

Exhibit No.:
Issues: December 2006 True-up
Witness: Steve M. Traxler
Sponsoring Party: MoPSC Staff
Type of Exhibit: Supplemental Direct
Testimony
Case No.: ER-2007-0004
Date Testimony Prepared: February 27, 2007

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SUPPLEMENTAL DIRECT TESTIMONY

OF

STEVE M. TRAXLER

**AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS-ELECTRIC
AND D/B/A AQUILA NETWORKS-L&P-ELECTRIC**

CASE NO. ER-2007-0004

*Jefferson City, Missouri
February, 2007*

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

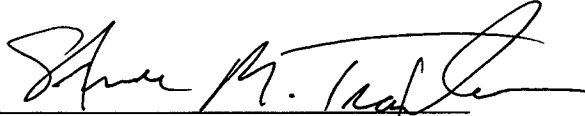
In the matter of Aquila, Inc. d/b/a Aquila Networks-MPS)
and Aquila Networks-L&P, for authority to file tariffs)
increasing electric rates for the service provided to)
customers in the Aquila Networks-MPS and Aquila)
Networks-L&P service area.)

Case No. ER-2007-0004

AFFIDAVIT OF STEVE M. TRAXLER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

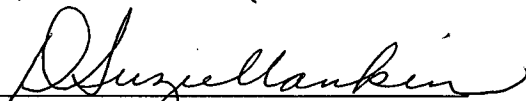
Steve M. Traxler, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Supplemental Direct Testimony in question and answer form, consisting of 6 pages to be presented in the above case; that the answers in the foregoing Supplemental Direct Testimony were given 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 26th day of February, 2007.





Notary Public

**TABLE OF CONTENTS OF
SUPPLEMENTAL DIRECT TESTIMONY
OF
STEVE M. TRAXLER**

1
2
3
4
5
6
7
8
9
10

EXECUTIVE SUMMARY 1

RESULTS OF THE UPDATE AUDIT 2

ACCUMULATED DEFFERED TAXES – MPS COMBUSTION TURBINES 4 & 5..... 4

AFFILIATE LOADINGS ADJUSTMENT..... 5

IRC SECTION 199 DEDUCTION FOR PRODUCTION ACTIVITIES 5

1 **SUPPLEMENTAL DIRECT TESTIMONY**

2 **OF**

3 **STEVE M. TRAXLER**

4 **AQUILA, INC.**

5 **D/B/A AQUILA NETWORKS-MPS-ELECTRIC**
6 **AND D/B/A AQUILA NETWORKS-L&P-ELECTRIC**

7 **CASE NO. ER-2007-0004**
8

9 Q. Please state your name and business address.

10 A. Steve M. Traxler, Fletcher Daniels State Office Building, Room G 8,
11 615 East 13th Street, Kansas City, Missouri 64106.

12 Q. Are you the same Steve M. Traxler who has previously filed direct testimony
13 in this proceeding for the Staff?

14 A. Yes, I am.

15 Q. What is the purpose of your supplemental direct testimony?

16 A. The purpose of this testimony is to report the results of the Staff's update audit
17 of Aquila's cost of service for its Aquila Networks-MPS (MPS) and Aquila Networks-L&P
18 (L&P) divisions in this proceeding, address acceptance of two adjustments made by Aquila
19 in its direct filing and address the calculation of the accumulated deferred tax reserve related
20 to Staff's rate base recognition of MPS combustion turbines 4 & 5. The direct and surrebuttal
21 testimony of Staff witnesses Cary G. Featherstone and Chuck R. Hyneman address the
22 Staff's recommended rate base recognition for MPS combustion turbine units 4 & 5.

23 **EXECUTIVE SUMMARY**

24 Q. Please briefly summarize your supplemental direct testimony.

1 A. The procedural schedule ordered for this case provides for a test year ending
2 December 31, 2005, updated for known and measurable changes through December 31,
3 2006. The Staff has completed an update audit of Aquila's electric operations for its MPS
4 and L&P divisions through December 31, 2006. In this supplemental direct testimony
5 I discuss: (i) the results of the Staff's update audit (ii) acceptance by Staff of two adjustments
6 proposed by Aquila in its direct filing and (iii) Staff's calculation of the accumulated deferred
7 tax reserve related to MPS turbine units 4 & 5.

8 **RESULTS OF THE UPDATE AUDIT**

9 Q. Please describe the update audit of Aquila's MPS & L&P electric operations
10 performed by the Staff in this proceeding.

11 A. Per the procedural schedule ordered for this proceeding, Aquila's test year
12 2005 is to be updated for known and measurable events through December 31, 2006. A direct
13 filing date was established at January 18, 2007 for all parties except Aquila. Staff's direct
14 filing was based upon the 2005 test year updated for known and measurable changes through
15 September 30, 2006. The procedural schedule established February 27, 2007 for the
16 supplemental direct filing for all parties but Aquila to present the results of updating Aquila's
17 cost of service for its MPS & L&P electric operations through December 31, 2006. The
18 revenue requirement areas updated by the Staff are the following:

19 Rate Base: Plant in Service completed as of December 31, 2006, Depreciation
20 Reserve, Accumulated Deferred Tax Reserve, Fuel Inventories, Emission
21 Allowances, Cash Working Capital, Materials and Supplies, Prepayments,
22 Regulatory Assets and Liabilities, Customer Contributions in Aid of
23 Construction, Customer Deposits, and Accounting Authority Orders.

