BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of KCP&L	)	
Greater Missouri Operations Company for	)	
Approval to Make Certain Changes in its Charges	)	Case No. ER-2010-0356
For Electric Service	)	

INITIAL POSTHEARING BRIEF OF

INDUSTRIAL INTERVENORS

AS TO THE GMO [CROSSROADS] ISSUE

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COME NOW Ag Processing, Inc. a cooperative, and the Sedalia Industrial Energy Users' Association (collectively referred to herein as "Industrial Intervenors") by and through undersigned counsel, pursuant to the Commission's March 7, 2011 Order Granting Extension of Time to File Briefs, and submit their Initial Posthearing Brief on the following issue:

1. Crossroads

    a. Should Crossroads be included in rate base at depreciated net book value in this proceeding? If not, what is the appropriate valuation of Crossroads?

I. INTRODUCTION

It is well established that the utility must be permitted to earn a return on the property devoted to the public convenience.

> The corporation may not be required to use its property for the benefit of the public without receiving just compensation for the services rendered by it. . . . We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation . . . must be the ***fair value of the property being used by it for the convenience of the public***. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be extracted from it than the services rendered by it are reasonably worth.[1]

[1] *Smyth v. Ames*, 169 U.S. 466, 546-547 (1898) (emphasis added).

Thus a critical aspect of any ratemaking decision is the "fair value" to be placed on the property devoted to the public convenience.

In the case at hand, the Commission is asked to calculate the "fair value" of the Crossroads units, located in Mississippi, that are now providing service to ratepayers in Missouri. GMO asks that the Commission set rates based upon depreciated, net book value of those units. In making this request, GMO ignores all evidence of the true "fair market value" of the units. Specifically, GMO ignores the fact that Crossroads was originally built in 2002 as a deregulated unit and initially devoted to selling energy in the wholesale market. With the collapse of Enron and the implosion of the exempt wholesale generator business plan, the value of the Crossroads combustion turbines decreased dramatically. As such, when these units were finally devoted to providing regulated service in August of 2008, the value of these units had declined dramatically. Nevertheless, GMO ignores all evidence of the depressed value of these units and asks that ratepayers be required to pay rates based upon the cost of the units at the time they were initially constructed – a full **six** years before they were ever devoted to providing regulated service.

In contrast, the Industrials assert that the Commission's affiliate transaction rule dictates that the Commission value the Crossroads unit based upon the lesser of: (1) fair market value or (2) fully distributed cost.[2] In this case, given the significant decrease experienced in the value of combustion turbines prior to the time that the Crossroads units was transferred to GMO and utilized for regulated service, fair market value is significantly less than GMO's net book value. The use of fair market value, therefore, is not only consistent with the Commission's affiliate transaction rule, but also consistent

[22] 4 CSR 240-20.015(2)(A).

with the Supreme Court dictate that ratepayers only be required to compensate the utility for the "fair value of the property being used."

II. AFFILIATE TRANSACTIONS RULE

In 1999, the Commission promulgated its affiliate transaction rule. As expressly noted in the purpose provision, that rule is intended to protect the ratepayers from any non-regulated activities undertaken by the utility's affiliates.

> This rule is intended to prevent regulated utilities from subsidizing their non-regulated operations. . . . The rule and its effective enforcement will provide the public the assurance that their rates are not adversely impacted by the utilities' non-regulated activities.[3]

Of critical importance to the Commission's rule is the requirement regarding the compensation to be provided when the regulated utility receives goods or services from an affiliated entity. In the context of such a transaction, the Commission limits the compensation to the lesser of fair market price or fully distributed cost.[4]

Recognizing that the new rule precludes the utility from using its regulated monopoly operations to subsidize an affiliate's deregulated activities, the utilities immediately challenged the Commission's rule. Ultimately, the Missouri Supreme Court held that the rule was lawful and that the Commission had the "authority to extend the reach of the rules to a utility's affiliates."[5]

It is clear then that the Commission's affiliate transaction rule is lawful. It is also clear that the Commission's affiliate transaction rule applies to the transfer of the deregulated Crossroads unit to the GMO regulated operations. As Staff points out, "in August 2008, Crossroads was moved from the books of Aquila's non-regulated business

[3] 4 CSR 240-20.015.
[4] 4 CSR 240-20.015(2)(A)(1).
[5] *State ex rel. Atmos Energy Corp. v. Public Service Commission*, 103 S.W.3d 753, 764 (Mo. banc 2003).

unit NREG to the regulated books for MPS. This transfer of assets is required to be accomplished in compliance with Commission Rule 4 CSR 240-20.015 Affiliate Transactions."[6]

Thus, in calculating the value of the Crossroads units that GMO purchased from its non-regulated affiliate, the Commission should be mindful to ensure that the value of Crossroads is not set higher than the fair market value of the Crossroads units. Set any higher, ratepayers will be paying rates that are, contrary to the purpose of the Commission's rule, "adversely impacted by the utilities' non-regulated activities."

