Exhibit No.	
Issues:	*Income Tax-Straight Line Tax; Depreciation; Post-Retirement Benefit Costs*
Witness:	*Steve M. Traxler*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Direct Testimony*
Case No.:	*ER-2005-0436*
Date Testimony Prepared:	*October 14, 2005*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

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-2005-0436

Jefferson City, Missouri
October 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 Retail Electric Service Provided to Customers in Its MPS and L&P Missouri Service Areas.	))))	Case No. ER-2005-0436 Tariff No. YE-2005-1045

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 Direct Testimony in question and answer form, consisting of 14 pages to be presented in the above case; that the answers in the following 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 13th day of October 2005.

Notary

TONI M. CHARLTON
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI

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

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CASE NO. ER-2005-0436

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. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor for the Missouri Public Service Commission (Commission).

Q. Please describe your educational background.

A. I graduated from Missouri Valley College at Marshall, Missouri, in 1974 with a Bachelor of Science degree in Business Administration with a major in Accounting.

Q. Please describe your employment history.

A. I was employed as an accountant with Rival Manufacturing Company in Kansas City from June 1974 to May 1977. I was employed as a Regulatory Auditor with the Missouri Public Service Commission from June 1977 to January 1983. I was employed by United Telephone Company as a Regulatory Accountant from February 1983 to May 1986. In June 1986, I began my employment with Dittmer, Brosch & Associates (DBA) in Lee's Summit, Missouri, as a regulatory consultant. I left DBA in April 1988. I was self-employed from May 1988 to December 1989. I came back to the Commission in December 1989. My current position is a Regulatory Auditor V with the Commission's Auditing Department.

Q. What is the nature of your current duties at the Commission?

A. I am responsible for assisting in the audits and examinations of the books and records of utility companies operating within the state of Missouri.

Q. Have you previously testified before this Commission?

A. Yes, I have. A list of cases in which I have filed testimony is shown on Schedule 1 of this direct testimony.

Q. Have you filed testimony in rate proceedings involving a regulated utility company in any jurisdictions besides Missouri?

A. Yes, I have also filed testimony in Kansas, Minnesota, Arizona, Indiana, Iowa and Mississippi.

Q. To which of the Aquila, Inc. (Aquila) operations are you directing your testimony?

A. This testimony addresses the electric operations of Aquila in Missouri.

Q. What are your principal areas of responsibility in Case No. ER-2005-0436?

A. As one of the Regulatory Auditor V's assigned to this case, I have oversight responsibility regarding areas assigned to other auditors on this case, an Application to increase rates filed by the Aquila Networks-MPS (MPS) and Aquila Networks–L&P (L&P), divisions of Aquila, Inc. (Aquila). In addition, my direct testimony will address the specific areas listed below:

(1) Income Tax-Straight Line Tax Depreciation

(2) Historical Ratemaking Treatment – OPEB Costs

(3) FAS 106 Funding Deficiency – MPS & L&P Divisions

(4) FAS 106 Curtailment – L&P Division

(5) Annualized FAS 106 Costs

Q. What knowledge, skill, experience, training or education do you have with regard to the areas you have been assigned?

A. I have approximately 27 years of experience in utility regulation. My experience includes 22 years with the Missouri Commission, four years with United Telephone Company of Kansas and three years as a regulatory consultant with the former Dittmer Brosch and Associates. I have provided expert testimony on regulatory matters in six other state jurisdictions. For most of my career, I have had responsibility for supervising other auditors on major rate cases. With specific regard to my areas in this case, I have presented expert testimony on these issues in prior cases and have had responsibility for providing training on these areas for the Auditing department.

EXECUTIVE SUMMARY

Q. Please provide a brief summary of your testimony.

A. My testimony addresses three primary areas:

1) Calculation of the tax deduction for book depreciation expense – straight - line tax depreciation.

2) Recommendation for addressing Aquila's admitted failure to fund its FAS 106 obligation as required under Section 386.315, RSMo. and

3) Appropriate level of FAS 106 expense to be included in cost of service in this case.

Straight line tax depreciation is the tax deduction for annualized book depreciation included in cost of service for ratemaking purposes. As part of the settlement of income tax issues in Case No. ER 2004-0034, Aquila committed to a comprehensive tax study in order to calculate a more accurate straight line tax depreciation result. The tax study has not been completed at this time. The method used in this case, Case No. ER-2005-0436, to calculate the straight-line tax depreciation deduction is consistent with the method used by the Staff in prior cases for both the MPS and L&P divisions.

