

Exhibit No:
Issues: Pensions
Accounting Orders
Witness: Joseph M. Bahr
Type of Exhibit: Rebuttal
Testimony
Sponsoring Party:
Case No: GR-2004-0072
Date Testimony Prepared: February 13, 2004

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-2004-0072

REBUTTAL TESTIMONY

OF

JOSEPH M. BAHR

ON BEHALF OF

**AQUILA, INC.
d/b/a
AQUILA NETWORKS – MPS
and
AQUILA NETWORKS – L&P**

Kansas City, Missouri

February, 2004

State of Missouri)
) ss
County of Jackson)

AFFIDAVIT OF JOSEPH M. BAHR

Joseph M. Bahr, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony and schedules entitled "Rebuttal Testimony of Joseph M. Bahr"; that said testimony was 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 best of his knowledge, information, and belief.

Joseph M. Bahr

Subscribed and sworn to before me this 12th day of February, 2004.

Alexa Nunnery
Notary Public

My Commission expires:

May 4, 2004



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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
REBUTTAL TESTIMONY OF JOSEPH M. BAHR
ON BEHALF OF
AQUILA, INC. d/b/a
AQUILA NETWORKS – MPS AND AQUILA NETWORKS – L&P**

1 **Q. Please state your name and business address.**

2 A. My name is Joseph M. Bahr and my business address is 10700 E 350 Hwy.
3 Kansas City, MO 64138.

4 **Q. Are you the same Joseph M. Bahr that has previously filed testimony in
5 this case before the Missouri Public Service Commission
6 (“Commission”)?**

7 A. Yes.

8 **Q. Please summarize your rebuttal.**

9 A. First, I will sponsor the Company’s response to the direct testimony of Staff with
10 respect to their proposed ratemaking treatment of pensions in this case and then
11 I will respond to the Office of the Public Counsel’s direct testimony with respect
12 to their proposed ratemaking treatment of Accounting Authority Orders.

13

14

PENSIONS

15 **Q. What is the purpose of this section of your rebuttal testimony?**

16 A. I will provide the Company’s response to the pension expense and prepaid
17 pension asset testimony of Staff. The Company intends in this case to
18 preserve the arguments and defense it has asserted in Case Nos. ER-2004-
19 0034 and HR-2004-2024 (Consolidated).

20 **Q. Is this testimony sponsored by you substantially the same as the
21 rebuttal testimony filed by Company Witness Davis Rooney in Case No.
22 ER-2004-0034?**

1 A. Yes. I have reviewed the testimony of Mr. Rooney, and we discussed his
2 testimony and research on these issues. The Company's position and
3 response to Staff is consistent for its electric, steam, and gas utilities. I have
4 also reviewed the testimony of Staff Witness Traxler in the referenced
5 consolidated electric and steam case. It is the Company's understanding that
6 the issues and proposed ratemaking treatment of pensions by Staff are
7 identical in the consolidated case to the gas case. It appears that Staff
8 Witness Traxler has filed identical direct testimony in both cases with respect
9 to Pensions. The use of different allocation factors causes the differences in
10 allocated dollars between the gas and consolidated cases.

11 **Q. What are the Company's primary issues with Staff's testimony?**

12 A. The following is a summary of the key issues:

- 13 • Staff proposes to disallow recovery of portions of the prepaid pension
14 balance. The regulatory treatment of these balances was resolved in prior
15 stipulated cases. The Commission should not disallow these amounts.
- 16 • The Employee Retirement Income Security Act of 1974 (ERISA)
17 authorizes a range of reasonable funding amounts. Staff proposes a
18 pension method that provides only the absolute minimum funding amount.
19 The Commission should allow for contributions within the range of
20 reasonable funding amounts allowed by ERISA, not limit that funding to
21 the absolute minimum.

