FILED

DEC 2 8 2004

Missouri Public Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of the tariff filing of The Empire District Electric Company to implement a General rate increase for retail electric service Provided to customers in its Missouri service area	)))))	Case No. ER-2004-0570

County of Jackson)
) ss
State of Missouri)

AFFIDAVIT OF H. DAVIS ROONEY

H. Davis Rooney, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of H. Davis Rooney;" that said testimony was prepared by him and 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 best of his knowledge, information, and belief.

H. Davis Rooney

Subscribed and sworn to before me this 4th day of November, 2004.

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

Exhibit No. 108
Case No(s). ER-2004-0570
Date 12-06-04 Rptr KF

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
REBUTTAL TESTIMONY OF H. DAVIS ROONEY
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO. ER-2004-0570

Q. Please state your name and business address.

A. My name is Davis Rooney. My business address is 10700 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. 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. The purpose of my testimony is to discuss the improper accounting methodology for net salvage as proposed by Staff. Specifically the exclusion of net salvage costs from accumulated depreciation reserve account 108.

Q. What is Staff's proposed accounting methodology for net salvage costs?

A. Staff proposes that net salvage costs should be charged directly to expense, reflected in the cost of service calculation and not reflected in rate base.

Q. Why is Staff's proposed accounting methodology for net salvage costs improper?

A. Staff's proposed accounting methodology for net salvage costs does not follow the Code of Federal Regulations (CFR) nor does it follow the Missouri Code of State Regulations (MoCSR). Furthermore, Staff's proposal can have a detrimental impact on the ratepayer as well as the Company. Before discussing this issue in detail the definition of key depreciation and accounting terms will be provided below as an aid to the understanding of this process. The Missouri Code of State Regulations at 4CSR 240-20.030 directs electrical corporations to use the uniform system of accounts (UsoC) prescribed by the Federal Energy Regulatory Commission (FERC). The following definitions were taken from the UsoC at Title 18 of the Code of Federal Regulations Part 101.

Net Salvage Value – "Net salvage value means the salvage value of property retired less the cost of removal."

Salvage Value - "Salvage value means the amount received for property retired, less any expenses incurred in connection with the sale or in preparing the property for sale; or, if retained, the amount at which the material recoverable is chargeable to material and supplies, or other appropriate account."

Property Retired - "Property retired, as applied to electric plant, means property which has been removed, sold, abandoned, destroyed, or which for any cause has been withdrawn from service."

Cost of Removal - "Cost of removal means the cost of demolishing, dismantling, tearing down or otherwise removing electric plant, including the cost of transportation and handling incidental thereto."

Depreciation - "Depreciation, as applied to depreciable electric plant, means the loss in service value not restored by current maintenance, incurred in connection

with the consumption or prospective retirement of electric plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities."

Service Value - "Service value means the difference between original cost and net salvage value of electric plant."

Original Cost - "Original cost, as applied to electric plant, means the cost of such property to the person first devoting it to public service."

Service Life - "Service life means the time between the date electric plant is includable in electric plant in service, or electric plant leased to others, and the date of its retirement. If depreciation is accounted for on a production basis rather than on a time basis, then service life should be measured in terms of the appropriate unit of production."

Q. Does the Code of Federal Regulations provide instructions on accounting for the retirement of electric plant and related net salvage charges?

A. Yes, Title 18 of the Code of Federal Regulations Electric Plant Instruction 10 F states the following "The book cost less net salvage of depreciable electric plant retired shall be charged in its entirety to account 108. Accumulated Provision for Depreciation of Electric Plant In Service."

Q. Are there other citations in Title 18 of the Code of Federal Regulations that refer to the accounting procedure for net salvage?

A. Yes, Title 18 of the Code of Federal Regulations Balance Sheet Account 108 paragraph B states the following "At the time of retirement of depreciable electric utility plant, this account shall be charged with the book cost of the property retired and the cost of removal and shall be credited with the salvage value and any other amounts recovered, such as insurance."

Q. Are the Missouri Code of Regulations the same as the Federal Code of

Regulations?

A. Yes. Missouri Code of Regulations section 4CSR 240-20.030 Uniform System of Accounts – Electrical Corporations states "PURPOSE: This rule directs electrical corporations within the commission's jurisdiction to use the uniform system of accounts prescribed by the Federal Energy Regulatory Commission for major electric utilities and licensees, as modified here, to file annual reports, and to submit a revised depreciation study, data base and property unit catalog at least every five years."