In response to Staff Data Request No. 263, Aquila admitted that a decision was made in 2003 to discontinue funding for its Missouri FAS 106 obligation. Aquila's explanation to the Staff is that this decision was made based upon an incorrect internal communication. Section 386.315, RSMo, requires funding for FAS 106 post-retirement benefit costs collected in rates. Aquila has committed verbally to correcting the $7 million funding deficiency by year-end 2005.

Aquila's booked FAS 106 cost for the test year 2004 was adjusted to reflect the 2005 level and remove the impact of the funding deficiency explained above.

INCOME TAX EXPENSE STRAIGHT LINE TAX DEPRECIATION

Q. Please explain the relationship between book depreciation and straight-line tax depreciation.

A. Annualized book depreciation is a result of multiplying the plant investment at June 30, 2005, the Staff's update period, by the book depreciation rates being recommended by Staff witness Gregory E. Macias of the Engineering and Management Services Department.

Straight-line tax depreciation is a result of multiplying annualized book depreciation expense by the ratio of the Tax Basis of Depreciable Plant to the Book Basis of Depreciable Plant. From a regulatory perspective, the only material difference between book depreciation included in cost of service and the tax deduction for book depreciation (straight-line tax depreciation) is the tax/book basis differences which were flowed through in rates prior to the passage of the Tax Reform Act of 1986. The ratio used in this case to calculate straight-line tax depreciation, 96.04% for MPS and 98.31% for L&P, estimates that ratepayers have already received a tax deduction, in prior years, for 3.89% and 1.69% respectively, of the book basis of depreciable plant.

Q. Please explain how ratepayers received the benefit of a tax deduction in prior years equal to 3.89% and 1.69% of the book basis of depreciable plant at June 30, 2005.

A. Prior to the Tax Reform Act of 1986, property taxes, interest, pensions and payroll taxes were capitalized as overheads for financial reporting (book) purposes, but deducted for tax purposes in the current year. The Staff used flow–through tax accounting for these tax-timing differences prior to the 1986 Tax Reform Act.

Flow–through accounting means that the tax deduction of these capitalized overhead costs was reflected in the current year for both federal income tax and ratemaking purposes. The Tax Reform Act of 1986 eliminated this tax timing difference by capitalizing these overhead costs for both book and tax reporting. The Tax basis/Book basis ratio used by the Staff to calculate straight-line tax depreciation properly excludes the annualized book depreciation related to the basis difference flowed through in rates prior to 1986.

Q. In your last answer, you indicated that the Staff's method used for calculating straight-line tax depreciation deduction estimates the book basis of depreciable property that was already taken as a tax deduction in rates (flowed-through) prior to the 1986 Tax Reform Act. Why must an estimate be used in this case to determine the prior flow-through tax deduction?

A. Additional information is required from Aquila in order to calculate a more accurate straight-line tax depreciation deduction for its MPS and L&P electric divisions. The difference between the Book Basis and Tax Basis of depreciable property includes other basis differences which result from IRS tax treatment. which differs from booked accounting treatment. However, a detailed historical study of prior tax treatment and amounts is required in order to address all of the differences that account for the difference in the Book Basis and Tax Basis of depreciable plant. In addition, there are other tax timing differences related to cost of removal, as one example, which must also be studied regarding prior ratemaking treatment.

Q. Was such a study of prior ratemaking treatment agreed to as part of the settlement of this issue in Aquila's last electric case, Case No. ER-2004-0034?

A. Yes. Appendix E attached to the Stipulation and Agreement in Case No. ER-2004-0034 explains the tax study agreed by the parties in that case. Appendix E is attached as Schedule SMT-2 to this direct testimony. Paragraph 2 of Appendix E summarizes the purpose of the study as follows:

> Aquila agrees to undertake a study to develop the level of detail needed to assess the best methodology to determine the regulated income tax expense of its MPS operations for Missouri ratemaking purposes. A specific outcome of the study is to create a mutually agreeable basis for the determination of the future adjustments to the amount of regulated

> book depreciation expense included in a cost of service study that should be used as a tax deduction for ratemaking purposes.

Q. What is the current status of Aquila's tax study?

A. The study has not been completed as of this date. Due to the complexity of the study and data required, it was not expected that Aquila would have completed the study at this date.

