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Witness:	H. Davis Rooney
Sponsoring Party:	Aquila, Inc.
Type of Exhibit:	Surrebuttal Testimony
Case No.:	EO-2005-0156
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MISSOURI PUBLIC SERVICE COMMISSION

SURREBUTTAL TESTIMONY

OF

H. DAVIS ROONEY

ON BEHALF OF

AQUILA, INC.

June 27, 2005

<u>Denotes Highly Confidential Information</u>

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF H. DAVIS ROONEY
ON BEHALF OF AQUILA, INC.
CASE NO. EO-2005-0156

Q. Please state your name and business address.

A. My name is Davis Rooney. My business address is 10750 E. 350 Highway, Raytown, MO 64138.

Q. What is your occupation?

A. I am employed by Aquila, Inc. ("Aquila" or "Company") as Director of Financial Management.

Q. Would you briefly describe your educational training and professional background?

A. I graduated from the University of Kansas. I received a B.A., with distinction, in Mathematics (1982), and a B.S., with distinction, in Business (1983), with majors in Accounting and Business Administration and a concentration in Computer Science. I obtained my Certified Public Accountant certificate in 1983 and practiced in public accounting from 1983 to 1992. In 1992 I joined Aquila as Controller of its WestPlains Energy division and have held several positions focused on financial management and analysis.

Q. What is the purpose of your testimony in this proceeding?

A. I will provide surrebuttal testimony to the rebuttal testimony offered by Ted Robertson of the Office of Public Counsel of the State of Missouri ("OPC" or "Public Counsel") and to the rebuttal testimony offered by Cary Featherstone of the Staff of the Missouri Public Service Commission ("Staff").

Rebuttal of Staff Valuation

Q. What value did Staff witness Mr. Featherstone propose for the turbine transfer?

A. Mr. Featherstone proposed a value of $66,760,000. This is the price offered by Aquila Merchant on August 9, 2002 to **________________________________** adjusted for the estimated cost of the expired warranty. Mr. Featherstone's valuation is $4,036,850 less (approximately 6%) than the value determined by the independent outside appraiser hired by Aquila. This proposed reduction is on top of a 10% reduction already recorded by Aquila as a result of the appraisal performed by R. W. Beck.

Q. How would you characterize Staff's efforts to arrive at this proposed value?

A. In my opinion, Staff made a thorough effort to understand the issues and options available to Aquila Networks-MPS. They issued numerous data requests. Staff's review included the support utilized by R. W. Beck, the appraiser hired by Aquila to determine the fair market value. Staff's review included the availability and pricing of the Siemens Westinghouse W510D5A turbines. Staff reviewed the availability and pricing of the smaller General Electric 7EA turbines. Staff also reviewed the larger Siemens Westinghouse W501F turbines. Additionally, Staff reviewed industry pricing literature.

Q. Did Mr. Featherstone arrive at an appropriate valuation?

A. No. While Mr. Featherstone considered an actual offer made by Aquila Merchant to sell this equipment, Aquila believes he did not fully consider several important elements of that **_____** offer. Mr. Featherstone did not properly consider the motivation for Aquila Merchant's offer to **_____**. Mr. Featherstone did not properly consider the time frame in which this offer was made.

Q. Why is the motivation for Aquila Merchant's offer to **_____** relevant?

A. R. W. Beck states that under Uniform Standards of Professional Appraisal Practice (USPAP), fair market value is the "most probable price…assuming the price is not affected by undue stimulus." (R. W. Beck appraisal report page 1-2). Staff witness Phillip Williams, on page 7 of his rebuttal testimony, cites a similar standard of fair market value stating that "The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale." (paratheticals omitted).

Q. Did Aquila inform Mr. Featherstone of the existence of such a price impacting stimulus?

A. Yes. Aquila Merchant was anticipating significant storage costs if the units were stored in the Siemens Westinghouse facility near Houston. At the time, Aquila Merchant was urgently seeking a lower cost storage option in the Kansas City area, but had not secured one. A prompt sale of the equipment would have reduced Aquila Merchant's exposure to significant storage related costs.

Q. At the time Aquila Merchant offered the Siemens Westinghouse D5A combustion turbines for sale to **_____**, what were the anticipated storage costs Aquila Merchant was attempting to avoid?

A. Mr. Featherstone quotes Aquila employee Dave Kreimer on this very issue. Mr. Kreimer, who was employed by Aquila Merchant at that time, stated that storage costs were an estimated **_________**. (Mr. Featherstone's Rebuttal, page 33, line 17).