III. HISTORICAL BACKGROUND OF CROSSROADS UNIT AND MPS ONGOING NEED FOR ELECTRIC CAPACITY

A. INTRODUCTION

By now, the Commission is well aware of the financial problems confronted by Aquila in the early 2000s. While many would believe, or ask the Commission to believe, that those financial problems were left behind with Aquila's acquisition by Great Plains Energy, the evidence on this issue clearly demonstrates that Missouri ratepayers are still suffering the implications of Aquila's ill-conceived foray into the deregulated energy market. As then-Chairman Davis appropriately recognized, "[t]here are ample grounds for questioning the prudence of Aquila's management, past and present. These include: management decision to pursue unregulated business ventures that eventually caused Aquila to hemorrhage money, lose its investment grade status and some would say neglect its customers for years." "There is no question Aquila's decisions have been

[6] Ex. 216, page 16 (emphasis added).

detrimental to its ratepayers." "These issues will continue to haunt Aquila management for years to come regardless of who's in charge."[7]

As this brief will show, Aquila initially sought to build all future generation as deregulated units. Once constructed, non-regulated Aquila Merchant would then extract maximum profits from the ratepayers through the execution of purchased power agreements with the regulated affiliate. With the collapse of Enron and the implosion of the deregulated business model, Aquila was left with significant financial problems. As a direct result of these financial problems, Aquila no longer had the financial resources to build the generating units needed to serve native load.[8] Instead, Aquila's Missouri operations became increasingly reliant on purchased power agreements.

In the past 10 years, Missouri operations have been in desperate need of "steel in the ground." Over that period of time, Missouri Staff has continually imputed the costs of generating units that Aquila should have built, but was financially incapable of building. Today, GMO seeks to finally provide the generating capacity long-craved by Missouri ratepayers. That said, however, GMO seeks to have these long-suffering ratepayers pay an inflated price for the proposed generating solution. In the final analysis, GMO's solution (Crossroads) is problematic for multiple reasons.

●The value placed on Crossroads by GMO is based entirely on the cost Aquila Merchant originally paid for the plant as part of its non-regulated operations. GMO continues to ignore the significant deterioration that occurred in the value of other deregulated assets during the intervening period of time. As such, GMO's desired solution ignores "fair market value" and is significantly overpriced.

[7] *Concurring Opinion of Chairman Davis*, Case No. ER-2007-0004, pages 11 and 12 (issued July 9, 2007).
[8] "It could be argued that investments should have already been made, but simply weren't made because Aquila did not have the cash flow to make them." *Id.* at page 10.

●The Crossroads unit is essentially a leftover of Aquila's former deregulated activities that GMO seeks to force upon Missouri regulated customers. This unit was originally constructed in Mississippi to take advantage of high wholesale electric costs that Aquila Merchant perceived would occur in that market. As such, the unit is plagued by all the disadvantages that come with a unit that is located 500 miles away from its actual service territory.

●The Crossroads unit was initially placed in Mississippi to take advantage of the high market prices that resulted from the transmission congestion that was prevalent in this area. As such, the same transmission congestion that made its location advantageous to serving in that area also made it virtually impossible for GMO to get the energy out of Mississippi without substantial transmission upgrades and cost.

●In the meantime, Aquila Merchant sold a number of combustion turbines that were identical to those employed at Crossroads. Specifically, Aquila Merchant sold combustion turbines located in Illinois, Nebraska and Colorado, and therefore much closer to the Missouri ratepayers, at significantly deflated prices. Despite these real life examples of the value of such combustion turbines, GMO now asks Missouri ratepayers to happily accept this leftover vestige of Aquila's deregulated activities at a price that hasn't been seen in over a decade.

●Finally, the evidence shows that, following the closing of the Aquila acquisition, Great Plains Energy repeatedly attempted, without any success, to sell the Crossroads units. In fact, given the lack of any market for Crossroads, Great Plains has admitted in several filings with the Securities Exchange Commission that the "fair market value" of the Crossroads unit approximates the actual salvage value of that unit.

Clearly, Missouri ratepayers continue to be treated as the undesirable little brother to the former big brother – Aquila Merchant. What was once a shiny new toy bought for the big brother has now been passed along to the deprived little brother. While GMO would have these ratepayers believe that they are the recipient of a great gift, ratepayers, like the perceptive little brother, recognize differently. While ratepayers have long desired a generating solution for their energy needs, there is nothing beneficial in receiving a unit that is located 500 miles away, with transmission constraints, at a greatly inflated price. If these are the strings that come with receiving this gift, ratepayers ask that the Commission give the gift back to the spoiled older brother and require GMO to find another electric solution.