Q Please summarize your testimony on this issue.

A. The Staff's method, in this case, for calculating the straight-line tax depreciation deduction, is consistent with the method filed by the Staff for the MPS and L&P divisions since 1997 and 1993, respectively. The tax basis used in the calculation includes all vintage property which is still accruing a book depreciation amount includable for rate recovery.

A more precise calculation is anticipated pending the completion and review of the comprehensive tax study, committed to by Aquila for its MPS division, in the Stipulation and Agreement in Aquila's last rate case, Case No. ER-2004-0034. The Staff's recommended method for calculating the straight-line tax depreciation deduction is based upon the best available data at this time.

HISTORICAL RATEMAKING TREATMENT – OPEB COSTS

Q. Please explain Financial Accounting Standard (FAS) 106.

A. FAS 106 is the Financial Accounting Standards Board (FASB) approved accrual accounting method used for financial statement recognition of annual Other Post-Retirement Employee Benefit (OPEB)costs over the service life of employees.

Q. When was the accrual accounting method for OPEB costs, FAS 106, adopted for ratemaking purposes?

A. House Bill 1405 (Section 386.315, RSMo), approved by the Missouri Legislature on August 28, 1994, required the adoption of FAS 106 for setting rates for OPEB costs. In Commission cases following the date that House Bill 1405 became law, the Staff began recommending the use of FAS 106 for determining ratemaking recovery for OPEB costs.

Q. What method was used for setting rates for OPEB costs prior to the effective date of Section 386.315, RSMo?

A. Prior to the effective date of Section 386,315, RSMo, rates were set on a "pay as you go" or "cash" basis for OPEB costs. The utility's actual paid claims for OPEB cost, for current retirees, were included for recovery for ratemaking purposes.

Q. When was FAS 106 adopted for ratemaking purposes for Aquila's L&P and MPS divisions?

A. FAS 106 was adopted for the former St. Joseph Light & Power Co. (SJLP) Company in Case No. ER-94-163. The effective date for the Commission's Order was June 15, 1994.

Aquila and the Staff recommended FAS 106 for Aquila's MPS division in Case No. ER-97-394. The effective date for the Commission's Order for Case No. ER-97-394 was March 6, 1998.

FAS 106 FUNDING DEFICIENCY FOR AQUILA'S MPS AND L&P DIVISIONS

Q. Does Section 386.315, RSMo, include a funding requirement as a prerequisite for the adoption of FAS 106 for ratemaking purposes?

A. Yes. A copy of Section 386.315, RSMo, is attached as Schedule SMT-3. The recognition of FAS 106 for ratemaking purposes is conditioned on a requirement that annual FAS 106 costs collected in rates be funded in a separate funding mechanism to be used solely for the payment of OPEB benefit costs to retirees. Paragraph 2 of Section 386.315 addresses the funding requirement:

> 2. A public utility which uses Financial Accounting Standard 106 shall be required to use an independent external funding mechanism that restricts disbursements only for qualified retiree benefits. In no event shall any funds remaining in such funding mechanism revert to the utility after all qualified benefits have been paid; rather, the funding mechanism shall include terms which require all funds to be used for employee or retiree benefits. This section shall not in any manner be construed to limit the authority of the commission to set rates for any service rendered or to be rendered that are just and reasonable pursuant to sections 392.240, 393.140 and 393.150, RSMo.

Q. Is Aquila currently in compliance with the funding requirement under Section 386.315, RSMo.?

A. No. In Staff Data Request No. 263, the Staff requested Aquila's annual FAS 106 expense and amounts funded for the last five years for the MPS and L&P divisions. A copy of the response to Staff Data Request No. 263 is attached as Schedule SMT-4 to this direct testimony. In its response, Aquila identified a funding policy change beginning in 2003 stated as follows:

> 2) Prior to 2003 VEBA funding was equal to the annual expense. Starting in 2003, the contributions would be equal to the claims paid less amounts returned from the VEBA trust. There is not a regulatory requirement that Missouri funding be equal to the annual expense.

This statement is an admission by Aquila that it decided, in 2003, to discontinue funding the accrued FAS 106 costs collected in rates. The statement above, indicates that beginning in 2003, Aquila limited its funding for its FAS 106 obligation to the amount necessary to pay its current benefits to existing "retirees." FAS 106 is an accrual accounting method which measures the future cost of benefits for current "employees" after retirement. The total expected OPEB obligation for an existing employee is allocated to expense over the remaining service life of the employee. Since FAS 106 costs represents a recovery in rates today for a future obligation, the intent of the statute was to protect these monies by requiring that they be deposited in a separate fund and available when OPEP benefits require a cash outlay to current employees after they retire.