Q. Was the offer price discounted to **_____** in an effort to avoid these costs?

A. Yes. Mr. Kreimer's interview makes that clear. As quoted in Mr. Featherstone's testimony, he stated that "…the offer price was in part based on avoiding delivery and avoiding an estimated **_________** of storage costs." (Mr. Featherstone's Rebuttal Testimony, p. 33, lines 16-18)

Q. What would have been the total benefit to Aquila Merchant had the sale proceeded?

A. Had **_____** purchased the units, the net benefit to Aquila Merchant would have been the **_________** offer price plus an estimated **__________** in anticipated avoided costs for a total benefit of approximately **_________**.

Q. Did the turbines get placed into storage at the Siemens Westinghouse facility?

A. No. In September 2002, Aquila Merchant was able to arrange a much less expensive storage arrangement by having the turbines delivered to the Kansas City area. This arrangement greatly reduced the storage cost.

Q. What was the actual cost incurred for storage of this equipment?

A. The cost recorded for storage of the equipment was approximately **_________**.

Q. With benefit of hindsight, what would the actual benefit for sale of the equipment at the offered price have been?

A. The benefit, defined as the offered price to **_____**, plus the actual storage costs incurred though November 2004 that otherwise would have been avoided with the sale, would have been just under **____ _______**.

Q. Did Aquila Merchant continue to offer the equipment to **_____** after it mitigated the storage costs?

A. No. In October 2002, Aquila Merchant withdrew its offer. In the terms of Staff's definition of fair market value, Aquila Merchant was no longer a "willing seller" at that price, in part because it had reduced the storage cost risk. This was communicated to Mr.

Featherstone by Mr. Kreimer in his interview. (Mr. Featherstone's Rebuttal, page 33, lines 29-31).

Q. What impact does this have on Mr. Featherstone's proposed fair market value?

A. Mr. Featherstone's market value determination is too low. Aquila Merchant's offer to **_____** was based on an "undue stimulus." Therefore the **_____** offer price was below the fair market value at the time. This conclusion is confirmed by the withdrawal of the offer. Once the storage cost risk was reduced, the **_____** offer was withdrawn. This indicates that the **_____** offer price was below market. Aquila was no longer a willing seller at its original offer price.

Q. How did Mr. Featherstone not properly consider the time frame of the **_____** offer?

A. The **_____** offer was made August 9, 2002. Aquila Networks-MPS did not assume ownership until November 30, 2004. Mr. Featherstone has essentially recommended that Aquila Networks-MPS should have purchased the turbines at the **_____** offer price in 2002. If Aquila Networks-MPS had purchased the turbines from Aquila Merchant on the same terms as the offer to **_____**, the regulated division Aquila Networks-MPS, not Aquila Merchant, would have incurred the storage costs and carrying costs during the two year period. Mr. Featherstone should add the cost of storage and the carrying cost of money that would have been incurred by Aquila Networks-MPS to hold the equipment for approximately two years until November 2004. Additionally, since the warranty was still in force at the time of the **_____** offer, Mr. Featherstone should not have deducted the warranty from the 2002 proposal. The seller should not reduce its price merely because a specific buyer does not intend to utilize a warranty that some other buyer might be able to use.

Q. Why should these costs be added?

A. Mr. Featherstone believes the value should be based on an offer to sell made by Aquila Merchant in August of 2002. For Aquila Networks-MPS to get the August 2002 price, it should have purchased the equipment in August of 2002. However, had Aquila Networks-MPS in fact purchased the equipment based on that offer, Aquila Networks-MPS would have incurred these additional costs. Mr. Featherstone is picking up only the benefit of the below market offer in 2002 without picking up any adjustment for the related costs of Aquila Networks-MPS to actually acquire and hold that equipment. No business can acquire assets at a discounted price and hold them without cost until needed. If Aquila Networks-MPS had purchased this equipment in August 2002, the warranty was still in force. Therefore, there is no need to deduct it.

Q. Are there additional terms in the **_____** offer that should be considered?

A. Yes. It is unclear from Mr. Featherstone's testimony whether they are valuing the equipment at the existing storage location or delivered to the construction site. The terms of the offer to **_____** specify that **_____** is responsible for the transportation costs from the storage facility to the construction site (Featherstone Rebuttal, Schedule 5.28 HC, Sec. 4.2). If Mr. Featherstone's valuation is at the construction site and not at the storage site, then an adjustment for transportation must be added to the **_____** offer. This adjustment is **__________**, excluding the heavy haul from the rail siding.