- 1 • Staff does not propose to adjust the ERISA minimum calculation to
2 remove the benefits provided to the ratepayer by disallowed “voluntary”
3 contributions. The ERISA minimum used for rate making should exclude
4 the benefits of prior contributions in excess of the ERISA minimum, unless
5 those amounts in excess of the minimum have been expressly allowed in
6 rates.
- 7 • Staff’s proposed method is based on annual amounts that are even more
8 volatile than Staff’s current method under Financial Accounting Standard
9 87 (FAS 87).

10 **Prepaid Pension Asset**

11 **Q. Have you reviewed the testimony and the work papers supporting**
12 **Staff’s prepaid pension asset calculations referred to in Mr. Traxler’s**
13 **direct testimony (page 15, lines 1-4)?**

14 A. Yes, I have.

15 **Q. What did you find noteworthy in your review?**

16 A. Staff failed to clearly identify in either their direct testimony or the listed
17 accounting adjustments the disallowance of over \$16,600,000 (\$6,824,036 for
18 L&P and \$9,782,554 for MPS) of the prepaid pension asset on the
19 Company’s books at September 30, 2003.

20 **Q. Why was this significant?**

21 A. Both L&P and MPS resolved this issue in prior cases. For L&P, it was Case
22 No. ER-94-163, and for MPS, it was Case No. ER-93-41.

23 **Q. What is the prepaid pension balance?**

1 A. The prepaid pension balance represents a prepaid expense under FAS 87.
2 As a prepaid expense recorded on the balance sheet, it has not yet been
3 charged to expense in the income statement. The prepaid expense will be
4 charged to expense in the income statement under FAS 87 at some point in
5 the future. Both L&P and MPS have already adopted the principles of FAS 87
6 for ratemaking purposes. This means that the expense determined under
7 FAS 87, including any prepaid pension charged to expense, is currently used
8 for rate making and would be included in rates as long as Aquila continues to
9 follow FAS 87. When Mr. Traxler proposes to transition the Company from
10 FAS 87 to the contribution method, he should have included the prepaid
11 pension balance as of September 30, 2003 in rate base and in his calculation
12 of amortization of prepaid pension costs.

13 **Q. What is your understanding of Staff's position?**

14 A. The Staff's recommendation results in a disallowance of previously allowed
15 costs.

16 **Q. How would this occur?**

17 A. Staff's position is that the entire prepaid pension balance should not be
18 recoverable, but only that portion of the Aquila Networks-MPS ("MPS")
19 prepaid pension balance since March 18, 1998 and that portion of the Aquila
20 Networks-L&P ("L&P") balance since June 15, 1994, is eligible for recovery in
21 rates. As part of their proposed transition from FAS 87 to ERISA minimum
22 contribution, Staff proposes recovery of this reduced prepaid pension balance
23 by amortizing it to expense ("prepaid pension amortization").

1 **Q. Why do you believe the entire prepaid balance is recoverable?**

2 A. First, as described above, the prepaid pension balance will eventually be
3 recorded as an expense under FAS 87. Under FAS 87 for ratemaking, this
4 expense would be recoverable in cost of service. Second, prior stipulated
5 cases address this issue.

6 **Q. How will the prepaid pension balance be recovered in rates?**

7 A. One way to understand this is to look at what happens if the Company
8 remains on FAS 87 for ratemaking, as it is today, and contributes exactly the
9 ERISA minimum going forward. Staff states:

10 "FAS 87 provides the Generally Accepted Accounting Principles
11 (GAAP) method used for recognizing the annual pension cost liability
12 for financial reporting purposes. The ERISA regulations address the
13 funding of the same pension plan liability. " (Traxler Direct, Page 13,
14 Lines 6-8)
15

16 Staff points out that both ERISA and FAS 87 use accrual actuarial methods to
17 address the same ultimate liability -- the actual pension moneys paid out to
18 retirees after their retirement. Since both approaches are starting from the
19 same funded pension balance, both would eventually result in all assets being
20 paid out to retirees. Both methods would eventually reach zero when all
21 pension benefits are paid out. Staff points out that the difference between the
22 two methods is in the timing of the annual amounts (Traxler Direct, Page 13,
23 Lines 8-10). The prepaid pension balance is this timing difference.