This decision is a violation of the funding requirement under Section 386.315, RSMo, because Aquila was not funding the accrued FAS 106 costs being recovered in rates.

Q. After receipt of Aquila's response to Staff Data Request No. 263, did you schedule a meeting for the purpose of discussing the funding deficiency issue?

A. Yes. Aquila's current Director of Employee Benefits and HRIS, Philip Beyer, indicated that he was not employed by Aquila in 1998 when FAS 106 became a funding requirement for MPS as a result of the Missouri Commission's order in Case No. ER-97-394. He was also unaware that FAS 106 was adopted for the former SJLP prior to Aquila's acquisition in 2001. Mr. Beyer indicated that he sought guidance from Aquila's regulatory department and was informed verbally that Missouri did not have a funding requirement for FAS 106 costs. Mr. Beyer's decision in 2003 to discontinue funding for FAS 106, for Aquila's Missouri MPS and L&P divisions, was based upon an incorrect internal communication.

Q. How did you calculate the FAS 106 funding deficiency for the MPS and L&P divisions?

A. For the MPS division, I compared MPS's annual FAS 106 cost and Aquila's cash deposits into the external VEBA trusts since the effective date of rates in Case No. ER-

97-394, March 6, 1998. The funding deficiency of ($2,982,099) represents the accumulated difference between MPS's annual FAS 106 costs and Aquila's actual funded amounts since March of 1998.

For the L&P division, I compared L&P's annual FAS 106 cost and Aquila's cash deposits into the external VEBA trusts since Aquila's acquisition of the L&P property in 2001. The funding deficiency of ($4,035,431) represents the accumulated difference between L&P's annual FAS 106 costs and Aquila's actual funded amounts since January of 2001.

Q. Have the Staff and Aquila reached an agreement in principle regarding a solution which will cure the funding deficiency for the MPS and L&P divisions?

A. Yes. Aquila has offered to make an immediate contribution of $4.8 million and an additional contribution by the end of 2005 to address the remaining funding deficiency.

This time frame for curing the funding deficiency is acceptable to the Staff.

<u>FAS 106 CURTAILMENT – L&P DIVISION</u>

Q. What is a curtailment under FAS 106?

A. A curtailment occurs under FAS 106 when it becomes necessary to recognize a material portion of the future OPEB obligation sooner than expected. FAS 106 estimates an employees future OPEB benefits, payable during retirement, and allocates the total expected benefit obligation ratably, as an accrued expense, over the expected working service life of the employee.

Assuming the average expected service life is 15 years, each employee's expected benefits, to be paid during their retirement, is accrued to expense in the financial statements during the 15-year period. At the employee's retirement date, the FAS 106 Accumulated Benefit Obligation will reflect the total expected benefits payable during retirement.

A FAS 106 curtailment will occur in the previous example when a significant number of employees retire sooner than "expected" resulting in the need to recognize the amount of their total expected FAS 106 benefits which have not been accrued / recognized as of the date of their retirement. For example assume that an early retirement program results in a significant number of employees retiring with 10 years of service as opposed to the 15-year "assumption" used in estimating annual FAS 106 costs to date. The FAS 106 cost, which was expected to be recognized / accrued in years 11-15, must now be recognized immediately under FAS 106.

Q. Did the L&P division experience a FAS 106 curtailment in 2001 as a result of Aquila's decision to offer an early retirement program at the time of L&P acquisition in 2001?

A. Yes. A FAS 106 curtailment cost was recognized in the financial statements in 2001 for $1,447,631.

Q. Why is the L&P curtailment, recognized in 2001, relevant to this case, Case No. ER-2005-0436?

A. The Staff's testimony in the UtiliCorp United/St. Joseph Light & Power (UCU/SJLP) merger case, Case No. EM-2000-0292, included a recommendation for the recovery of transition costs required to consummate the merger. The FAS 106 curtailment in 2001 for the L&P division is included in this case as a transition cost subject to recovery in rates. Staff witness Charles R. Hynemen is sponsoring an adjustment in this case for an amortization of transition costs related to the UCU/SJLP merger.

