense, as I understand it, wouldn't that have a tendency to
14 result in -- oh, a volatile type of rate resulting from
15 retirement of assets?

16 A. I'm not sure that it would result in a
17 volatile rate. What it is doing is providing an allowance
18 just like any other expense allowance, as the test period
19 expense, and based upon the most -- the average of the most
20 recent five years of experience.

21 Now, to the extent that the company's actual
22 removal expense going forward is different than that
23 allowance, and especially -- especially if we do not bring
24 that allowance through the depreciation reserve, then we've
25 created a problem of whether or not we're ever going to

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1 recover.

2 Now, the other implication of that allowance
3 is that we're not accruing for the future. Think about it in
4 a very simple way. Suppose we have a plant account where I
5 have not had any salvage or renewal expense, there haven't
6 been any retirements, but I know for certain that I'm going
7 to incur that in the future. Staff would provide no
8 allowance for that cost estimate today.

9 Q. And that's where I'm thinking that volatility
10 could come into play, especially if -- if the expense were to
11 be allowed at the time it were incurred and not amortized
12 over the future, but if it were amortized over the future,
13 then there's further intergenerational inequity.

14 A. I fully agree with you when you say
15 volatility, I was thinking in terms of stability of
16 depreciation rates, but there's a bunching affect.

17 Q. Uh-huh.

18 A. And I think, maybe that's what you had in mind
19 in using the term volatility, and I fully agree with that.

20 Q. And it appears that one result could be rate
21 shock to certain -- at certain times to rate payers if the
22 Commission were to actually allow retirement to be expensed
23 in the year that it was retired.

24 A. You mean the removal expense in the year?

25 Q. Removal, yes.

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1 A. Yeah.

2 Q. I want to ask you about, I believe, it's your
3 rebuttal testimony on Page 2 and 3. I would just like a
4 little clarification there. On Page 2, you say the reduction
5 and depreciation rates advocated by Staff reduces the
6 company's requested 2002 annualized depreciation expense by
7 over \$15 million, over more than 26 percent; is that correct?

8 A. Yes, that's relative to the companies, and you
9 can see that from Table 1 just right above that paragraph.
10 The companies request an aggregate based on my annualized
11 calculation, would be 56.6 million, Staff would calculate
12 41.4 million on that same basis, so a reduction of 15.2
13 million.

14 Q. And that is a reduction from the company's
15 request, not the company's current?

16 A. That is correct, and the next paragraph
17 describes the relationship to the current.

18 Q. The one on Page 3?

19 A. No, I'm sorry, on Page 11 of Page 2, starting
20 on Line 10, the reduction in rates advocated to Staff
21 relevant to current would be 2.2 million.

22 Q. All right. And when you say relative to the
23 company's request, that is with the changes that the company
24 is requesting in terms of the straight -- from the straight
25 line method and the -- well, let's see, they're not asking to

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1 change the straight line method, but from the broad group
2 procedure to the vintage group procedure and whole life
3 technique to remaining life technique?

4 A. Correct, correct.

5 Q. But if we were to continue to apply the broad
6 group procedure and the whole life technique, but treat net
7 salvage cost of removal as the company is requesting, then
8 the difference would be the 2.2 million; is that right?

9 A. No.

10 Q. No?

11 A. No, that 2.2 million is comparing Staff's
12 proposal to current prescribed depreciation rates.

13 Q. Okay. Current actual numbers?

14 A. Yes. Commissioner, just one point that I
15 would like to make. You mentioned that one of the changes is
16 the broad group to the vintage group procedure. That is not
17 a radical change by any means. That is not an equal life
18 group procedure. A vintage group procedure distinguishes
19 average service lives among vintage.

20 Staff assumes that all vintages have the same
21 average service life. It doesn't shift the timing of
22 depreciation expense, it doesn't increase or decrease
23 depreciation rates. It allows us to address each vintage
24 independently in our estimate of the average service life, so
25 that's not a requesting accelerated depreciation or

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1 something. It's a step, to again, more nearly achieve the
2 goals of depreciation accounting. It's -- the dollar impact
3 is deminimus in going from one to the other.

4 My use of the vintage group procedure, I
5 regularly develop depreciation using vintage group because I
6 think it more nearly achieves accounting goals, but I also
7 think it's important for Aquila because we're using vintage
8 group procedure system wide.

9 Q. Is this the only jurisdiction in which you're
10 not?

11 A. That's correct.

12 Q. And how about the remaining life technique?

13 A. This is the only jurisdiction that does not
14 prove rates based upon remaining life. So we have that
15 reserve imbalance that we talked about, that unless at some
16 point in time that's addressed, it's going to continue to
17 remain in perpetuity.