24 **Q. What happens to this timing difference over time?**

1 A. In reaching zero under FAS 87 for ratemaking, the Company would record the
2 reductions in its prepaid pension balance as charges to expense. Under
3 current ratemaking under FAS 87, the Company would recover its prepaid
4 pension balance in rates.

5 **Q. What is the effect of Staff's proposal?**

6 A. In changing from FAS 87 to the ERISA minimum method, Staff is proposing a
7 transition adjustment that denies recovery of an amount the Company would
8 otherwise recover.

9 **Q. Is this the only analysis Aquila preformed to reach the conclusion that**
10 **Staff was recommending an inappropriate disallowance?**

11 A. No. The Company also researched each Company's ratemaking history
12 regarding pension costs.

13 **Q. Has this issue been addressed before?**

14 A. Yes. Based on the Company's review of the rate orders for MPS and L&P,
15 both MPS and L&P resolved this issue in prior cases. Each Company
16 resolved the issue in a different manner, because each had unique facts. The
17 Company found that this issue had been addressed in specific language in
18 stipulations approved by the Commission for both MPS and L&P.

19 **Q. What was the order that showed that L&P had addressed this issue**
20 **before?**

21 A. For L&P, it was the result of two cases. The first order was in Case No. ER-
22 93-41. This case ordered L&P onto ERISA minimum funding for ratemaking.

1 The second order was in Case No. ER-94-163. That case ordered L&P back
2 onto FAS 87. Contrary to the stated intent of the Commission in that case,
3 Case No. ER-93-41 actually created a difference between the ratemaking and
4 financial prepaid pension balance. This was corrected in Case No. ER-94-
5 163 when the parties stipulated to the elimination of the difference between
6 the ratemaking and financial prepaid pension balance.

7 **Q. What was the order that showed MPS was on FAS 87 for ratemaking**
8 **prior to March 18, 1998?**

9 A. For MPS, the order was in Case No. ER-93-37. The stipulation in that case
10 states in part, "Signatories agree that Company's accounts shall reflect
11 pension costs equal to contributions made to its established pension funds,
12 discontinuing its previous practice under FAS 87 effective June 29, 1993."
13 (Case No. ER-93-37, Stipulation and Agreement attached to Report and
14 Order filed as Exhibit 88, page 7, item 7.) This ratemaking order specifies the
15 day on which MPS was to discontinue FAS 87 and begin a contribution
16 approach. This stipulation preserves the financial reporting prepaid pension
17 balance as of June 29, 1993 as a regulated asset.

18

19 **L&P Prepaid Pension Asset**

20 **Q. What ratemaking treatment was ordered for pension expense in Case**
21 **No. ER-93-41?**

22 A. L&P was ordered on to the ERISA minimum contribution method in that case.

1 **Q. What did the Commission conclude in that case?**

2 A. The Commission Report and Order stated in part:

3 "The Commission, therefore, is of the opinion that the application of a
4 funding cash contribution should not result in a write off as advocated
5 by SJLPC. ...Pension costs are legitimate, historically approved costs
6 of providing service, and absent any evidence that they are excessive
7 or imprudently incurred, they may be recovered by SJLPC on a funding
8 cash contribution basis. The Commission believes it is probable that
9 these pension costs booked under SFAS 87 above the minimum
10 ERISA contribution, capitalized as a regulatory asset, will be recovered
11 in rates." (ER-93-41 Report and Order).