Q. Is there an additional FAS 106 funding requirement as a result of amortizing the 2001 curtailment cost as a transition cost in this case?

A. Yes. Section 386.315, RSMo, requires that all costs collected in rates for OPEB costs, calculated under FAS 106, be funded in an external funding mechanism. During verbal discussions with Aquila they have indicated agreement with the Staff's position that the annual recovery of the 2001 L&P FAS 106 curtailment will require funding of this amount in their existing VEBA trusts.

ANNUALIZED FAS 106 COSTS

Q. Please explain Staff adjustments S-85.12 and S-84.11.

A. Adjustments S-85.12 and S-84.11 adjust the MPS and L&P 2004 test year costs for FAS 106 to reflect the more current costs for 2005.

Q. Are additional adjustments required to eliminate the FAS 106 funding deficiency impact on the 2005 FAS 106 costs for the MPS and L&P divisions?

A. Yes. One of the components, used in a FAS 106 calculation, is the expected rate of return to be earned on funded assets. The expected annual earnings on the funded assets offsets the current year service, transition obligation amortization and interest costs included in the FAS 106 calculation. The funding deficiency previously discussed for the MPS and L&P divisions results in higher 2005 FAS 106 cost, as a result of the lower earnings expectation, due to the funding deficiency.

In order to avoid recognizing excessive FAS 106 costs in this case, the expected rate of return assumption was recalculated assuming that the funding deficiency did not exist. This adjustment may require further refinement based upon the response to outstanding Staff Data Request No. 430.

Q. Please explain Staff adjustments S-85.13 and S-84.12.

A. Staff adjustments S-85.13 and S-84.12 reduce the 2005 MPS and L&P FAS 106 costs to eliminate the impact of the funding deficiency previously discussed.

Q. Does this conclude your direct testimony?

A. Yes, it does.

Steve M. Traxler

SUMMARY OF RATE CASE INVOLVEMENT

Year	Case No.	Utility	Type of Testimony	
1978	Case No. ER-78-29	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1979	Case No. ER-79-60	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1979		Elimination of Fuel Adjustment Clause Audits (all electric utilities)		
1980	Case No. ER-80-118	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1980	Case No. ER-80-53	St. Joseph Light & Power Company (electric)	Direct	Stipulated
1980	Case No. OR-80-54	St. Joseph Light & Power Company (transit)	Direct	Stipulated
1980	Case No. HR-80-55	St. Joseph & Power Company (industrial steam)	Direct	Stipulated
1980	Case No. TR-80-235	United Telephone Company of Missouri (telephone)	Direct Rebuttal	Contested
1981	Case No. TR-81-208	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal Surrebuttal	Contested
1981	Case No. TR-81-302	United Telephone Company of Missouri (telephone)	Direct Rebuttal	Stipulated
1982	Case No. ER-82-66	Kansas City Power & Light Company	Rebuttal	Contested
1982	Case No. TR-82-199	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal	Contested
1982	Case No. ER-82-39	Missouri Public Service	Direct Rebuttal Surrebuttal	Contested
1990	Case No. GR-90-50	Kansas Power & Light - Gas Service Division (natural gas)	Direct	Stipulated

Year	Case No.	Utility	Type of Testimony	
1990	Case No. ER-90-101	UtiliCorp United Inc., Missouri Public Service Division (electric)	Direct Surrebuttal	Contested
1991	Case No. EM-91-213	Kansas Power & Light - Gas Service Division (natural gas)	Rebuttal	Contested
1993	Case Nos. ER-93-37	UtiliCorp United Inc. Missouri Public Service Division (electric)	Direct Rebuttal Surrebuttal	Stipulated
1993	Case No. ER-93-41	St. Joseph Light & Power Co.	Direct Rebuttal	Contested
1993	Case Nos. TC-93-224 and TO-93-192	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal Surrebuttal	Contested
1993	Case No. TR-93-181	United Telephone Company of Missouri	Direct Surrebuttal	Contested
1993	Case No. GM-94-40	Western Resources, Inc. and Southern Union Company	Rebuttal	Stipulated
1994	Case Nos. ER-94-163 and HR-94-177	St. Joseph Light & Power Co.	Direct	Stipulated
1995	Case No. GR-95-160	United Cities Gas Co.	Direct	Contested
1995	Case No. ER-95-279	Empire Electric Co.	Direct	Stipulated
1996	Case No. GR-96-193	Laclede Gas Co.	Direct	Stipulated
1996	Case No. WR-96-263	St. Louis County Water	Direct Surrebuttal	Contested
1996	Case No. GR-96-285	Missouri Gas Energy	Direct Surrebuttal	Contested
1997	Case No. ER-97-394	UtiliCorp United Inc. Missouri Public Service (electric)	Direct Rebuttal Surrebuttal	Contested
1998	Case No. GR-98-374	Laclede Gas Company	Direct	Settled
1999	Case No. ER-99-247 Case No. EC-98-573	St. Joseph Light & Power Co.	Direct Rebuttal Serrebuttal	Settled
2000	Case No. EM-2000-292	UtiliCorp United Inc. and St. Joseph Light & Power Merger	Rebuttal	Contested