Q. Does the Missouri Code of Regulations provide additional guidance on how to account for net salvage?

A. Yes, In Missouri Code of Regulations section 4CSR 240-20.030 section 2(H) the Following instruction is given: "Charge original cost less net salvage to account 108, when implementing the provisions of Part 101 Electric Plant Instructions 10.F and paragraph 15,060.10F:"

Q. Would you please provide a brief overview and explanation of how the above definitions and regulations fit together?

A. Both FERC and Missouri regulations require accounting for net salvage to be charged to accumulated depreciation reserve account 108. Net salvage consists of cost of removal (costs to retire plant) and gross salvage (proceeds from the sale of plant or material recoverable). Depreciation reflects the loss of service value. Service value includes not only the original cost of the asset but net salvage as well; therefore, depreciation expense charged to the income statement should be offset by a charge to accumulated depreciation account 108.

Q. Does Staff's proposed accounting treatment of net salvage costs comply with FERC and Missouri Code of State Regulations?

A. No, as mentioned above net salvage is required by both FERC and Missouri regulations to be recorded in accumulated depreciation reserve account 108.

Q. Can Staff's accounting methodology have a detrimental impact on ratepayers and the Company?

A. Yes, Staff's methodology will not allow for the recovery of excess or deficient net salvage costs, because net salvage is not allowed to be recorded in accumulated depreciation reserve account 108. There is no mechanism which will adjust rate base to account for the excess or deficiency. If the allowed amount of net salvage costs exceed actual net salvage costs the ratepayer will be overcharged. If the allowed amount of net salvage costs are less than actual net salvage costs then the Company will under recover its cost.

Q. Is there an alternative to the Staff's accounting methodology for net salvage?

A. Yes, the annual allowed amount of net salvage can be charged to depreciation expense with an offset to accumulated depreciation reserve account 108. Depreciation expense would be separated into two components: a life component, and a net salvage component. Actual net salvage would also be charged to the accumulated depreciation reserve account 108.

Q. What are the benefits of using this method to account for net salvage?

A. There are several benefits in using this methodology to account for net salvage:

1) Recording net salvage in accumulated depreciation reserve account 108 meets accounting requirements listed in the FERC and Missouri Code of Regulations.

2) Cost of removal, gross salvage and net salvage ratios can be developed by utility account as required by FERC and Missouri Code of Regulations.

3) Determination of excess or deficient collection of net salvage is simplified plus protection is afforded to both the ratepayer and the Company.

4) Only the annual allowed amount of net salvage will be charged to expense.

Q. How are the ratepayer and Company protected?

A. This can best be illustrated by example. In Schedule HDR001 three examples are provided. In all examples the net salvage allowance and actual net salvage is recorded in depreciation reserve account 108.

Example One - actual and allowed net salvage costs are the same. As such the ratepayer was fairly charged for net salvage costs and the Company earned a return on and of their investment.

Example Two - actual net salvage costs were $25,000 less than allowed net salvage costs. However, the ratepayer is protected in that rate base has been reduced by $25,000 and thus the revenue requirement has been reduced by $25,000.

Example Three - actual net salvage costs were $25,000 more than allowed net salvage costs. The Company is protected in that rate base has increased by $25,000 and thus the revenue requirement has been increased by $25,000.

As the examples demonstrate recording the net salvage allowance and actual net salvage in accumulated depreciation reserve account 108 provides a mechanism to account for excess or deficient net salvage costs, protecting both the ratepayer and the Company.

Q. Are there additional safeguards to protect both the ratepayer and Company?

A. Yes, Missouri Code of Regulations section 4CSR240-20.030 paragraphs (5)(B)2 and (5)(B)(3) require a depreciation study be filed when the utility files its tariff(s) with the Commission proposing a general rate increase or at a minimum every five years. This requirement provides for the opportunity to review net salvage allowances at regular intervals and make adjustments as necessary.

Q. What safeguards are in place to ensure that only the allowed net salvage amount is charged to expense?

A. Specifically identifying the net salvage allowance in accumulated depreciation reserve account 108 and thus separating net salvage depreciation expense from life depreciation expense provides a mechanism to monitor the reserve. Also, as mentioned above, Missouri Code of Regulations require a depreciation study be filed when requesting a general rate increase or at a minimum every five years.

Q. Has this accounting methodology been approved by the Commission previously?

A. Yes, in Aquila, Inc. Cases No. ER-2004-0034, HR-2004-0024 and GR-2004-0072. The stipulation and agreement states "Aquila shall book for its MPS electric and L&P electric and steam, actual levels of annual net cost of removal as an expense up to the amounts listed above. For any actual amount of annual net cost of removal that differs from these amounts, Aquila will record the difference in its accumulated depreciation reserve." The stipulation and agreement is identical for the gas utilities.