12 **Q. What is the significance of this Order?**

13 A. It was not the intent of the Commission to have the Company write off its
14 existing prepaid pension balance.

15 **Q. What happened as a result of the order in Case No. ER-93-41?**

16 A. L&P wrote off their FAS 87 Prepaid Pension balance to expense. They did
17 this by recording a regulatory liability for their prepaid pension balance. L&P
18 continued adjusting the regulatory liability to equal their prepaid pension
19 balance until their next rate case

20 **Q. How would you characterize this regulatory liability?**

21 A. This regulatory liability gave financial statement recognition to the difference
22 between the amount of prepaid pension asset on L&P's books and the
23 amount of prepaid pension asset being allowed for ratemaking. When the
24 prepaid pension balance is netted with the regulatory liability the resulting net
25 asset is zero. In short, L&P wrote off its prepaid pension balance for
26 ratemaking.

1 **Q. What happened in the second L&P case?**

2 A. In Case No. ER-94-163, L&P was ordered back onto FAS 87 and allowed to
3 reverse the existing regulatory liability. Since the regulatory liability
4 represented the difference between the amount of prepaid pension asset on
5 L&P's financial books and the prepaid pension asset allowed for ratemaking,
6 the Commission order established that the financial prepaid pension balance
7 was also the ratemaking prepaid pension balance. Additionally, by returning
8 to FAS 87 for ratemaking, the order provided a mechanism (FAS 87 expense)
9 for recovery of the prepaid pension balance.

10 **Q. What did the order say?**

11 A. That order in part reads:

12 "A. The rates in the sample tariff sheets in Appendix A reflect adoption
13 by SJLP of Financial Accounting Standards Board Statements
14 ("FAS") 87 and 106, and that SJLP is hereby authorized to adopt
15 FAS 87 and FAS 106 for ratemaking purposes.

16 **B. In setting rates in future SJLP electric rate cases, the**
17 **Commission shall not consider the following items existing**
18 **on the books of SJLP as of the effective date of the tariff**
19 **sheets authorized in this case: any regulatory liability**
20 **balances related to FAS 87, and** the accumulated difference
21 **between (a) the recorded FAS 106..."** Case No. ER-94-163
22 Report and Order Attachment 1, Item 3A and 3B(i). (emphasis
23 added)
24

25 **Q. What was the effective date of the order in Case No. ER-94-163?**

26 A. The effective date was June 15, 1994.

27 **Q. What was the amount of the liability on the effective date?**

28 A. It was equal to the FAS 87 prepaid pension balance at that date of
29 \$6,824,036.

1 **Q. What is the purpose of the regulatory liability?**

2 A. The purpose is to recognize the difference between prepaid pensions allowed
3 for ratemaking and prepaid pensions recorded under FAS 87.

4 **Q. What amount or prepaid pension balance is the Staff disallowing from
5 recovery in this case (GR-2004-0072)?**

6 A. Staff reduced the prepaid pension balance in this case by the balance at June
7 15, 1994, \$6,824,036.

8 **Q. What does this indicate to you?**

9 A. Contrary to the agreement in Case No. ER-94-163, Staff has reduced the
10 prepaid pension balance by the balance at June 15, 1994.

11 **Q. Who represented Staff regarding pensions in Case No. ER-94-163 at the
12 Stipulation and Agreement hearing?**

13 A. Although Charles R. Hyneman filed the Staff's direct testimony on pensions,
14 Steve Traxler responded for Staff at the Stipulation and Agreement hearing to
15 a question by Commissioner McClure regarding pensions (Case No. ER-94-
16 163 Stipulation and Agreement Transcript dated May 31, 1994 page 24 lines
17 3-6).

18 **Q. Do you find any portion of that Stipulation and Agreement hearing to be
19 relevant?**

20 A. Yes. Examiner Bensavage asked for clarification regarding the meaning of
21 Section B subsection (i) (quoted above). Aquila's counsel, Mr. Duffy,
22 responded in part:

1 “But I guess one way to put it would be that this would preclude the
2 parties from going back and grabbing something that existed on June
3 15th and using it in a manner that’s not intended by resolution of this
4 case.”