Year	Case No.	Utility	Type of Testimony	
2000	Case No. EM-2000-369	UtiliCorp United Inc. and Empire Electric Merger	Rebuttal	Contested
2000	Case No. EM-2000-369	UtiliCorp United Inc. and Empire Electric District Co.	Rebuttal	Contested
2001	Case No. TT-2001-328	Oregon Mutual Telephone Co.	Direct	Settled
2002	Case No. ER-2001-672	UtiliCorp United Inc.	Direct, Surrebuttal	Settled
2002	Case No. EC-2002-1	Union Electric Company d/b/a AmerenUE	Surrebuttal	Settled
2003	Case Nos. ER-2004-0034 and HR-2004-0024 (Consolidated)	Aquila, Inc., d/b/a Aquila Networks-MPS and Aquila Networks-L&P	Direct	Stipulated

Missouri Revised Statutes

Chapter 386
Public Service Commission
Section *386.315*

August 28, 2004

Commission shall not change terms of employment subject to collective bargaining or certain accounting standards--use of accounting standard by utility, requirements--tariff filing allowed, conditions--examination of tariffs, review period.

386.315. 1. In establishing public utility rates, the commission shall not reduce or otherwise change any wage rate, benefit, working condition, or other term or condition of employment that is the subject of a collective bargaining agreement between the public utility and a labor organization. Additionally, the commission shall not disallow or refuse to recognize the actual level of expenses the utility is required by Financial Accounting Standard 106 to record for postretirement employee benefits for all the utility's employees, including retirees, if the assumptions and estimates used by a public utility in determining the Financial Accounting Standard 106 expenses have been reviewed and approved by the commission, and such review and approval shall be based on sound actuarial principles.

2. A public utility which uses Financial Accounting Standard 106 shall be required to use an independent external funding mechanism that restricts disbursements only for qualified retiree benefits. In no event shall any funds remaining in such funding mechanism revert to the utility after all qualified benefits have been paid; rather, the funding mechanism shall include terms which require all funds to be used for employee or retiree benefits. This section shall not in any manner be construed to limit the authority of the commission to set rates for any service rendered or to be rendered that are just and reasonable pursuant to sections 392.240, 393.140 and 393.150, RSMo.

3. Any public utility which was the subject of a rate proceeding resulting in the issuance of a report and order subsequent to January 1, 1993, and prior to August 28, 1994, directing or permitting the establishment of new rates by such utility, may file one set of tariffs modifying its rates to reflect the revenue requirement associated with the utility's expenses for postretirement employee benefits other than pensions, as determined by Financial Accounting Standard 106, including the utility's transition benefit obligation, regardless of whether the deferral or immediate expense recognition method was used, if such utility is funding the full extent of its Financial Accounting Standard 106 obligation at the time such tariffs are filed. The tariffs shall reflect the annual level of expenses as determined in accordance with Financial Accounting Standard 106. The commission may suspend such tariffs for no longer than one hundred fifty days to examine the assumptions and estimates used and to review and approve the expenses required by Financial Accounting Standard 106, including an amortization of the transition benefit obligation over no greater amortization period than twenty years based upon sound actuarial principles, and to address any rate design issues associated with the utility's Financial Accounting Standard 106-based revenue requirement. The commission shall not examine any other revenue requirement issues.

(L. 1993 S.B. 289, A.L. 1994 H.B. 1405)

Schedule SMT-2

TAX STUDY

All Parties agree that Aquila first implemented Staff's method for calculating straight-line tax depreciation with the effective date of Case No. ER-97-394. MPS will continue for purposes of this Stipulation and Agreement to calculate straight-line tax depreciation in accordance with Staff's method.