Also, in Missouri Gas Energy Case No. GR-2004-0209 similar accounting treatment was ordered in that excess amounts above the net cost of removal

allowance were to be charged to a regulatory asset and/or liability account. The stipulation and agreement states "MGE shall book for its gas operations, actual levels of annual cost of removal as expense up to the amount listed above. Company is authorized to record the difference between the rate case provision of $771,039 and the actual levels of annual net cost of removal as a regulatory asset and/or liability. This regulatory asset and/or liability is intended to track the difference between the provision for net cost of removal provision included in rates in this case and the Company's actual levels of annual net cost of removal after the effective date of rates established in this case. This regulatory asset and/or liability will be included in rate base in the Company's next rate case and amortized over a (5) year period. The Company is authorized to make such additional entries as are appropriate under FAS71 for this item."

Q. Have others supported this alternative methodology in accounting for net salvage costs?

A. Yes, Office of the Public Counsel witness Mr. Michael J. Majoros Jr. proposes a similar alternative. Mr. Majoros states in his direct testimony on page 48 lines 10 through 12 "As an alternative, I am recommending an unbundled specific identifiable net salvage allowance that can be included as a component of depreciation expense and recorded in accumulated depreciation."

Q. Would you please summarize your recommendations?

A. My recommendation is that Empire's depreciation proposal be adopted. Net salvage amounts should be included as a component of the depreciation accrual rate, charged to depreciation expense with an offsetting entry to accumulated

depreciation reserve account 108. Actual net salvage amounts (cost of removal and gross salvage) should also be charged to accumulated depreciation reserve account 108.

An alternative recommendation would separate depreciation expense into two components. One component would represent depreciation expense related to asset life. The second component would represent depreciation expense related to the net salvage allowance. The offsetting entry would be to accumulated depreciation reserve account 108. Depreciation expense charged to accumulated depreciation reserve account 108 would be separated into a life component and a net salvage allowance component. Also, actual net salvage (cost of removal and gross salvage) would be charged to the accumulated depreciation reserve account 108.

Q. Does this conclude your testimony?

A. Yes it does.

IMPACT OF NET SALVAGE ALLOWANCE ON RATE BASE UNDER DIFFERENT SCENARIOS
NET SALVAGE ALLOWANCE AND ACTUAL NET SALVAGE IS RECORDED IN ACCUMULATED DEPRECIATION RESERVE ACCOUNT 108

SCHEDULE HDR-001

Example 1: Cost of Removal Allowance Is Equal To Actual Net Salvage

	Plant In Service			Accumulated Depreciation Reserve									Net Book Value
					Depreciation			Actual					
Year	Beginning Balance	Retirement	Ending Balance	Beginning Balance	Life	Net Salvage Allowance	Total	Cost Of Removal	Gross Salvage	Net Salvage	Retirements	Ending Balance	
1	$ 100,000	$ -	$ 100,000	$ -	$ (20,000)	$ (10,000)	$ (30,000)	$ -	$ -	$ -	$ -	$ (30,000)	$ 70,000
2	$ 100,000	$ -	$ 100,000	$ (30,000)	$ (20,000)	$ (10,000)	$ (30,000)	$ -	$ -	$ -	$ -	$ (60,000)	$ 40,000
3	$ 100,000	$ -	$ 100,000	$ (60,000)	$ (20,000)	$ (10,000)	$ (30,000)	$ -	$ -	$ -	$ -	$ (90,000)	$ 10,000
4	$ 100,000	$ -	$ 100,000	$ (90,000)	$ (20,000)	$ (10,000)	$ (30,000)	$ -	$ -	$ -	$ -	$ (120,000)	$ (20,000)
5	$ 100,000	$ (100,000)	$ -	$ (120,000)	$ (20,000)	$ (10,000)	$ (30,000)	$ 75,000	$ (25,000)	$ 50,000	$ 100,000	$ -	$ -

Assumptions:
1) Asset has a five year life. The annual depreciation rate is 20% [1/5=20%]. Annual Depreciation is $ 20,000 per year [$100,000 * 20% = $20,000].
2) Annual net salvage allowance is $10,000.
3) Plant is retired at the end of year five.
4) Actual removal cost is $ 75,000. Actual gross salvage is $(25,000). Actual net salvage is $ 50,000

Results:
In this example the estimated life of the asset matched the actual life of the asset. The net salvage allowance recovered of $ 50,000 matched actual net salvage costs of $ 50,000 at time of retirement.
The ratepayer and the Company are both whole.

