

Exhibit No.:
Issues: FAS 106 Funding Deficiency;
Deferred Income Tax Debits
Witness: Steve M. Traxler
Sponsoring Party: MoPSC Staff
Type of Exhibit: Surrebuttal Testimony
Case No.: HR-2005-0450
Date Testimony Prepared: December 13, 2005

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

STEVE M. TRAXLER

FILED²

FEB 24 2006

Missouri Public
Service Commission

AQUILA, INC.

d/b/a AQUILA NETWORKS-L&P (Steam)

CASE NO. HR-2005-0450

Exhibit No. 1035
Case No(s) HR-2005-0450
Date 1-06-06 Rptr XX

Jefferson City, Missouri
December 2005

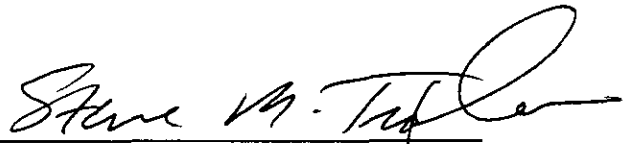
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Tariff Filing of Aquila, Inc.,)	
to Implement a General Rate Increase for)	Case No. HR-2005-0450
Retail SteamHeat Service Provided to Customers)	Tariff No. YH-2005-1066
in Its L&P Missouri Service Area.)	

AFFIDAVIT OF STEVE M. TRAXLER

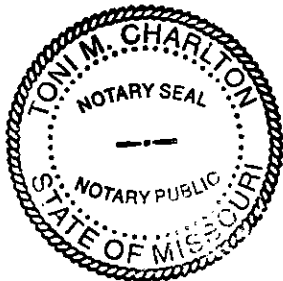
STATE OF MISSOURI)	
)	ss.
COUNTY OF COLE)	

Steve M. Traxler, being of lawful age, on his oath states: that he has participated in the preparation of the following Surrebuttal Testimony in question and answer form, consisting of 2 pages to be presented in the above case; that the answers in the following Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



Steve M. Traxler

Subscribed and sworn to before me this 12th day of December 2005.





Notary

TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

TABLE OF CONTENTS
SURREBUTTAL TESTIMONY
OF
STEVE M. TRAXLER
AQUILA, INC.
d/b/a AQUILA NETWORKS-L&P (Steam)
CASE NO. HR-2005-0450

FAS 106 FUNDING DEFICIENCY	1
EFFRON REBUTTAL – FAS 106 FUNDING DEFICIENCY	3
EFFRON REBUTTAL - ELIMINATION OF SPECIFIC DEFERRED TAX DEBITS FROM RATE BASE.....	5

SURREBUTTAL TESTIMONY

OF

STEVE M. TRAXLER

AQUILA, INC.

d/b/a AQUILA NETWORKS-L&P (Steam)

CASE NO. HR-2005-0450

Q. Please state your name and business address.

A. Steve M. Traxler, Fletcher Daniels State Office Building, Room G 8, 615 East 13th Street, Kansas City, Missouri 64106.

Q. Have you prefiled direct testimony in this proceeding?

A. Yes, I have.

Q. What is the purpose of your surrebuttal testimony?

A. Because the Staff now has information from Aquila that allows it to do so, I quantify an adjustment to Aquila's FAS 106 funding deficiency for loss of investment earnings that I identified in my prefiled direct testimony. Aquila agrees with this adjustment. I also respond to rebuttal testimony of AARP witness David J. Effron related to Aquila's FAS 106 funding deficiency and the elimination of specific deferred income tax debits from rate base.

FAS 106 FUNDING DEFICIENCY

Q. Have you addressed Aquila's existing funding deficiency related to Aquila's FAS 106 obligation before in this case?

Surrebuttal Testimony of
Steve M. Traxler

1 A. Yes. On pages 8 – 10 of my prefiled direct testimony I address the funding
2 deficiency that resulted from Aquila's failure to comply with the funding requirement under
3 Section 386.315 RSMo.

4 Q. Has the Staff made any adjustments based on Aquila's funding deficiency?

5 A. Yes. On pages 12 and 13 of my prefiled direct testimony I explain the
6 adjustments made to the FAS 106 cost calculation, for the L&P division, to eliminate the
7 funding deficiency's detrimental impact on the 2005 FAS 106 calculation of postemployment
8 benefits other than pensions (OPEB costs).