Aquila agrees to undertake a study to develop the level of detail needed to assess the best methodology to determine the regulated income tax expense of its MPS operations for Missouri ratemaking purposes. A specific outcome of the study is to create a mutually agreeable basis for the determination of the future adjustment to the amount of regulated book depreciation expense included in a cost of service study that should be used as a tax deduction for ratemaking purposes.

Aquila proposes that the study be conducted in at least two stages. The study will use plant balances as of December 31, 2002 for study purposes. Progress on the first phase of the study will be reviewed with Staff no later than September 30, 2004. This date does not preclude the Company from reviewing with Staff its progress or seeking Staff's input on the study at earlier dates. The purpose of the preliminary study is to address several of the major items, provide a preliminary view of the results, assess the time and resources required, and allow both the Staff and the Company to identify additional items that may require assessment in the next stage. In the initial phase of the study, the Company will:

- Quantify the basis differences deducted by year.
- Quantify the allowance for funds used during construction ("AFUDC") equity capitalized for book by year.

- Determine the ratio of original book plant in service to current book plant in service by year.
- Identify book depreciation rates by year.
- Quantify remaining undepreciated tax basis.
- Quantify remaining undepreciated book basis.
- Calculate the "gross up" of accumulated deferred taxes by dividing by the appropriate tax rates.
- Calculate required vs. recorded accumulated deferred income taxes.
- Prepare, with input from Staff, a prioritized list of issues unresolved by the preliminary study.
- Prepare a timetable for delivery of the next stage.

The study will incorporate the following outline for Phase 1 in order to identify the items that will be addressed to arrive at study's desired outcome.

1) The difference between the book and tax basis of the property by year the property was first placed in service.

a) The individual items that make up that difference.

i) The individual items that are permanent differences between tax and book basis of property.

ii.) The individual items that are differences between tax and book basis of property that are recognized in different periods.

a.) The differences that result in the book basis being greater than the tax basis.

b.) The differences that result in the tax basis being greater than the book basis.

b) For the 1.(a)ii. items that have at one time had their tax consequences treated under the flow-through method for determining the amount of regulated income tax expense to be used to establish rates.

i.) The time period that each item was treated using flow-through method.

ii.) The amount for each item that was flow-through to consumers by relevant tax rate.

2) The difference in methods used to determine the amount of book depreciation expense versus the method used to determine the amount of straight-line tax depreciation used to calculate regulated income tax expense.

A) Book rate versus Guideline Line rate.

B) Open ended accounting versus close-end accounting.

C) Recording of Retirements

D) Other Differences

E) 2A. through 2D. for method differences that have at one time been used to calculate regulated depreciation expense differently than the straight-line tax depreciation amount used to determine the amount of regulated income tax expense for the establishment of rates.

i) The time period that each type method difference was used for book and straight-line tax purposes.

ii) The amount of the difference that was used to establish rates to consumers by relevant tax rate.

3) Identify sources of data relevant to Phase 1 of the study.

A) Property records system.

B) Income tax system.

C) Schedule M per Annual Tax returns.

D) Workpapers identified from any regulatory proceedings.

E) Straight-line tax schedules.

F) Other.

Staff and Company acknowledge that in a study of this type, limitations in the available records may exist. In the event such limitations exist, Staff and Company will work together to suggest reasonable and mutually acceptable solutions. The Staff method used to calculate the tax deduction for book depreciation in the calculation of regulated income tax expense in this case will continue to be used in future rate cases until this study is completed or another method is mutually agreed upon.

Staff agrees to join Aquila in letter requesting a private letter ruling from the IRS that the method that Aquila has been using for computing straight-line tax depreciation does not violate the normalization requirements of the IRS code – the language in the letter to the IRS must be approved by the Staff prior to the letter being submitted to the IRS.