B. AQUILA'S ENTRY INTO THE NON-REGULATED ENERGY MARKET

In its testimony, Staff paints an accurate picture of the Aquila business decisions that led to the capacity planning problems that still plague Missouri ratepayers. In 1978, Congress passed the National Energy Act. One part of this act was the implementation of the Public Utility Regulatory Policies Act ("PURPA"). Among other things, PURPA required regulated monopoly utilities to buy power from non-regulated entities if that power was less than the utility's own "avoided cost."[9] This free market approach to electric generation provided an opportunity for independent power producers to build generating stations and force the energy upon the regulated utility.

Suddenly, with the implementation of PURPA, opportunities arose for utilities, acting through non-regulated affiliates, to make profits much greater than those realized in the staid regulated marketplace. Consistent with the business plan utilized by Enron,

[9] See, 4 CSR 240-20.060.

Aquila formed a non-regulated affiliate (Aquila Merchant) and sought to take advantage of the seductive profits offered in the deregulated market.

In 1997, Aquila formulated a plan by which it would transfer all of its Missouri regulated generating units to Aquila Merchant and sell the energy back to the regulated entity at market rates.[10] By pricing the energy at market rates, Aquila Merchant would be permitted to extract greater profits from Missouri ratepayers. After receiving significant resistance from Staff and other parties, Aquila ultimately withdrew its application.[11]

Aquila's efforts to enjoy the heightened profits being realized in the deregulated market did not end with this failed attempt. In 1998, Aquila's MPS division realized a need for generating capacity. With this in mind, MPS moved towards construction of the Aries unit. That unit was originally conceived, planned, designed, and engineered by the regulated MPS division. Once Aquila realized that it may be able to realize unregulated profits, the project was quickly turned over to the unregulated affiliate, Aquila Merchant to be operated as a non-regulated asset.[12] As Staff notes, "[b]ecause of Aquila's then corporate policy to not build regulated generating units, Aquila decided this unit would be a non-regulated non-rate based EWG [exempt wholesale generator] operating within MPS's service area."[13]

Ultimately, Aquila Merchant, along with its deregulated partner Calpine, built the 585 MW Aries combined cycle generating plant in Pleasant Hill, Missouri.[14] Since it was no longer going to be the owner of the Aries unit, the MPS regulated operations were

[10] Ex. 217, page 18. See also, Commission Case No. EM-97-395.
[11] *Id.*
[12] *Id.* at page 5.
[13] *Id.* at page 27.
[14] *Id.* at page 13.

instead required to take the energy from that unit through a five year purchased power agreement running through May 31, 2005.[15]

Aquila's foray into the deregulated energy market was not limited solely to the construction of Aries. During this time, Aquila Merchant also negotiated for the purchase and subsequent construction of several other non-regulated units. For instance, Aquila Merchant built the 340 MW Raccoon Creek and 510 MW Goose Creek generating stations in Illinois.[16] Aquila Merchant also designed and built the Crossroads Energy Center in Clarksdale, Mississippi.[17] In addition, Aquila Merchant also purchased three combustion turbines that were to be constructed as Aries II.[18] Ultimately, while Aries II was never constructed and the combustion turbines were instead placed in storage,[19] Aquila still had high hopes. As Staff notes,

> Aquila intended to install them [three combustion turbines] at its Aries site and sell power from them to MPS. It was expected that once Aries II went into service, MPS would enter into a purchased power agreement with Aquila Merchant, a wholly owned non-regulated affiliate. The term for the agreement was to be for 15 years starting June 1, 2005, to coincide with the expiration of the Aries agreement May 31, 2005.[20]

Thus, Aquila had grand plans to maximize profits received from Missouri ratepayers through the use of purchased power agreements with Aquila Merchant.

C. COLLAPSE OF DEREGULATED ENERGY MARKET AND EFFECT ON AQUILA

In late 2001, the largest participant in the deregulated energy market (Enron) unexpectedly collapsed under the weight of numerous accounting improprieties. In the

[15] *Id.*
[16] Ex. 215, page 49.
[17] Ex. 216, page 4.
[18] Ex. 215, page 39.
[19] Ex. 217, page 16.
[20] Ex. 215, page 40.

wake of the scandal which called into question the business practices of all deregulated energy companies, Aquila suddenly began experiencing significant financial pressures. As a result of this financial pressure and the questions now surrounding the deregulated business model, Aquila began to divest itself of its deregulated assets. While this section provides interesting historical background, it is also supremely relevant in that it demonstrates the significant decrease in the fair market value of deregulated assets like the Crossroads Energy Center.