9 Q. How did the Staff calculate its adjustments, included in the Staff's direct
10 filing, to eliminate the detrimental impact of the funding deficiency on Aquila's 2005
11 FAS 106 calculation?

12 A. One of the components of the FAS 106 calculation is the expected rate of
13 return assumption. The expected rate of return represents the estimated earnings on investing
14 the funded assets. The investment earnings are used to offset the current year estimate for the
15 OPEB benefits earned in the current year by employees. The higher the investment earnings
16 the lower the net FAS 106 cost will be. In its direct filing, the Staff computed the expected
17 rate of return assuming that the funding deficiency did not exist, using the same investment
18 return used by Aquila's actuary – 7%. The 7% rate of return was applied to the accumulated
19 funding deficiency and used to reduce the 2005 FAS 106 calculation.

20 Q. Is that adjustment sufficient to eliminate the detrimental impact of the funding
21 deficiency?

Surrebuttal Testimony of
Steve M. Traxler

1 A. No. An additional adjustment is required to reflect the loss of earnings on the
2 funding deficiency. If Aquila had made the required annual contributions to the VEBA trust,
3 additional funds would have accumulated due to additional investment earnings.

4 Q. Did the Staff include this loss of investment earnings adjustment in its direct
5 filing?

6 A. No. The Staff did not have sufficient information when that filing was made
7 to quantify the adjustment. I noted in my prefiled direct testimony that the Staff had issued
8 Staff Data Request No. 430 to obtain that information, but that that data request had not been
9 answered prior to the Staff's direct filing.

10 Q. Would you please explain the Staff's calculation of the loss of investment
11 earnings adjustment?

12 A. Aquila's response to Staff's Data Request No. 430 provided the actual
13 investment returns earned from investing the assets in Aquila's VEBA trust. The Staff used
14 this data to calculate the loss of earnings on the funding deficiency, which would have
15 accrued in the fund, had Aquila timely made all required fund contributions. Adjustment
16 S-35.18 has been updated to reflect this change for the L&P division. Aquila has agreed to
17 this updated adjustment.

18 **EFFRON REBUTTAL – FAS 106 FUNDING DEFICIENCY**

19 Q. On page 4 of his rebuttal testimony, Mr. Effron states that the "Staff has not
20 recognized the time value of money to Aquila from its failure to fund its OPEB obligation, as
21 required by Missouri law." Do you agree with this assertion?

Surrebuttal Testimony of
Steve M. Traxler

1 A. No, I do not. The "time value of money" concept has been addressed by the
2 additional adjustments explained above. The Staff has restated the expected rate of return
3 assumption in Aquila's 2005 FAS 106 calculation to reflect, both:

4 1) the assumption that the funding deficiency had not occurred and was
5 available for investment with the expected earnings used to reduce the 2005 FAS 106
6 cost; and

7 2) the assumption to also include the additional earnings that would have
8 accrued on the funding deficiency in prior years, had these amounts been funded on
9 an annual basis and been available for investment.

10 Q. Does Mr. Effron's proposed adjustments to address the "time value of money"
11 have anything to do with restating Aquila's 2005 FAS 106 cost for the purpose of eliminating
12 the detrimental impact resulting from Aquila's failure to fund its FAS 106 obligation as
13 required under Section 386.315 RSMo?

14 A. No. Mr. Effron is proposing to flow back \$402,000 to L&P ratepayers over a
15 three-year period. This amount represent the value to Aquila for having had the use of the
16 funding deficiency amounts, as a result of collecting these amounts in rates, but not making
17 annual contributions of these monies to fund its FAS 106 obligation. Mr. Effron has used the
18 Staff's midpoint rate of return, grossed up for income taxes, to compute the value to Aquila
19 of having had the use of the funding deficiency monies through December 31, 2005.
20 Mr. Effron's proposed adjustment is not necessary to restate Aquila's 2005 FAS 106 cost for
21 the purpose of eliminating the detrimental impact resulting from the funding deficiency.