AQUILA, INC.
AQUILA NETWORKS-MISSOURI (ELECTRIC)
CASE NO. ER-2005-0436
MISSOURI PUBLIC SERVICE COMMISSION
DATA REQUEST NO. MPSC-0263.1
REVISED

DATE OF REQUEST: August 18, 2005

DATE RECEIVED: August 18, 2005

DATE DUE: August 28, 2005

REQUESTOR: Steve Traxler

REQUEST:

DR 263.1 – FAS 106 Funding Refer to the response to DR 263. 1)Update the response to include FAS 106 expense levels and funding amounts, by year, for the MPS and L&P divisions, from 1994 – 2000. 2)Do the funding amounts provided in response to DR 263 represent actual benefit payments to retirees? If not explain the significant differences between annual FAS 106 expense amounts and the funding amounts provided. 3)The response to DR 263 indicates that "Prior to 2003 VEBA funding was equal to annual expense...." The 2002 FAS 106 direct cost for the L&P Division was $603,024. The direct contribution amount was a negative (75,130). Please explain how this result complies with the policy above. 4)Starting with 2003, Aquila changed its funding policy, "Starting in 2003, the contributions would be equal to the claims paid less amounts returned from the VEBA trust" Provide all rationale for the change in policy regarding the funding of FAS 106 costs. 5)Explain the reference to "less amounts returned from the VEBA trust" in the quote in question 4 above. 6)Confirm our understanding that DR 263 states that Aquila's funding policy for FAS 106, since 2003, is unrelated to annul expense recognition under FAS 106. If not explain. 7)Please explain Aquila's understanding of the funding requirements of Mo. Statute Chapter 386, Section 386.315. 8)Provide all contributions by business unit from 1994 – 2001 so that the Staff can fulfill its audit responsibility for the area.

RESPONSE:

1. See Attachment.
2. The original funding amount reported on DR 263 came from the disclosure statements, which represent the sponsor contributions plus participant contributions plus/minus the net of actual benefits paid for the participants less reimbursements received from the VEBA. No FAS 106 benefits are ever paid directly to a participant.
3. Due to the timing difference between benefits paid for the participants from Aquila general funds and the quarterly reimbursements of such from the VEBA trust (see #5), the net result as described in #2 can be either a positive or a negative. See #1 for sponsor contribution amounts unaffected by these timing differences.
4. The change in funding policy was due to our understanding per our regulatory department that there was no requirement to fund the FAS 106 expense.

Data Request MPSC-0263.1 Revised

FAS 106 Funding & Expense

Missouri Public Service

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Missouri Public Service Employer Funding	**466,100**	**410,411**	**450,915**	**1,000,000**	**743,557**	**706,000**	**822,374**	**1,070,000**	**938,000**	**-**	**-**	-
Missouri Public Service FAS 106 Expense	1,231,815	988,989	767,659	704,663	653,682	659,275	821,619	1,075,759	937,860	567,432	927,133	1,099,280
Allocated FAS 106 expense from UCU Corporate	16,067	5,592	18,072	38,626	40,340	61,332	61,976	53,969	25,214	51,359	(18,925)	13,291
Allocated FAS 106 expense from GSS					619	821	1018	1223	1134	399	601	1,446
Allocated FAS 106 expense from UED					0	0	0	0	0	(9,237)	33,844	166,293
Allocated FAS 106 expense from UPS					2197	0	0	0	0	0	934	22,355
Total MPS FAS 106 expense	**1,247,882**	**994,581**	**785,731**	**743,289**	**696,838**	**721,428**	**884,613**	**1,130,951**	**964,208**	**609,953**	**943,587**	**1,302,665**

St Joseph Light & Power

		2001	2002	2003	2004	2005
St Joseph Light & Power Employer Funding		**1,173,499**	**604,000**	**-**	**-**	**-**
St Joseph Light & Power FAS 106 Expense	*	1,528,518	603,024	591,243	1,187,995	1,632,836
2001 Curtailment Expense		1,447,631				
2003 Regulatory Adjustment for 1999 through 2003				160,805		
Total Direct SJLP FAS 106 Expense		**2,976,149**	**603,024**	**752,048**	**1,187,995**	**1,632,836**
Allocated FAS 106 cost from UCU Corporate		16,586	8,231	16,470	(6,597)	4,670
Allocated FAS 106 cost from GSS		156	115	52	76	184
Allocated FAS 106 cost from UED				(2,243)	9,350	52,412
Allocated FAS 106 cost from UPS					364	8,683
Total SJLP FAS 106 expense		**2,992,891**	**611,370**	**766,327**	**1,191,188**	**1,698,785**

Note GSS Allocation factor for 1998 is not available, it was etimated to be the same as 1999.

Note 2005 FAS 106 expense is a full year expense based on 2005 FAS 132 Disclosure from Hewitt. The first quarter was calculated before the plan amendment and the remaining 3 quarters include the plan amendment.

Schedule SMT-4-2