18 Q. And when you say remain in perpetuity, does
19 that get -- does it get adjusted out after the asset or the
20 -- well, since you're talking about groups of assets, is
21 there a point in time in which it ever gets adjusted out?

22 A. No.

23 Q. Okay.

24 A. Unless some deliberate step is taken.

25 Q. All right. On Page 19 of your rebuttal
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01358

1 testimony, you show a figure there of roughly \$9.6 million
2 that the elimination of net salvage --

3 A. Yes.

4 Q. -- makes, and that's a reduction of
5 depreciation rates?

6 A. I would like to clarify that to you -- for
7 you, too, Commissioner, if I can. That 9.6 million reflects
8 not only the removal of a depreciation rate -- net salvage
9 rate from the depreciation rate, but it also reflects that
10 now there's a reserve imbalance attributable to the treatment
11 of net salvage, and so that 9.6 million is the combination of
12 the two. If one only looked at the impact by adjusting the
13 rate without considering the implications of the reserve
14 imbalance, we would come to a different number.

15 Q. And how could you eliminate the reserve
16 imbalance?

17 A. Well, in my judgment, you can't. The problem
18 is when you start to break apart a rate and particularly the
19 accrual, a dollar impact, and say how much is associated with
20 a service life, how much is associated with net salvage, how
21 much is associated with any other item, those changes are not
22 mutually exclusive, you can't add them together, so you have
23 cross effects, and an easy way to look at it is to just
24 remove removal expense, for example, from the whole life
25 piece, and let the reserve imbalances flow with the life

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1 statistic imbalances. To really break it down into its
2 components is difficult to do.

3 Q. Now, does that have -- I'm really trying to
4 understand the concept there. If -- if as the Commission did
5 in the Laclede case, which is frequently cited as a
6 Commission policy on net salvage, new Commission policy,
7 although I don't know that it was ever, certainly not ever an
8 agreement from the Commission, that that was a new Commission
9 policy, as I understand it in that case, GR-98-324, the --
10 the amount for the average salvage that was realized over the
11 period of time Staff was suggesting that we calculate net
12 salvage on, it was even though we were not including -- well,
13 let me try to state that again.

14 We still allowed that to be treated as
15 component of the depreciation expense, which was posted to
16 the depreciation reserve, and is that the same thing as we
17 were just talking about or is that a totally different issue?

18 A. It's a totally different issue. They're
19 related, but it's not exactly what we were talking about.
20 In the Laclede case, I have some familiarity with that case
21 because I testified in that case. Staff there used a
22 ten-year time period, as I recall, for calculating the
23 average of realized net salvage over that period.

24 They also -- having calculated that average
25 net salvage in dollars that they realized over a ten-year
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1 period, they then adjusted the net salvage rate that was in
2 the formula for the depreciation rate to produce an end
3 result that would be exactly the same as using zero net
4 salvage in the depreciation rate and adding a component for
5 removal expense, which was equal to the average over the last
6 10 years.

7 Now, that's just a mathematical exercise that
8 it's equivalent, but they kept it as part of the depreciation
9 rate, and consequently were posting salvage and removal
10 expense to the depreciation reserve. Now Staff is taking it
11 another step, as you've described earlier.

12 A. They don't even want to post to the
13 depreciation reserve now.

14 A. Correct.

15 Q. They just want to call it an expense.

16 A. Correct.

17 Q. Okay. Thank you. On Page 22 of your rebuttal
18 testimony, you make a statement on Lines 18 and 19 that the
19 treatment of net salvage as a cost of service allowance is
20 inequitable to the extent that realized cost of removal in
21 excess was the cost allowed was non-recoverable. Could you
22 explain that, please?

23 A. Sure. If Staff allows, as a cost of service
24 allowance, \$100 for removal expense, and that appears as a
25 revenue requirement, now, it's not going to come through the
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1 depreciation reserve, we're not going to accrue \$100 in
2 depreciation reserve, it's simply an allowance.

3 Now, let me suppose that I actually incur \$200
4 of removal expense. I have no way of recovering that
5 incremental \$100. If it comes through my depreciation
6 reserve, then I can continue to accrue for it, but there's no
7 mechanism in the rate-making process that would allow me to
8 recover that additional \$100 that I incurred.