1 Income Statement: Revenue adjustments for Customer Growth, Large Customer
2 changes, Off-System Sales, Weather Normalization and Rate Change ordered
3 in Case No. ER-2005-0436. Expense adjustments for Off-System Sales Fuel
4 & Purchase Power cost, Bad Debts, Payroll (Employee Levels and Wage
5 Rates), Employee Benefits, Pension Cost (FAS 87), Supplemental Executive
6 Retirement Plan (SERP) costs, Other Post Retirement Benefit Costs (FAS
7 106), Amortization of Regulatory Assets & Liabilities, Payroll Taxes, Fuel
8 and Purchased Power Expense (Fuel and Purchased Power Prices, System
9 Loads), SO2 Emission Allowances Expense, Rate Case Expense, Depreciation
10 Expense, Maintenance Expense, Correction of 2005 Affiliate Loadings,
11 Deferred Income Tax and Current Income Tax deductions for Straight-Line
12 Tax Depreciation and IRC Section 199 Domestic Production Activity.

13 Rate of Return: Rate of Return Calculation (excluding Return on Equity), Capital
14 Structure and Weighted Cost of Debt.

15 Q. How did the Staff conduct its update audit?

16 A. The Staff updated its analysis in the areas listed above using the same
17 methods and approaches it used in its cost of service calculation supporting its direct filing in
18 this case. Any method and/or assumption changes from Staff's direct filing are addressed in
19 Staff's supplemental direct and/or rebuttal testimony.

20 Q. What capital structure is the Staff using for Aquila as of December 31, 2006?

21 A. The Staff is using a hypothetical capital structure which consists of 48.17%
22 common equity and 51.83% long-term debt.

23 Q. What is the Staff's updated rate of return recommendation in this case?

1 A. After updating the long-term debt rate and capital structure percentages, the
2 Staff's rate of return recommendation at true-up is 8.09% for MPS and 8.63% for L&P,
3 reflecting a mid-range return on equity of 9.00%.

4 Q. What is the overall result of the Staff's update audit?

5 A. The Staff's recommended revenue requirement for the MPS and L&P
6 divisions is \$31,982,341 and \$16,266,662 respectively.

7 **ACCUMULATED DEFERRED TAXES – MPS COMBUSTION TURBINES 4 & 5**

8 Q. Has the Staff reflected additional investment in generating facilities in lieu of
9 recognizing two purchased power capacity contracts scheduled for the summer of 2007?

10 A. Yes. Staff witnesses Cary G. Featherstone and Chuck R. Hyneman present in
11 their direct and surrebuttal testimony the Staff's use of the costs Aquila prudently incurred
12 in acquiring and building its South Harper generating facility as the basis for the costs of
13 five 105 MW combustions turbines and site the Staff has imputed to Aquila as the MPS
14 combustion turbine units 1-5.. The Staff has used the MPS combustion turbine units 1-5 in
15 lieu of Aquila's South Harper generating facility and two purchased power capacity
16 contracts scheduled for the summer of 2007.

17 Q. Did Staff make the same recommendation in Aquila's previous rate case,
18 ER-2005-0436?

19 A. Yes. This issue was addressed in the direct and surrebuttal testimony of
20 Robert E. Schallenberg and Cary G. Featherstone in that case.

21 Q. What adjustment are you sponsoring related to the MPS combustion
22 turbines 4 and 5?

1 A. It is Staff's position that Aquila should have had those combustion turbines in
2 service by July 2005. They would have generated additional deferred income tax expense
3 from the difference between the IRS accelerated depreciation expense deduction and the
4 straight-line tax depreciation deduction used in setting rates for a regulated utility. Based
5 upon data supplied in response to Staff Data Request 360, I have calculated the additional
6 deferred income tax to be approximately \$3.2 million between July 2005 and December 31,
7 2006. Staff is recommending that this amount be reflected in rate base for the MPS
8 division.

9 **AFFILIATE LOADINGS ADJUSTMENT**

10 Q. Please explain the affiliate loadings adjustment sponsored by Aquila witness
11 Ronald A. Klote in his direct testimony in this case.

12 A. Prior to 2005, Aquila's accounting system generated monthly journal entries
13 for allocating overhead costs to its non-regulated business units. This automatic system
14 journal entry was turned off in 2005 as a result of Aquila's exit from and/or reduction in its
15 non-regulated operations. The allocation of corporate overhead cost to the remaining non-
16 regulated operations for 2005 was addressed by Mr. Klote's proposed adjustment CS-7
17 which used a three year average of the allocated overhead costs to non-regulated operations
18 for the years 200, 2003 and 2004. The Staff considers this adjustment to be reasonable and
19 has reflected it in its updated cost of service calculations for the MPS and L&P divisions.

20 **IRC SECTION 199 DEDUCTION FOR PRODUCTION ACTIVITIES**

21 Q. Did the American Jobs Creation Act of 2004 create an additional tax
22 deduction for regulated utilities?

1 A. Yes. The American Jobs Creation Act became law on October 22, 2004.
2 A current year tax deduction is allowed for a regulated utility related to income from
3 qualified production activities. In his direct testimony, Aquila witness Jeffrey J. Stamm
4 refers to this deduction as the IRC (Internal Revenue Code) Section 199 Deduction and
5 identifies the amount calculated for the MPS division on a stand alone basis.

6 Q. Does the Staff agree that this tax deduction should be reflected in calculating
7 current income tax for the MPS division?

8 A. Yes. The Staff has accepted Mr. Stamm's calculation of the IRC Section 199
9 Deduction and reflected it in its update of the MPS cost of service calculation through
10 December 31, 2006. An IRC Section 199 Deduction was also reflected by the Staff and
11 Kansas City Power & Light Company in Case No. ER 2006-0314.

12 Q. Does this conclude your supplemental direct testimony?

13 A. Yes, it does.