5 -- Case No. ER-94-163 Stipulation and Agreement Transcript dated
6 May 31, 1994 page 31, lines 15-18.

7 **Q. Did the Company’s review find other pertinent facts?**

8 A. Yes, the Company found that St. Joseph Light & Power Company (SJLP)
9 orders apply also to Aquila Networks-L&P (“L&P”).

10 **Q. Please explain how SJLP orders apply to L&P.**

11 A. The merger order in Case No. EM-2000-292 transfers all rights and privileges
12 of SJLP to UtiliCorp United, Inc. (now called L&P).

13 **Q. What do you conclude regarding L&P?**

14 A. I conclude that:

- 15 • That L&P wrote off its prepaid pension balance by establishing an offsetting
16 regulatory liability as a result of Case No. ER-93-41.
- 17 • That in Case No. ER-94-163, as part of the stipulation implementing FAS
18 87 for ratemaking, the prepaid pension balance was re-established as a
19 recoverable ratemaking asset, allowing L&P to reverse the offsetting
20 regulatory liability. This fulfilled the stated intent of the Commission in
21 Case No. ER-93-41.
- 22 • That in the current case Staff is going back and attempting to disallow the
23 balance that existed at June 15, 1994 for current ratemaking in direct
24 contradiction to the terms of the stipulation in Case No. ER-94-163. See
25 Schedule JMB-7 for Staff’s work paper in this case showing the reduction

1 of the L&P prepaid pension balance by the balance at June 15, 1994. This
2 is precisely the same balance as the regulatory liability balance referred to
3 in the stipulation to Case No. ER-94-163.

- 4 • Since the prepaid pension balance arose for ratemaking on June 15, 1994,
5 the total balance at September 30, 2003 of \$40,898,260 should be
6 amortized into rates over 9.25 years at \$4,421,433 per year with
7 appropriate adjustments for jurisdiction and capitalization of this expense.
- 8 • If the Commission upholds Staff's position it would be confiscating a
9 regulatory asset that L&P established through the ratemaking process in
10 Case No. ER-94-163. L&P would be required to reestablish the regulatory
11 liability that existed as of June 15, 1994 and which was reversed as a result
12 of the stipulation in Case No. ER-94-163. This would be contrary to the
13 plain language of the stipulation.

14 **MPS Prepaid Pension Asset**

15 **Q. How much of MPS's prepaid pension balance has Staff disallowed from**
16 **current rate recovery?**

17 **A.** The amount of MPS's prepaid pension balance that has been excluded is
18 \$9,782,554 per Schedule JMB-7.

19 **Q. Is this entire amount in dispute?**

20 **A.** No. As indicated in the direct testimony of Mr. Rooney in ER-04-0034 and
21 consistent with the stipulation in Case No. ER-93-37, MPS recorded an
22 offsetting regulatory liability in the amount of \$2,309,530 during the period

1 from 6/29/1993 to 3/18/1998; therefore only the prepaid pension balance at
2 6/29/1993 of \$7,473,024 is in dispute.

3 **Q. What was the order that showed MPS was on FAS 87 for ratemaking**
4 **prior to March 18, 1998?**

5 A. MPS and Staff stipulated to this in Case No. ER-93-37. The stipulation states
6 in part, "Signatories agree that Company's accounts shall reflect pension
7 costs equal to contributions made to its established pension funds,
8 discontinuing its previous practice under FAS 87 effective June 29, 1993."
9 (Case No. ER-93-37 Stipulation and Agreement attached to Report and Order
10 filed as Exhibit 88, page 7, item 7.) This ratemaking order specifies the day
11 on which MPS was to discontinue FAS 87 and begin a contribution approach.