9 Q. So when are you saying that the \$100 would be
10 allowed in revenue requirement?

11 A. The incremental \$100?

12 Q. Yes.

13 A. It can be done in two ways. One, of course,
14 is to accrue for my estimate, and to the extent that my
15 estimate and my realized are different, now all I've done is
16 create an imbalance in the depreciation reserve. I've
17 accrued for a certain amount through the depreciation
18 expense, my realized was different from what I accrued for,
19 and I have a reserve imbalance, and there again, is where
20 remaining life rates come into play. We want to amortize
21 that imbalance, and so that mechanism in itself by posting
22 the depreciation reserve preserves that opportunity for
23 capital recovery, and it's a two-way street. We can incur
24 less than we accrued for, and that should also be amortized.

25 Q. So that leaves some exposure -- rate payers to

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1 some exposure that it would work in reverse; is that correct?

2 A. Actually, I was just saying a situation in
3 which that benefits them.

4 Q. I'm sorry. Yes, you're right. That's what I
5 meant, but. I think that may be all. Just let me look here
6 a minute.

7 Just one more general question, in terms of
8 calculation of depreciation, in general, isn't -- aren't -- I
9 can't think of any aspect of depreciation that is not based
10 upon some estimate, I mean, is there any aspect of
11 depreciation that is based on certainty?

12 A. Not of the parameters that are used to make up
13 the depreciation rate, and by that I mean we need to describe
14 the distribution of retirements. We generally use Iowa
15 curves or some other function, that's an estimate.

16 The projection life, that is the mean life of
17 that population that I talked about before, that's certainly
18 an estimate. Average net salvage rate is an estimate because
19 it's a combination of both realized and future. Future by
20 definition is an estimate, so all of those parameters are
21 estimates, and that's why we conduct studies periodically and
22 adjust those depreciation rates to respond to changes that
23 are apparent from experience.

24 Q. And cost of removal is an estimate, is it not?

25 A. Yes, it is.

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1 Q. All right. I think that's all I have. Thank
2 you very much.

3 A. Thank you.

4 JUDGE JONES: Okay. As I said earlier, we
5 were going to stop at 4:30, take a break, and come back and
6 spend the night with one another until we finish this issue.
7 I was sitting here going through the numbers, and including
8 this issue, we have a total of 29 witnesses to get through,
9 and that includes tomorrow and next, I believe, Thursday, in
10 order to do that.

11 I don't see it as possible, but I think we
12 should at least give it a try and at least get this issue out
13 of the way tonight. My suggestion was that we leave now at
14 4:30, pick up children, get a burger at McDonald's and come
15 back at 5:30, or if it's more convenient, we can come back at
16 6:00. Does anyone have a particular preference on when we
17 come back? Would you all rather come back at 5:30 or 6:00,
18 does it matter?

19 MR. SCHWARZ: I think I can get my kid picked
20 up and burger or something and get in by 5:30.

21 JUDGE JONES: Does anyone else have anything
22 else they need to take care of in order to get back by 5:30
23 or is 6:00 easier? Well, in that case --

24 MR. SWEARENGEN: Let's just make sure they
25 leave the doors open, they have a tendency to lock the doors

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1 around here, and if you don't have one of those white cards,
2 you can't get in and out.

3 JUDGE JONES: I can certainly take care of
4 that for the hearing room. As far as the outside door is
5 concerned, I'll have to check into how to take care of that.
6 If it -- if it might be a problem, I'm sure somebody here,
7 myself included, will be able to let people in to the
8 building, okay. So try not to worry about it. I'm sure we
9 won't start without you in particular.

10 COMMISSIONER MURRAY: And you might tell them
11 to go to the Madison Street door in case that is a problem,
12 so we know where to post someone.

13 MR. SWEARENGEN: I wasn't just thinking about
14 myself.

15 JUDGE JONES: I understand, I was trying to be
16 light-hearted about it. All right. So I'll see you all back
17 here at 5:30.

18 WHEREUPON, the recorded portion of the hearing
19 was continued until 5:30, March 4, 2004, reported by
20 Stephanie Kurtz Morgan.

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INDEX

1		
2	MARK OLIGSCHLAEGER:	
	Questions by Judge Jones	1140
3	Questions by Commissioner Murray	1145
	Questions by Chairman Gaw	1158
4	Further Questions by Commissioner Murray	1182
	Recross-Examination by Mr. Swearngen	1194
5	Redirect Examination by Mr. Williams	1214
6		
	CARY FEATHERSTONE:	
7	Direct Examination by Mr. Williams	1232
	Questions by Chairman Gaw	1237
8	Questions by Commissioner Murray	1258
	Recross-Examination by Mr. Swearngen	1267
9	Redirect Examination by Mr. Williams	1293
10		
	RONALD WHITE:	
11	Direct Examination by Mr. England	1300
	Voir Dire Examination by Mr. Schwarz	1310
12	Cross-Examination by Mr. Schwarz	1329
	Questions by Commissioner Murray	1347
13		
14		
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		