Q. What is the impact of adding storage, transportation, carrying costs, and the warranty?

A. As noted above, the storage costs for two years were approximately **____________**. The estimated warranty adjustment was **___________**. Company witness Williams will address the carrying costs. Therefore the cost to Aquila Networks-MPS to have acquired the turbines in August 2002 (excluding carrying costs) would have been as follows:

Staff Proposal	**__________**
Storage Costs	**__________**
Transportation to Site	**__________**
Warranty (still good in 2002)	**__________**
Total Adjusted Cost	**__________**

Q. How does this adjusted price compare to the recommendation by the professional appraiser R. W. Beck?

A. R. W. Beck's appraisal, which considered not only this offer but other factors in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP), was $70,796,850.

Q. What do you conclude regarding Mr. Featherstone's proposed valuation?

A. Rather than accepting a professional appraiser's recommendation of fair market value, Mr. Featherstone has offered a lower price based in part on a price point from an offer made in August 2002, a price point already considered by the professional appraiser. If Mr. Featherstone had made all appropriate adjustments to that offer, a value greater than the value recommended by the professional appraiser would have resulted.

Q. What is your recommendation to the Commission?

A. The Commission should accept the fair and considered November 2004 fair market valuation offered by the professional appraiser R. W. Beck of $70,796,850 and reject the August 2002 valuation offered by Staff witness Mr. Featherstone. If the Commission accepts Mr. Featherstone's proposal of the August 2002 price, it should include in its order 1) recognition that Staff's recommendation gave additional consideration to

General Electric 7EA and Siemens Westinghouse W501F turbines as well as Siemens Westinghouse W501D5A equipment; 2) recognition that Staff's proposal was based on the **_____** offer price, which does not include transportation from the storage location to the construction site; and 3) provide the adjustments recommended above and by Company witness Williams for the storage, transportation, carrying costs, and warranty.

Rebuttal of OPC Valuation

Q. What valuation did OPC witness Ted Robertson propose for the turbine transfer?

A. It is unclear what Mr. Robertson's proposal is. On the one hand, he concludes his rebuttal testimony on page 81 stating "Thus, I believe, that the GTW published prices are a more moderate position that benefits both the shareholders and ratepayers." On page 66 of Mr. Robertson's testimony he states the GTW price is $59.7 million. On the other hand, on page 57 of his testimony, Mr. Robertson seems to support a separate valuation for the breakers and transformers that is within $3,300 of the value proposed by R. W. Beck. Including Mr. Robertson's value for the breakers and transformers with the proposed GTW value would produce a value of $62,087,750. Additionally, on page 61 of his testimony, Mr. Robertson states, that incorporating his adjustments, adjustments which also reflect Mr. Robertson's view of current pricing, would result in a value of $63,746,570. As the GTW price was the proposal presented at the conclusion of his testimony, we believe this is the Mr. Robertson's proposal for the entire transfer. This proposal of $59.7 million is based on the Gas Turbine World (GTW) 2003 Handbook.

Q. Is this valuation comparable to the assets transferred and the items considered in the R. W. Beck appraisal?

A. No. The 2003 GTW valuation proposed by Mr. Robertson excludes the breakers, transformers, training, transportation, technical field assistance and dry low NOx combustors which are included in the transferred plant and included in R. W. Beck appraisal. This proposed valuation is based on the Gas Turbine World 2003 Handbook.

Q. Was Mr. Robertson aware that the transferred property included the omitted items?

A. Yes. Mr. Robertson makes reference to OPC Data Request No. 10. The Company's response to that DR notes breakers, transformers, training, transportation, and technical field assistance are included in the items being transferred. The Company's appraiser states in his report that adjustment for dry, low NOx burners is required to place equipment on a comparable basis. In addition, OPC received Aquila's response to OPC Data Request 0008 in which the CT Combustors are listed as Dry Low NOx and the NOx emission guarantee is listed as "15 ppmmvd @ 15% O_2 – Method 20." (DR OPC-0008 ESA Appendix V page 2)

Q. How do you know these items have been excluded from Mr. Robertson's valuation?

A. On page 66 of Mr. Robertson's testimony he states that the $59.7 million excludes the cost of the transformers and breakers. Staff witness Mr. Featherstone also considered the 2003 Gas Turbine World data. Staff witness Mr. Featherstone notes that the 2003 Gas Turbine World price is **____

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______________________________________** (Page 1 of Mr. Featherstone's Schedule 3-1 HC). Additionally, the 2003 GTW states that "Electrical distribution, main step-up transformers, switchgear…are not included." (Page 11 of 2003 GTW). "Equipment-only" means that training and technical field assistance is excluded. "FOB the factory" means transportation from the factory to the site is excluded. "Conventional combustion system unless designated as DLE" means that dry low NOx combustion is excluded. "Electrical distribution, main step-up transformers, switchgear" means breakers and transformers are excluded.