Despite having a guaranteed load (Missouri regulated operations) to which to sell its energy from Aries, Aquila Merchant made the decision to sell the Aries generating station in 2004. Ultimately, Aquila Merchant received nothing for this asset. Instead, given the depressed value of deregulated units and the significant debt load underlying the Aries capitalization, Aquila actually paid Calpine **_____ _____** to take over ownership of the Aries unit.[21]

Shortly afterwards, in 2005, Aquila Merchant agreed to sell its combustion turbine facilities in Illinois.[22] Known as Raccoon Creek and Goose Creek, the combustion facilities were sold to AmerenUE "as distressed property."[23] As Staff notes, these units were sold "at highly discounted values."[24] In fact, Aquila later noted in an SEC filing, that it incurred a loss of $99.7 million on the sale of Raccoon Creek and Goose Creek.[25]

Continuing its efforts to divest itself of deregulated assets, Aquila Merchant also attempted to sell the Crossroads Energy Center. As Aquila noted in response to a Staff

[21] Ex. 217, page 19.
[22] *Id.*
[23] *Id.* at page 15.
[24] *Id.* at page 43.
[25] Ex. 215, page 51.

Data Request, it contacted **__** parties in 2005 in an attempt to sell the Crossroads unit.[26] Reflecting the depressed value of these type of assets and the transmission constraints surrounding the Crossroads unit, **_____** for the Crossroads unit.[27]

As Section G, *infra*, demonstrates, Aquila's response to the collapse of the deregulated energy market not only involved the sale of its non-regulated assets. Ultimately, Aquila undertook a comprehensive sale of its regulated assets, culminating in the sale of the remainder of the Company (Missouri electric operations and Crossroads) to Great Plains in 2007.

D. STAFF'S EFFORTS TO FORCE AQUILA TO CONSTRUCT A MISSOURI REGULATED GENERATING STATION

During this time, Aquila routinely ignored the efforts of Staff to build regulated generating stations for Missouri ratepayers. This was clearly the prudent approach. As Chairman Davis has recognized:

> PSC staff has taken positions in favor of Missouri electric utilities owning their own electric generation because it is more reliable to have generation facilities located near the customers being served and cheaper once the costs are depreciated over a period of thirty years or longer. Companies that followed this strategy and built excess generation capacity, like KCP&L and AmerenUE, have used off-system sales of their excess electricity to subsidize costs to their regulated utility customers.
>
> Both utilities and customers have benefited under this regulatory framework. AmerenUE and KCP&L generated earnings for their investors and avoided rate increases for almost two decades, while actually reducing the rates paid by their customers over that same period. This accomplishment is no small feat and ***provides strong support for the long-term approach espoused by Mr. Schallenberg and the rest of the PSC staff in this regard***.[28]

[26] Ex. 216, page 13.
[27] *Id.*
[28] *Concurring Opinion of Chairman Davis*, Case No. ER-2007-0004, pages 8-9 (issued July 9, 2007).

As Staff continues to point out, "steel in the ground is preferable to relying on short-term PPA's."[29] There are multiple reasons for this preference. ***First***, the utility realizes advantages of ownership in terms of reliability.

> Utilities are able to control the operations of the generating facilities if they own and operate those assets. Utilities will not be subjected to the volatility of the marketplace with cost increases related to purchase power if they operate their own generating assets. ***Also, utilities are able to provide a much more reliable source of energy when the regulated company has its generation under its authority.*** The regulated entity can operate the unit in a prudent and economic manner and can maintain and make capital improvements to prolong the life of this valuable asset.[30]

Interestingly, management for Aquila's regulated entity recognized this advantage. There are "significant advantages in both owning and operating the generation equipment in developing maintenance expertise."[31] The regulated entity also recognized advantages in "the areas of costs, manpower and staffing and dispatch flexibility."[32]

Second, the advantages of ownership of the generating station are also realized by the ratepayers in the form of lower revenue requirements over the life of the asset.

> Generally, the costs (revenue requirements) are higher in the early years of ownership. The capital costs of the plant investment require a return (return on investment) and the utility is entitled to a recovery of the investment (return of investment). As the plant investment is recovered through depreciation – (the return of investment) – the rate base return required – (return on the investment) – decreases. At some point in the future . . . the customers will have the benefit of the plant while the rate base investment is very low. The return on investment declines which causes the revenue requirements to decline dramatically through ownership.[33]

Therefore, for almost 15 years we have seen an ongoing, unresolved conflict. While ratepayers clamored for the benefits associated with construction of a Missouri

[29] Ex. 232, page 2.
[30] Ex. 217, page 20.
[31] *Id.* at page 21.
[32] *Id.*
[33] *Id.*

regulated generating station, Aquila's management ignored their pleas and opted in favor of the false promise of heightened profits in the deregulated market. Ultimately, this unresolved conflict has led to the capacity shortage that Missouri operations are still experiencing today. "Staff believes that had Aquila built Aries as a regulated generating station and rate based it in the traditional manner, Aquila likely would not have the capacity issues it has today."[34] While Aquila continually rejected the notion of regulated generating units, Staff consistently urged Aquila to make these regulated investments.