12 **Q. What is the impact of this agreement?**

13 A. It requires that pension expense for ratemaking will reflect contributions made
14 beginning June 29, 1993. This ratemaking treatment continued until MPS
15 was ordered back onto FAS 87 in Case No. ER-97-394. One impact of this
16 stipulation in Case No. ER-93-37 was that it fixed and limited the ratemaking
17 balance of prepaid pensions to the balance of prepaid pensions as of June
18 29, 1993, until the ratemaking changed with the order in Case No. ER-97-34.
19 The stipulation preserved the FAS 87 balance for later recovery. The
20 mechanism for that recovery was the return to FAS 87 for ratemaking in Case
21 No. ER-97-394.

1 **Q. How did the stipulation fix and limit the balance of prepaid pensions as**
2 **a regulatory asset?**

3 A. Under FAS 87, the company would still be required to record changes in the
4 prepaid pension balance. However, as a result of this order to record
5 contributions as the ratemaking expense, a difference arises after June 29,
6 1993 between financial reporting and ratemaking prepaid pensions.
7 Differences between financial reporting and ratemaking, authorized by
8 commission order, give rise to regulatory assets and liabilities. Instead of
9 recording changes in the prepaid pension balance to expense, as would be
10 customary under FAS 87, increases from the balance at June 29, 1993 are
11 recorded to a regulatory liability, offsetting the increase. Decreases from the
12 balance at June 29, 1993 are recorded to a regulatory asset, offsetting the
13 decrease. Basically, MPS was ordered to record expense equal to
14 contributions. Since changes in the prepaid pension balance were not to be
15 recorded to expense, the proper place to record the change was to a
16 regulatory asset or liability. When these accounts (the prepaid pension,
17 regulatory liability, and regulatory asset accounts) are added together, the net
18 balance will remain constant and will equal the prepaid pension balance that
19 existed at June 29, 1993. Thus, while the Company is on contribution
20 accounting for ratemaking, the net of the regulatory asset, regulatory liability
21 and prepaid pension balance remains fixed at the balance as of June 29,
22 1993. There is no difference between the prepaid pension balance at June

1 29, 1993 and the net regulatory asset fixed and limited to that balance by this
2 stipulation.

3 **Q. What would have happened if the prepaid pension balance had declined**
4 **to zero?**

5 A. If prepaid pension balance had decreased to zero, the decline would have
6 been offset by an equal increase in a regulatory asset, created under this
7 stipulation.

8 **Q. Under this scenario, what would be the result of Staff's position?**

9 A. As described above, under this stipulation MPS was authorized to create a
10 regulatory asset equal to decline in the prepaid pension balance. Staff's
11 argument to disallow the net balance of \$7,473,024 (the balance at June
12 29, 1993) becomes an argument to disallow the very regulatory asset created
13 by this stipulation.

14 **Q. Does the answer change under the actual facts in this case?**

15 A. No. There is no difference between the prepaid pension balance at June 29,
16 1993 and the net regulatory asset fixed and limited to that balance by this
17 stipulation. The stipulation was a joint agreement to both fix and limit the net
18 balance. MPS created and acknowledged its regulatory liability for the period
19 this agreement was in force (Case No. ER-93-37 until Case No. ER-97-394).
20 This regulatory liability upholds its agreement to limit the balance during this
21 time. Staff seeks to set aside its agreement that fixed the balance.

1 **Q. What was Staff's position on Prepaid Pensions at the time of the**
2 **stipulation in Case No. ER-93-37?**

3 A. As noted above Staff took the position in the L&P case that no write off was
4 necessary for the existing prepaid pension balance. In hearing testimony,
5 Staff defends their position with L&P by noting that in MPS Case No. ER-93-
6 37, there was no write off suggested (Case No. ER-93-41, Hearing Transcript
7 dated 4/21/93, Page 363 lines 4-13).

8 **Q. What was the position of the Commission during this time?**

9 A. The Commission accepted Staff's position that no write off of the existing
10 prepaid pension balance was required (see Case No. ER-93-41).