Q. What value has been omitted by Mr. Robertson in relying on the 2003 GTW price without making these adjustments?

A. Aquila's attachments to DR OPC-0014 indicate that dry low NOx adds **__________** per unit. R. W. Beck included a value of **__________** for the turbines and breakers. The estimated cost of transportation is **__________** according to R. W. Beck. R. W. Beck also estimated technical field assistance and training as **__________**.

Q. Can you summarize these adjustments?

A. See the following table:

Breakers and Transformers	**__________**
Transportation	**__________**
Technical Field Assistance and training	**__________**
Dry Low NOx Combustors	**__________**
Total Omissions	**__________**

Q. Is Mr. Robertson's proposal of the 2003 GTW price a fair market value price?

A. No. GTW provides extensive descriptions of what has and has not been included. Mr. Robertson ignores the guidance included in the GTW Handbook regarding what is and is not included in the 2003 GTW price. Mr. Robertson's proposal omits the items noted above. GTW world states that their "pricing levels are arrived at by a consensus of industry users and industry suppliers on what constitutes a 'good number' for budgeting purposes." Budget numbers, while providing guidance when properly used, are not either "cost" or "fair market value." Company witness Neal Suess provides additional testimony why the 2003 GTW prices are not appropriate to use for this valuation.

Q. If the 2003 GTW prices were properly adjusted, what would be the result?

A. The properly adjusted budgeting value would support the reasonableness of the R. W. Beck valuation.

Q. Mr. Robertson states of the $59.7 million proposed value that "the GTW published prices are a more moderate position that benefits both the shareholder and the ratepayer." (Robertson page 81 line 11). Do you agree with this statement?

A. Mr. Robertson appears to mean by "moderate" a number less than offered by the independent professional appraiser. Mr. Robertson appears to mean by "benefits both the shareholder and the ratepayer" that offering nothing for the items omitted from Mr. Robertson's proposal still results in Aquila's investors receiving more than nothing on the turbines. Mr. Robertson implies that among all possible comparable and non-comparable price points in his testimony, he has been "moderate" by not proposing the lowest price point (comparable or not). He then picks for his proposal a price point that is clearly not comparable. Further, Mr. Robertson provides no testimony that his proposal for market value is the "most probable price", which is the criterion applied by R. W. Beck in accordance with appraisal standards.

Q. What is your recommendation to the Commission?

A. The Commission should accept the fair and considered fair market valuation offered by the professional appraiser R. W. Beck of $70,796,850 and reject the erroneous and unreasonable valuation offered by OPC witness Mr. Robertson. If the Commission

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accepts Mr. Robertson's recommendation, it should include in its order recognition that Mr. Robertson's proposed 2003 Gas Turbine World price of $59,700,000 included no fair market value at all for the breakers, transformers, training, transportation, and low NOx combustion system included with the equipment transferred to Aquila Networks-MPS.

Rebuttal of OPC Analysis- Depreciation Adjustment

Q. Did OPC witness Mr. Robertson challenge R. W. Beck's assessment of the original cost of the turbine equipment?

A. Yes.

Q. Can you summarize Mr. Robertson's position?

A. Mr. Robertson's position, as stated on page 56 of his rebuttal testimony, centers on two primary issues. First, Mr. Robertson asserts that the original costs of the equipment should have been devalued by $5,782,165 of depreciation. Secondly, Mr. Robertson asserts that **_________** of option payments were not credited against the "true" cost of the turbines but instead represented some sort of speculation payment over and above the cost of the turbines. R. W. Beck adjusted their cost analysis for the largest option payment of **_________**. Therefore, in total Mr. Robertson asserts that R. W. Beck overstated its original cost approach by $7,882,165, representing **_________** of book depreciation and **_________** for the second option payment. I will discuss Mr. Robertson's depreciation adjustment in this section of my testimony.

Q. Do both Mr. Robertson and R. W. Beck agree that adjustment must be made for loss of value due to changes in technology (technological obsolescence) and wear and tear (physical deterioration)?