> Staff has had issues with Aquila's decision making regarding building generating units since Aquila's 2001 rate case, Case No. ER-2001-672. In each rate case since the 2001 through the last Aquila rate case, Case Nos. ER-2004-0034, ER-2005-0436 and ER-2007-0004, Staff expressed its concerns on the Company's decision not to build generating units and relying on purchase power agreements to meet capacity.[35]

E. AQUILA'S INTEGRATED RESOURCE PLAN REPEATEDLY CALLED FOR THE CONSTRUCTION OF GENERATION

In 1992, the Commission first implemented its integrated resource planning rule.[36] As designed, that rule is intended to provide a process by which utilities analyze an optimal mix of supply side resources and demand side management to meet expected electric needs. Consistent with the construction option that has been repeatedly advocated by Staff, Aquila's 1992 preferred plan called for the construction of **___ _____**. While the regulated operations initially proceeded with the planning for this combined cycle unit, Aquila opted to build the unit as a deregulated unit [Aries] and sell the power to MPS through a 5-year purchase power agreement expiring on May 31, 2005.[37]

[34] *Id.* at page 28.
[35] *Id.*
[36] 4 CSR 240-22.
[37] Ex. 217, page 29.

Subsequent integrated resource plans came to similar conclusions. Given the expiration of the purchase power agreement for the energy from Aries, Aquila's 2004 integrated resource plan again called for the construction of generating capacity. In this case, the least cost plan dictated the construction of five combustion turbines in 2005.[38] Given the collapse of the deregulated energy market, Aquila was no longer adamant against the construction of regulated generating units. Now, however, given the losses suffered by its foray into the deregulated market, Aquila no longer had the financial means to build the needed regulated units. Instead, Aquila felt financial pressures to forego the capital costs associated with constructing these regulated units and instead opted in favor of purchase power agreements.[39] Still, Staff persisted.

Realizing that the three combustion turbines that originally were designed to be Aries II had been sitting in storage for over three years, Staff insisted that Aquila construct these CTs as regulated capacity. Interestingly, personnel for Aquila's regulated operations were not even aware of the existence of these stored combustion turbines.[40] Only when informed of the existence of these turbines did the regulated employees even inquire as to their availability. Given its financial problems, however, Aquila hesitated and instead sought to sell these combustion turbines.[41] Reflecting the depressed market for these turbines, Aquila was unsuccessful in selling the CTs.[42] Finally, Aquila relented and agreed to construct the three combustion turbines as the South Harper unit.

[38] Ex. 216, page 2.
[39] Ex. 217, page 18 ("From the time Aquila signed the Aries agreement in February 1999, it started considering replacing the Aries capacity, but only with purchased power agreements."
[40] *Id.* at page 41.
[41] Ex. 215, page 40.
[42] *Id.*

F. CONSTRUCTION OF SOUTH HARPER AND CONTINUING CAPACITY SHORTAGE

As indicated, Aquila's 2004 integrated resource plan called for the construction of five combustion turbines. Given the collapse of the deregulated electric industry, Aquila was no longer opposed, in principle, to the construction of regulated units. Now, however, Aquila no longer had the financial means to construct such units. Therefore, while its integrated resource plan called for the construction of five combustion turbines, Aquila initially intended to fill its energy and capacity needs solely through the use of purchase power agreements.[43] Only after being notified that Aquila Merchant had three combustion turbines in storage for over three years did Aquila relent and agree to the construction of three combustion turbines. Ultimately, these three combustion turbines became the South Harper units.

While the initial book value of these three combustion turbines was significantly higher, Aquila conceded the depressed state of the market for CTs. Given the requirement in the affiliate transaction rule to only reflect the "fair market value" of any assets transferred from a non-regulated affiliate, Aquila agreed to a significant write-off on the value of the South Harper turbines.[44]

Recognizing that Aquila had refused to construct any regulated generation since 1983,[45] the construction of the three South Harper turbines represented a significant step forward. That said, however, it did not completely fulfill the needs set forth in the 2004 integrated resource plan. Remember, while South Harper consisted of three combustion turbines, the preferred resource plan demanded the construction of five combustion

[43] *Id.* at page 41.
[44] *Id.* at page 38.
[45] Ex. 217, page 21.

turbines. Therefore, for the past seven years, Aquila had continued to recognize a shortfall for the capacity originally anticipated by the other two missing turbines.