22 Q. How would you characterize Mr. Effron's "time value of money" adjustment?

Surrebuttal Testimony of
Steve M. Traxler

1 A. Mr. Effron's proposed time value of money adjustment can be fairly
2 characterized as a penalty to Aquila for having failed to comply with the funding requirement
3 of Section 386.315 RSMo. Since Mr. Effron's time value of money adjustments are not
4 necessary to restate Aquila's 2005 FAS 106 cost, in order to eliminate the impact of the
5 funding deficiency, they represent a penalty to Aquila for not having made the required
6 annual contributions to fund its FAS 106 obligation.

7 Q. How should any penalty to Aquila, for its failure to comply with Section
8 386.315 RSMo be addressed?

9 A. The Office of the Public Counsel (OPC) has filed a complaint, Case No.
10 EC-2006-0171, against Aquila for its failure to comply with Section 386.315 RSMo. It is the
11 Staff's view that any penalties, resulting from the violation of the funding requirement under
12 Section 386.315 RSMo, must be addressed in Case No. EC-2006-0171.

13 **EFFRON REBUTTAL - ELIMINATION OF SPECIFIC DEFERRED TAX DEBITS**
14 **FROM RATE BASE**

15 Q. What additional section of the rebuttal testimony of AARP witness David
16 Effron do you wish to respond to?

17 A. On pages 5-8 of his rebuttal testimony, AARP witness David Effron proposes
18 to eliminate specific Deferred Income Tax Debit balances from Rate Base. I will express the
19 Staff's agreement on elimination of some of the specific deferred tax balances addressed by
20 Mr. Effron, and disagreement on others.

21 Q. On pages 5 and 6 of his rebuttal testimony, Mr. Effron asserts that the deferred
22 tax debit balance related to Aquila's FAS 106 OPEB liability should be eliminated from Rate

Surrebuttal Testimony of
Steve M. Traxler

1 Base because it results from Aquila's failure to fund its FAS 106 obligation. What is the
2 Staff's view on this recommendation?

3 A. The Staff agrees with Mr. Effron's argument that the deferred tax debit,
4 related to FAS 106 OPEB costs, should be excluded from Rate Base because it resulted from
5 Aquila's failure to fund its FAS 106 costs collected in rates. If Aquila had made annual
6 contributions to its VEBA trust equal to its annual FAS 106 cost, a deferred tax debit would
7 not exist.

8 Q. On pages 7 and 8 of his rebuttal testimony, Mr. Effron identifies specific
9 deferred tax debits, in Account 190, that in his view should be removed from Rate Base.
10 Does the Staff agree with these recommendations?

11 A. Mr. Effron identifies the specific deferred tax debit balances he is addressing
12 on his rebuttal schedule DJE-2. As previously stated, the Staff agrees with Mr. Effron's
13 recommendation on the Other Post Retirement Benefits shown as the first balance on
14 Effron's rebuttal schedule DJE-2.

15 The Staff agrees with Mr. Effron's recommendation related to Aquila's Supplemental
16 Retirement Plan because the cost of this plan has not been included in cost of service by the
17 Staff in prior cases. Any tax timing difference and resulting deferred tax balance should also
18 be ignored for ratemaking purposes.

19 Q. What is the Staff's position regarding the deferred tax debit for Allocated
20 Costs listed on Mr. Effron's rebuttal schedule DJE-2?

21 A. Allocated Costs include pension and OPEB costs allocated from Aquila's
22 corporate headquarter departments to the L&P division. As previously explained, any
23 deferred tax debit related to FAS 106 OPEB costs should be excluded from Rate Base.

Surrebuttal Testimony of
Steve M. Traxler

1 The timing difference for pension cost results from using an accrual accounting
2 method, FAS 87, for financial reporting and the ERISA contribution in determining taxable
3 income for IRS purposes. The prior rates for the L&P division were set based upon the
4 ERISA minimum contribution. The rates established in this case, Case No. ER-2005-0436,
5 will also be based upon the ERISA minimum contribution for pension cost. Since the ERISA
6 contribution is also used for IRS purposes, the timing difference related to pension cost has
7 been eliminated for ratemaking purposes. If the deferred tax debit balance for pension cost
8 occurred since the ERISA contribution has been used for setting rates, it is appropriate to
9 exclude the deferred tax balance for pension cost from Rate Base. . Staff has requested that
10 Aquila identify the amount of pension cost and OPEB cost which is included in Account 190
11 – Allocated Costs.

12 Q. Does this conclude your surrebuttal testimony?

13 A. Yes it does.