A. Yes. (Robertson Rebuttal, page 56, lines 7-10).

Q. How did R. W. Beck determine their adjustment for this loss of value?

A. R. W. Beck performed an inspection of the equipment. They reviewed the storage facilities. They reviewed Aquila's storage and preservation records and the manufacturer's storage and preservation manual. R. W. Beck gave consideration to the wear and tear resulting from the duration of storage. They gave consideration to product modifications released by Siemens Westinghouse since the equipment was purchased. They developed adjustment values based upon discussions with Siemens Westinghouse and their own experience with similar costs. Finally they made an adjustment to the original cost. The adjustment represents their estimate of what Aquila would have to pay to make this equipment comparable in technology and wear and tear to similar new current technology equipment. R. W. Beck believes this cost to Aquila would be **_____ __________**. Mr. Robertson believes this cost is over $5.7 million.

Q. How did Mr. Robertson determine his adjustment for this loss of value?

A. Mr. Robertson made an arithmetic calculation by dividing his view of the cost by 30 years and multiplying the result by 2.5 years.

Q. Is this calculation essentially the same as a book depreciation calculation one might make for plant in service?

A. Yes.

Q. Is this plant in service?

A. No.

Q. Does Mr. Robertson's arithmetic calculation represent an adjustment for loss of value due to changes in technology or wear and tear?

A. No.

Q. Please explain why?

A. Mr. Robertson's entry is not a valuation adjustment. It is a math calculation unsupported by any objective economic evidence, but based instead on an accounting convention.

Q. Has Mr. Robertson properly applied the depreciation accounting convention?

A. No. His proposed entry is not a valid accounting adjustment. Contrary to his statement on page 53 of his testimony that the equipment is "used", the turbines are unused, not in service, not generating revenue and not subject to accounting depreciation by Aquila Merchant. Even if the turbines had been held by the regulated utility, the regulated utility would not have made the entry Mr. Robertson proposes. Under utility accounting, depreciation does not begin until it is "in service". Sometimes the term "used and useful" is chosen. Missouri has in-service criteria for combustion turbines. These turbines, at the valuation date, do not meet that in-service criterion. Aquila responded in detail to OPC on Data Request OPC-1036 (attached as Schedule HDR-1) regarding this issue. Mr. Robertson requested in DR OPC-1036 that Aquila cite the accounting literature supporting its position of not recording accounting depreciation. Aquila did so.

Q. Please summarize the key points of your response to Data Request OPC-1036.

A. Accounting depreciation is an allocation intended to spread the original cost over an asset's useful life in order to provide a matching of the annual revenue making capability of the asset with an allocation of its original cost. Key to the system of depreciation is distributing the cost over the <u>**useful life**</u>. Useful life is the period in which it is capable of producing revenue. For turbine property, this is the period between the in-service date and the date of retirement. Also key is the concept of matching costs with revenues. As of the valuation date, this equipment is unused, never installed, and has never generated. It is not in-service, it is not operating, and it is not revenue producing.

Q. What is your evaluation of Mr. Robertson's depreciation adjustment?

A. Mr. Robertson's depreciation adjustment violates the matching principle of accounting, ignores that the property is not in-service and seeks to reduce the original cost book value solely so Mr. Robertson can argue its "value" is lower. As stated in the Financial Accounting Standard Boards' Accounting Research Bulletin 43, Chapter 9C, paragraph 5, "It (depreciation) is a process of allocation, not valuation."

Q. Has Mr. Robertson cited any accounting literature to justify its claim that depreciation is appropriate?

A. No. On the contrary, Mr. Robertson states "…the CTs have not been utilized in an actual generating capacity…" (Robertson Rebuttal, page 53, line 20) and "Normally, depreciation is only taken against plant that is actually in service…" (Robertson Rebuttal, page 53, line 20). Mr. Robertson cites no authority or literature for making such an entry. In Data Request OPC-1036 (attached as Schedule HDR-1), Aquila provides six cites in three different publications for **not** making just the entry Mr. Robertson proposes.

Q. Is depreciation a valuation technique?

A. No. As cited in Data Request OPC-1036, "It should be emphasized that the primary objective of depreciation accounting is the allocation of cost to expense **rather than valuation of the asset**." (Public Utility Depreciation Practices published by NARUC Chapter IV) (emphasis added). Mr. Robertson is attempting to create a valuation adjustment from an accounting entry that does not even apply since the asset is not in service.