G. KCPL ACQUISITION AND INTRODUCTION OF CROSSROADS

As indicated, given the collapse of the deregulated energy market and the subsequent impact that it had on Aquila's financial condition, Aquila began to sell off various assets. Initially starting with deregulated assets, Aquila eventually turned to selling its regulated service areas as well. In early 2006, Aquila sold its gas operations in Michigan, Minnesota and Missouri. Later in the same year, Aquila sold its electric operations in Kansas. Finally, in February 2007, Aquila entered into an agreement by which it would sell its gas assets in Iowa, Nebraska, Kansas and Colorado as well as its electric assets in Kansas.[46] The remainder of Aquila's assets, consisting primarily of Aquila's Missouri operations and the 340 MW Crossroads Energy Center in Mississippi would be purchased by Great Plains Energy.[47] With its acquisition of Aquila, Great Plains Energy inherited the "issues" (lack of generation capacity) that Chairman Davis predicted would "haunt Aquila management for years to come regardless of who's in charge."

As the following section indicates, throughout that acquisition process, Great Plains Energy repeatedly sought to sell the Crossroads unit. Given the depressed nature of the market for deregulated generating assets as well as the transmission constrains associated with exporting the energy out of that unit, Great Plains Energy repeatedly failed to find a buyer for the unit. Given its inability to find a purchaser for Crossroads, Great Plains made several filings with the Securities Exchange Commission noting the

[46] *Report and Order*, Case No. EM-2007-0374, page 8 (issued July 1, 2008). See also, Ex. 216, page 3.
[47] Ex. 216, page 4.

value of Crossroads to be only $51.6 million. Recognizing the requirement that assets be transferred from a non-regulated affiliate at the lesser of cost or fair market value, this statement plays a significant role in determining the fair market value of the Crossroads units.

IV. FAIR MARKET VALUE OF CROSSROADS

As this brief has demonstrated, Aquila was the self-inflicted victim of bad timing. Aquila entered the deregulated market when Enron was flying high and the value of deregulated assets was at their highest point. Thus, Aquila Merchant paid full book value when it built the Aries unit, Raccoon Creek, Goose Creek and Crossroads. Aquila Merchant also paid full book value for the three combustion turbines that were placed in storage for three years before eventually being constructed at South Harper.

It is undisputed, however, that between the time that these deregulated assets were purchased or constructed (1999-2001) and the time that Great Plains Energy purchased the remaining remnants of Aquila (2007), the value of these same deregulated assets declined significantly. Nevertheless, GMO completing ignores the Supreme Court's holding in *Smyth* as well as the Commission's affiliate transaction rule and asks that the Commission place the Crossroads unit in rate base at the depreciated, net book value of the assets. Specifically, GMO requests that the Commission place Crossroads in rate base at a value of $89.3 million.[48] In addition, in order to overcome the significant transmission constraints surrounding the placement of that unit, GMO asks for rate base

[48] *Id.* at pages 5-6.

treatment for $17.8 million of transmission costs.[49] Thus, GMO asks for rate base treatment of a total of ***$107 million***.[50]

As this section of the brief will demonstrate, however, the depreciated net book value of Crossroads is not an accurate measure of the "fair value of the property being used by it for the convenience of the public."[51] Nor, is depreciated net book value of Crossroads an accurate measure of the "fair market price" required by the Commission's affiliate transaction rule. Instead, quantification of "fair value" necessary to fulfill these requirements are found in: (1) filings made by Great Plains Energy with the Securities Exchange Commission at the time it acquired Aquila; (2) the value of other identical combustion turbines actually being sold by Aquila Merchant to third parties at that same time; and (3) the fact that neither Aquila nor Great Plains could find a single entity interested in purchasing the Crossroads unit.

A. GREAT PLAINS ENERGY SEC FILINGS

In February 2007, Great Plains Energy announced that it was acquiring the remaining assets of Aquila. These assets consisted of the Missouri electric operations and the Crossroads Energy Center. This acquisition announcement followed several months of due diligence by Great Plains as to the value of the assets that it was acquiring.[52]

Almost immediately upon announcing the acquisition, but before the acquisition had even closed, Great Plains made filings with the Securities Exchange Commission as to the fair market value of the Crossroads Energy Center. In that filing, Great Plains

[49] *Id.* at page 6.
[50] *Id.* at page 7.
[51] *Smyth v. Ames*, 169 U.S. 466, 546-547 (1898).
[52] Ex. 216, page 7.

announced that, despite a net book value at the time of $117.9 million, Crossroads had a "fair value" of only $51.6 million.[53] As a result, the value of Crossroads was written off by $66.3 million.