Example 2: Cost of Removal Allowance Is Greater Than Actual Net Salvage

	Plant In Service			Accumulated Depreciation Reserve									Net Book Value
					Depreciation			Actual					
Year	Beginning Balance	Retirement	Ending Balance	Beginning Balance	Life	Net Salvage Allowance	Total	Cost Of Removal	Gross Salvage	Net Salvage	Retirements	Ending Balance	
1	$ 100,000	$ -	$ 100,000	$ -	$ (20,000)	$ (15,000)	$ (35,000)	$ -	$ -	$ -	$ -	$ (35,000)	$ 65,000
2	$ 100,000	$ -	$ 100,000	$ (35,000)	$ (20,000)	$ (15,000)	$ (35,000)	$ -	$ -	$ -	$ -	$ (70,000)	$ 30,000
3	$ 100,000	$ -	$ 100,000	$ (70,000)	$ (20,000)	$ (15,000)	$ (35,000)	$ -	$ -	$ -	$ -	$ (105,000)	$ (5,000)
4	$ 100,000	$ -	$ 100,000	$ (105,000)	$ (20,000)	$ (15,000)	$ (35,000)	$ -	$ -	$ -	$ -	$ (140,000)	$ (40,000)
5	$ 100,000	$ (100,000)	$ -	$ (140,000)	$ (20,000)	$ (15,000)	$ (35,000)	$ 75,000	$ (25,000)	$ 50,000	$ 100,000	$ (25,000)	$ (25,000)

Assumptions:
1) Asset has a five year life. The annual depreciation rate is 20% [1/5=20%]. Annual Depreciation is $ 20,000 per year [$100,000 * 20% = $20,000].
2) Annual net salvage allowance is $15,000.
3) Plant is retired at the end of year five.
4) Actual removal cost is $ 75,000. Actual gross salvage is $(25,000). Actual net salvage is $ 50,000

Results:
In this example the estimated life of the asset matched the actual life of the asset. The net salvage allowance recovered of $ 75,000 exceeded actual net salvage costs of $ 50,000 at time of retirement.
The $ 25,000 excess net salvage allowance results in a negative asset net book value of ($25,000). The negative net book value reduces the Company's rate base, thus protecting the ratepayer.

Example 3: Cost of Removal Allowance Is Less Than Actual Net Salvage

	Plant In Service			Accumulated Depreciation Reserve									Net Book Value
					Depreciation			Actual					
Year	Beginning Balance	Retirement	Ending Balance	Beginning Balance	Life	Net Salvage Allowance	Total	Cost Of Removal	Gross Salvage	Net Salvage	Retirements	Ending Balance	
1	$ 100,000	$ -	$ 100,000	$ -	$ (20,000)	$ (5,000)	$ (25,000)	$ -	$ -	$ -	$ -	$ (25,000)	$ 75,000
2	$ 100,000	$ -	$ 100,000	$ (25,000)	$ (20,000)	$ (5,000)	$ (25,000)	$ -	$ -	$ -	$ -	$ (50,000)	$ 50,000
3	$ 100,000	$ -	$ 100,000	$ (50,000)	$ (20,000)	$ (5,000)	$ (25,000)	$ -	$ -	$ -	$ -	$ (75,000)	$ 25,000
4	$ 100,000	$ -	$ 100,000	$ (75,000)	$ (20,000)	$ (5,000)	$ (25,000)	$ -	$ -	$ -	$ -	$ (100,000)	$ -
5	$ 100,000	$ (100,000)	$ -	$ (100,000)	$ (20,000)	$ (5,000)	$ (25,000)	$ 75,000	$ (25,000)	$ 50,000	$ 100,000	$ 25,000	$ 25,000

Assumptions:
1) Asset has a five year life. The annual depreciation rate is 20% [1/5=20%]. Annual Depreciation is $ 20,000 per year [$100,000 * 20% = $20,000].
2) Annual net salvage allowance is $5,000.
3) Plant is retired at the end of year five.
4) Actual removal cost is $ 75,000. Actual gross salvage is $(25,000). Actual net salvage is $ 50,000

Results:
In this example the estimated life of the asset matched the actual life of the asset. The net salvage allowance recovered of $ 25,000 is less than actual net salvage costs of $ 50,000 at time of retirement.
The ($25,000) deficient net salvage allowance results in a positive asset net book value of $ 25,000. The positive net book value increases the Company's rate base, thus protecting the Company.