Q. Why does Mr. Robertson believe this adjustment is necessary?

A. Mr. Robertson states "its costs, which were incurred in a seller's market, are not representative of pricing that exists in today's market for similar equipment." (Robertson Rebuttal, page 56, line 10-12) (emphasis added).

Q. Is current pricing an appropriate factor in evaluating **original cost**?

A. No. Current pricing is another way of saying market value. It makes no sense to adjust original cost to market value. Such an adjustment would render meaningless the comparison of original cost and market. Current pricing is considered in the evaluation of replacement cost and in the evaluation of the market approach. Company witness Neal Suess provides additional surrebuttal testimony on the issue of original cost.

Q. So why does Mr. Robertson make this arithmetic adjustment that is not related to original cost, is not related to economic loss of value, and is not appropriate for accounting purposes?

A. It appears to me, Mr. Robertson is simply not satisfied with the considered and professional analysis provided by R. W. Beck. Mr. Robertson states of R. W. Beck's adjustments "The adjustments, which I believe are an attempt to recognize costs similar in nature to depreciation are admirable, but insufficient." As described above, Mr. Robertson has it backward. R. W. Beck is making an appropriate **valuation** adjustment. It is Mr. Robertson that is making an inappropriate **accounting** adjustment unrelated to valuation.

Q. What do you conclude regarding Mr. Robertson's proposed depreciation adjustment?

A. It is inappropriate. It is an arithmetic calculation not an evaluation of value. It is unsupported by the accounting literature. R. W. Beck has considered the impact of the wear and tear on the value and has considered the change in technology on value. Mr. Robertson has made an arithmetic calculation that is unsupported by any determination of value.

<u>Rebuttal of OPC and Staff - Option Payments</u>

Q. Can you summarize Mr. Robertson's position on the option payments?

A. Mr. Robertson asserts on page 53 of his testimony that **__________** of option payments were an actual cost of the turbines but instead represented some sort of speculation payment over and above the true cost of the turbines. R. W. Beck adjusted their cost analysis for the largest option payment of **__________**. Therefore, in Mr. Robertson asserts that R. W. Beck overstated its original cost approach **__________** for the second, smaller, option payment.

Q. What is Staff witness Mr. Featherstone's position?

A. Mr. Featherstone, on page 39 of his testimony, takes a similar position that neither option payment represents part of the original cost to purchase the turbines.

Q. What was the base price for the turbines?

A. The base price of **__________** for the three EconoPacs (the dry low NOx turbines and generators excluding transportation, training, technical field assistance, breakers and transformers) was established in the Letter Agreement dated February 4, 2000 with Siemens Westinghouse.

Q. Was this price above market value at the time?

A. No. The 2000-2001 Gas Turbine World Handbook reported the budget price as $76,500,000 <u>without</u> dry low NOx combustors (with dry low NOx the price would have been much higher). Aquila's price was well below that price. The higher GTW price confirms that Aquila was not paying a "premium" or something "extra" above the market price at the time. The price might be high, but it accurately reflects the original cost of turbines.

Q. Were the option payments credited against this base price?

A. Yes. This was communicated to Mr. Robertson in Aquila's response to OPC Data Request No. 1033, which Mr. Robertson quotes in part (Robertson, page 52, line 9-16). Mr. Robertson omits the portion of the Company's response stating that the option payments were applied as a reduction of the contract price. I have attached in its entirety Aquila's response to OPC Data Request No. 1037 as Schedule HDR-2 HC. In Aquila's response to OPC Data Request No. 1037, Company points out that the February 2000 Letter agreement states both in the term sheet in item #23 and on the payment schedule that the option payment will be credited, not additional, to the base price (see Data Request OPC 1037 attached as HDR-3 HC including the February 2000 Letter Agreement and its Amendments). Amendment #4 of the letter agreement (attached to OPC Data Request No. 1033) offers to **extend** the option period. The payment schedule to the amendment shows the contract price is **__________** because Aquila extended its first option by paying an additional **_________**.

Q. How was the **__________** contract price in Amendment #4 determined?

A. It was determined by crediting the two option payments against the Base Price agreed to in the February 2000 Letter Agreement as follows:

Base Price February 2000 Letter Agreement	**__________**
Less Option Payment #1	**__________**
Less Option Payment #2	**__________**
Contract Price per Amendment #4	**__________**

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It is clear that the parties agreed to reduce the contract price directly for the option payments instead of applying them to the first payment, as contemplated in the terms of the original letter agreement.

Q. The contract price in the September 2001 Equipment Supply Agreement (ESA) is **____ _____________**. Where does that amount come from?