> The pro forma adjustment represents the adjustment of ***the estimated fair value of certain Adjusted Aquila non-regulated tangible assets*** and reduction of depreciation expense associated with the decreased fair value. The adjustment was determined based on Great Plains Energy's estimates of fair value based on estimates of proceeds from sale of units to an unrelated party of similar capacity in the current market place. ***The preliminary internal analysis indicated a fair value estimate of Aquila's non-regulated Crossroads power generating facility of approximately $51.6 million.*** This analysis is significantly affected by assumptions regarding the current market for sales of units of similar capacity. The $66.3 million adjustment reflects the difference between ***the fair value of the combustion turbines at $51.6 million*** and the $117.9 million book value of the facility at March 31, 2007. Great Plains Energy ***management believes this to be an appropriate estimate of the fair value of the facility***.[54]

Thus, at the time of acquisition by Great Plains, the value of Crossroads had to be reduced by $66.3 million to reflect "fair value." That said, however, GMO refuses to recognize this fair value or the write off that occurred. Instead, GMO returns to the original net book value for ratemaking purposes.

B. VALUE OF OTHER COMBUSTION TURBINES

The Crossroads Energy Center is a 300 MW natural gas combustion turbine generating site, consisting of four 75 MW General Electric model 7 EA combustion turbines.[55] Given its plans to enter the deregulated market in many locations throughout the nation, Aquila Merchant purchased a total of eighteen (18) of these General Electric combustion turbines. Therefore, after the deregulated electric industry collapsed in late

[53] *Id.*
[54] *Id.* at page 12 (citing to Great Plains Energy & Aquila Joint Proxy Statement / Prospectus, filed with the SEC on May 8, 2007, at page 175) (emphasis added).
[55] Ex. 217, page 8.

2001, Aquila Merchant had significant experience selling the remaining fourteen (14) combustion turbines that were identical to those now located at Crossroads. That real market experience provides direct evidence that the "fair market value" for these General Electric turbines is significantly less than that now claimed by GMO, and is actually in line with the "fair value" previously noted by Great Plains.

For instance, of the 18 General Electric Turbines, six turbines were installed at the 510 MW Goose Creek Energy Center in Illinois.[56] An additional four turbines were installed at the nearby 340 MW Raccoon Creek facility.[57] Following the onset of the financial problems caused by the entry into the deregulated market, Aquila Merchant immediately began seeking third parties that were interested in purchasing these units. As documented by Staff, the final sale price for both units (10 combustion turbines for a total capacity of 850 MWs) was $175 million.[58] As such, the final purchase price amounted to **$205.88** per installed kilowatt.[59] This sale was closed in 2006 and is, therefore, contemporaneous with the Great Plains acquisition in 2007.

As it later revealed in an SEC filing, Aquila Merchant suffered an after-tax loss on the sale of Goose Creek and Raccoon Creek of $99.7 million.[60] Interestingly, despite its regulated operations expressed need for capacity, and despite the fact that these units were significantly closer than Crossroads, Aquila never gave the regulated operations an opportunity to buy these depressed assets.[61]

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[56] Ex. 215, page 49.
[57] *Id.*
[58] *Id.* at page 50.
[59] *Id.* at page 51 (citing to Aquila's SEC Form 8K filing with the Securities Exchange Commission, filed December 16, 2006).
[60] *Id.*
[61] *Id.* at page 52.

While Aquila Merchant suffered large losses associated with the sale of the 10 General Electric combustion turbines located at Raccoon Creek and Goose Creek, Aquila Merchant suffered even larger losses associated with subsequent sales. For instance, Aquila Merchant sold three other General Electric turbines to utilities in Nebraska and Colorado.[62] The total purchase price for these three General Electric turbines was **_____**. Given the total capacity of 225 MWs, the purchase price for these turbines, identical to those installed at Crossroads, was only **_____** per kilowatt.[63]

Finally, Aquila Merchant released the last combustion turbine back to General Electric. In doing so, Aquila Merchant received no money, and lost the entirety of the reservation (option) payment that it had previously made.[64]

As can be seen then, the fair value of General Electric 7 EA combustion turbines being sold to third-parties was in the range of **_____** and $205.88 / kw.

C. NO WILLING PURCHASERS

The "fair market value" of Crossroads is also impacted by the fact that Aquila, and later Great Plains Energy, despite their professed desires to sell the Crossroads Energy Center, was unable to find a single interested bidder. As previously indicated, shortly following the implosion of the deregulated electric industry, Aquila Merchant began to divest itself of its deregulated assets. In short order, Aquila Merchant sold its ownership interest in the completed Aries, Raccoon Creek, and Goose Creek units. Furthermore, Aquila sold its ownership interest in three combustion turbines that had been purchased, but not yet installed by Aquila Merchant.[65]

[62] *Id.* at page 48.
[63] *Id.*
[64] *Id.* at pages 48-49.
[65] Ex. 215, page 48.