A. Also attached to OPC Data Request No. 1033 was Amendment #5 adjusting the contract price to include transportation, training, and technical field assistance. Including these services increases the contract price to **__________**.

Q. Does the theory advanced by Staff and OPC that the options were "extra" make sense?

A. No. On the one hand they assert that it was a brutal seller's market. They assert that the option payments are "extra". They must ignore that the final contract price contains a <u>reduction</u> in base price from the original letter agreement exactly equal to the option payments. And, most importantly, they must ignore that in this brutal seller's market, the second option payment, which was not contemplated in the original letter agreement, did not result in an increase in the total cost. One can only conclude that the payments were really down payments.

Q. If both option payments were applied to the contract, why did R. W. Beck exclude the first option payment from its evaluation of original cost?

A. This is discussed further in the Surrebuttal Testimony of Company witness Neal Suess of R. W. Beck. Simply, Aquila was unable, at the time, to support its position to Beck's satisfaction. Aquila did not locate and supply R. W. Beck with the letter amendments #4 and #5 until after Beck issued its report. The documentation we did have at the time of the appraisal did not provide a clear reconciliation of how the final contract price was

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determined. Therefore, R. W. Beck took what Aquila viewed a conservative but reasonable approach and deducted the first option payment from its analysis of book cost. In the final analysis, the decision by R. W. Beck to deduct the first option payment in its analysis of original cost did not change the recommended fair market value.

Q. Is Mr. Featherstone's statement on page 41 of his testimony accurate that the **________ ______** option fee was written-off?

A. No. The **___________** payment was part of the book value just as the other payments for the turbine were part of book value. The write-off recorded was to adjust the total book value, not adjust any one specific payment.

Q. On pages 38 and 39 of his testimony, Mr. Featherstone's states that the additional **____ ______** option payment was required because a contract was not reached during the first 180-days. Is this accurate?

A. No. The original 180 day option period was extended by mutual agreement all the way through July 2001, 18 months after the original letter agreement. On August 2, 2001, Siemens Westinghouse sent Amendment #4, offering to further extend the option period through September 30, 2001 for an additional down payment (option payment) of **____ ______**.

Q. Is it appropriate to exclude the option payments from the original book cost of the turbines?

A. No. The option payments were applied as down payments toward the original letter agreement price. Based on the documentation now available, and as discussed in the Surrebuttal Testimony of Company witness Neal Suess, R. W. Beck now concurs with this conclusion. While this increases the assessment of original cost, it does not change R. W. Beck's recommendation of a lower fair market value.

Q. What is your recommendation to the Commission?

A. The Commission should accept the market value determination presented by R. W. Beck. The R. W. Beck report presents a conservative (low) assessment of original cost. OPC's recommendation to further adjust that conservative assessment of original price by excluding the second option payment of **_________** is contrary to the facts that are now available. The option payments were credited as down payments against the Letter Agreement price.

<u>Rebuttal of OPC Analysis- Breakers and Transformers</u>

Q. Did Mr. Robertson challenge R. W. Beck's valuation of the breakers and transformers?

A. Yes.

Q. What was the difference between Mr. Robertson's and R. W. Beck's valuation of the breakers and transformers?

A. The difference was $3,300 on R. W. Beck's valuation of **_________**.

Q. What was the reason for this difference?

A. At the completion of manufacturing the HICO transformers they are tested by HICO. As a result of storage in Korea, Burns & McDonnell had the transformers retested prior to shipment. In both cases Burns & McDonnell paid a local engineer to observe and inspect the testing of the transformers. The local engineer's inspection fee for the first inspection was $3,305. R. W. Beck included one of the two inspection fees of $3,300 in their cost analysis. This cost was included in the documents attached to Data Request OPC-0014.

Mr. Robertson did not allow either inspection fee in their cost analysis. This is the $3,300 difference.

Q. Do you agree that this cost should be excluded?

A. No. It was a prudent and reasonable cost to ensure the transformers had been manufactured properly. The engineer in Korea received $3,305 for 10 days work including three round trip air fares and 7 nights lodging, meals and per diems. The cost to inspect in the U.S. would have been much greater and would have resulted in the loss of time and potentially additional shipping costs if a problem were found after delivery to the U.S.

Q. What do you conclude?

A. The $3,300 inspection fee is a proper and prudent cost and should be included in the original cost valuation just as R. W. Beck has done.

Summary

Q. Please summarize your testimony.

A. My testimony can be summarized as follows:

- R. W. Beck is an independent professional appraiser qualified to evaluate this type of equipment. Their recommendation regarding market value should be followed.
- Staff's recommendation that Aquila Networks-MPS should have accepted an offer made in August 2002, should be rejected because it does not provide for the storage, warranty or carrying costs that were incurred. The offer was made under undue stimulus. Using that offer as the valuation is contrary to the definitions of fair market value.

NP

- OPC's recommendation that Aquila Networks-MPS value the equipment at the 2003 GTW budgeting guidance price should be rejected because it totally omits providing **<u>any</u>** fair market value for the breakers, transformers, training, transportation, technical field assistance and dry low NOx combustors.

Q. Does this conclude your direct testimony?

A. Yes.

AQUILA, INC.
AQUILA NETWORKS-MPS-INVESTOR (ELECTRIC)
CASE NO. EO-2005-0156
OFFICE OF PUBLIC COUNSEL
DATA REQUEST NO. OPC-1036

DATE OF REQUEST: April 28, 2005

DATE RECEIVED: April 28, 2005

DATE DUE: May 18, 2005

REQUESTOR: Ted Robertson

QUESTION:

Has Aquila (MEP, AE, other affiliate, etc.) booked any depreciation expense related to its ownership of the generators and related equipment before or since taking possession of the investment? If yes, please provide a reconciliation showing the amount of depreciation expense taken, which company booked the expense by amount, when it was booked by amount and in what USOA accounts it was booked by amount. If no, please explain the rationale for not booking any depreciation expense and provided copies of the accounting literature or documentation that supports that rationale.

RESPONSE:

No. No accounting depreciation has been booked on this equipment. Accounting depreciation generally begins when property is placed in service. For property not yet in service accounting depreciation is not recorded.

Assets are subject to adjustment to reflect market or realizable values. The valuation prepared by RW Beck resulted in such a valuation adjustment.

The rationale for not booking depreciation expense is in the description of Account 403 of the USOA "This account shall include the amount of depreciation expense for all classes of depreciable electric plant in service..." This equipment is not yet in service.

There are many other supporting references including the definition of depreciation in the USOA "12. Depreciation, as applied to depreciable electric plant, means the loss in service value ... in connection with the consumption or prospective retirement of electric plant in the course of service...." This definition again refers to "in the course of service". This equipment is not yet in service.

ARB43, Ch. 9C, par. 5 states that depreciation accounting is "a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not valuation." As this equipment is not yet in service, it has not begun its "useful life".

Another reference can be found in “Public Utility Depreciation Practices” published by NARUC, in particular, the section in Chapter IV subtitled “The Basic Accounting Concept” References in that section refer to “useful life” and “match(ing) expenses with revenues”. Useful life is similar to the term “service life” defined in the USOA. “35. Service life means the time between the date electric plant is includible in electric plant in service, or electric plant leased to others, and the date of its retirement.” This equipment is not yet in service.

With regard to the matching principle, depreciation expense is assigned to accounting periods in a manner that matches expenses with revenues. This matching principle is further described in “Public Utility Depreciation Practices” published by NARUC. Chapter II, cites the definition of depreciation accounting used by the American Institute of Certified Public Accountants as defined in Accounting Research and Terminology Bulletin #1. Then goes on to state “This definition of depreciation accounting brings the “allocation of cost” concept into much clearer focus. It de-emphasizes the concept of depreciation expense as a “loss in service value” or an “allowance” and emphasizes the concept of depreciation expense as the cost of an asset which is allocable to a particular accounting period.”

Another reference can be found in “Public Utility Depreciation Practices” published by NARUC. The section in Chapter IV subtitled “The Basic Accounting Concept” states, “It should be emphasized that the primary objective of depreciation accounting is the allocation of cost to expense rather than valuation of the asset.”

ATTACHMENT:

ANSWERED BY:

Davis Rooney

____

SIGNATURE OF RESPONDENT

DATE: ________________________

AFFIDAVIT

H. Davis Rooney, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of H. Davis Rooney;" that said testimony and schedules attached hereto were prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the test of his knowledge, information and belief.

H. Davis Rooney

H. Davis Rooney

State of Missouri

County of Jackson

SUBSCRIBED and sworn to before me this 27th day of June 2005.

Terry D. Lutes

Notary Public

Terry D. Lutes

My Commission Expires: 8-20-2008

Notary Public Notary Seal State of Missouri

TERRY D. LUTES
Jackson County
My Commission Expires
August 20, 2008