Given its dire cash needs, Aquila Merchant was anxious to sell the remainder of its deregulated assets as well. Ultimately, Aquila Merchant succeeded in divesting every deregulated asset except Crossroads. In a data request, GMO acknowledges that Aquila Merchant attempted to sell Crossroads in both **_____**. Both times, however, Aquila Merchant was unsuccessful in finding a purchaser. In fact, **_____ _____** for the Crossroads unit.

Later, following its announced acquisition of Aquila, Great Plains also attempted to sell the Crossroads unit. In a webcast call with investors, Great Plains management was asked specifically about its intentions for the Crossroads unit. In response, Great Plains Chief Financial Officer indicated "[w]e looked at the ability to utilize that or sell it. Our preference would be probably to get value through monetizing it."[66] As Staff notes, the fact that Great Plains did not sell Crossroads, despite its stated preference, "means that like Aquila, it could not find a buyer."[67]

D. FAIR MARKET VALUE

Aquila Merchant's sale of the General Electric 7 EA combustion turbines, identical to those located at Crossroads Energy Center, provides real-life evidence of the depressed value of these turbines. Importantly, given the dates of these sales (2004-2006), they provide contemporaneous evidence of this depressed value. Therefore, the "fair market value" of General Electric 7 EA combustion turbines is within the range of **_____** per kilowatt (the sales to the Nebraska and Colorado utilities) to $205.88 per kilowatt (the sale of Goose Creek and Raccoon Creek). Recognizing that the Crossroads unit were installed and capable of generating, its value lies closer to the high end of that

[66] Ex. 216, page 14.
[67] *Id.*

range. That is to say, since they are installed, they are more comparable to the installed Goose Creek and Raccoon Creek units, than the uninstalled Nebraska / Colorado sales.

Therefore, one measure of Crossroads "fair market value" is based upon Aquila Merchant's contemporaneous sale of other General Electric 7 EA combustion turbines. Using a value of $205.88 / kilowatt, Crossroads then has a "fair market value" of ***$61.76 million.***[68] The other, and probably more dependable, measure of the "fair market value" of Crossroads is taken from Great Plains Energy filings with the SEC in which it states that the "fair value estimate of Aquila's non-regulated Crossroads power generating facility is approximately ***$51.6 million***." It is important to realize, however, that both of these quantifications reflect the value at the time of the acquisition by Great Plains (2007). Therefore, either figure should be reduced for the effect of three years of subsequent depreciation. Ultimately, both of these quantifications of "fair market value" show the greatly inflated nature of the ***$107 million*** net book value that GMO believes should be used as the rate base for Crossroads.

V. CONCLUSION

As has been demonstrated, the Commission has been charged, by the Supreme Court and its own affiliate transaction rule, with determining the "fair market value" of the Crossroads Energy Center. In this regard, there are two readily available surrogates for Crossroads' fair market value. ***First***, upon announcing the acquisition of Aquila, Great Plains Energy made a filing with the SEC in which they assert that the "fair value" estimate of Crossroads is $51.6 million. ***Second***, there are real-life examples of sales of identical General Electric 7 EA combustion turbines by Aquila Merchant to third party purchasers. Those purchases indicate that the fair market value falls within a range of

[68] $205.88 / installed kw * 300,000 kw at Crossroads = $61.76 million.

$157.30 to $205.88 / kw. Therefore, the fair market value of Crossroads is no more than $61.7 million. Again, it is important to remember that both of these quantifications reflect the "fair value" at the time of the acquisition by Great Plains. Therefore, the Commission should account for the effect of the subsequent three years of depreciation.

In contrast, GMO requests that the Commission ignore all evidence of fair market value and use a net book value of $107 million. In the final analysis, it is ludicrous to believe that Great Plains Energy actually paid $107 million for Crossroads when it purchased Aquila. Instead, given its stated belief that the "fair value" was only $51.6 million, it is likely that Great Plains purchased Aquila using a Crossroads value of $51.6 million.

Long and short, GMO's requested net book value is in direct violation of the Commission's affiliate transaction rule. Contrary to the stated purpose of that rule, GMO's request will not provide "the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activites." Given all the reasons stated herein, the Commission should set a value for Crossroads in 2007 of $51.6 million. For purposes of ratemaking, the Commission should utilize this value less the subsequent three years of depreciation.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.

David L. Woodsmall

Dated: March 25, 2011