11 **Q. What is Staff's current position on this issue in this case?**

12 A. Contrary to Company's understanding, contrary to the Commission's position
13 at the time in Case No. ER-93-41, and contrary to Staff's position at the time
14 these amounts arose, Staff now believes, more than 10 years later, the prior
15 prepaid pension balance should be written off.

16 **Q. What are your conclusions regarding the MPS prepaid pension balance?**

17 A. I conclude the following:

- 18
- 19 • MPS negotiated a stipulation in Case No. ER-93-37.
 - 20 • This stipulation both established and limited the prepaid pension
21 balance for ratemaking to the balance at June 29, 1993.
 - 22 • The Staff now seeks to overturn that stipulation by reducing current
prepaid pensions by total of \$9,782,554. This is \$7,473,024 more than

1 the \$2,309,530 reduction in prepaid pensions created by the stipulation
2 in ER-93-37.

3 • It was neither the Staff's position at the time nor the Company's
4 understanding when it negotiated this stipulation, that a write off of that
5 balance was required.

6 • The Commission should reject this effort to disallow amounts
7 negotiated over 10 years ago and allow amortization into rates of
8 MPS's prepaid pension balance of \$21,720,199, less the regulatory
9 liability for pensions or \$2,309,530, created by the stipulation in ER-93-
10 37, with appropriate adjustments for jurisdiction and capitalization of
11 this expense.

12 Pension Expense

13 **Q. How is Staff proposing to calculate ratemaking pension expense?**

14 A. They propose to use the ERISA minimum amount.

15 **Q. Does Company agree with Staff's choice of the ERISA minimum?**

16 A. No. Aquila disagrees for the following reasons:

- 17 • Staff does not adjust the ERISA minimum for the benefits of what they
18 term "voluntary" contributions that they propose to disallow.
- 19 • The ERISA minimum is likely to be as volatile as the FAS 87 amounts.
- 20 • The ERISA minimum places unnecessary limitations on management's
21 discretion in determining the timing and amount of pension
22 contributions.

- 1 • The ERISA rules provide for a range of allowable funding levels. Staff
2 has chosen to focus on the lowest possible funding level.

3 **Q. Are ERISA minimums as volatile as the FAS 87 amounts?**

4 A. Yes. Staff notes that the FAS 87 amounts for 2001 and 2003 increased from
5 (\$15,267,120) to \$8,427,028, an increase of \$23.7 million in two years
6 (Traxler Direct, page 9, line 12-13). In contrast, the ERISA minimum in 2002
7 was \$0 and the projected 2004 ERISA minimum was \$37 million, an increase
8 of \$37 million. This greater volatility in the annual amount of ERISA
9 minimums is why Mr. Traxler finds the annual amounts unacceptable and
10 resorts to using a 5-year average to attempt to address this volatility.

11 **Q. How does the ERISA minimum approach limit management discretion?**

12 A. Management may desire to limit the potential volatility of the annual ERISA
13 minimum. One method may be through averaging its contributions, much as
14 Staff proposed an averaging of the ERISA minimum for ratemaking.
15 Management may also desire to provide employees with some amount of
16 funding “cushion” against market downturns. As we have seen recently,
17 failure to have an adequate buffer during a market downturn, puts employee
18 pensions at risk, increases exposure to unnecessary Pension Benefit
19 Guarantee Corporation (PBGC) variable premium costs, and can result in
20 undesirable financial statement entries that concern our investors. The
21 ERISA rules also provide for a maximum allowable contribution. Exclusive
22 use of the ERISA minimum limits the Company and its employees to the
23 minimum protection. This approach can increase the volatility of the ERISA

1 minimum since only the minimum buffer exists to soften the impact against
2 market movements. Staff proposes to disallow any contribution above the
3 minimum.

4 **Q. How is Staff seeking to disallow recovery of future contributions in**
5 **excess of the ERISA minimum?**

6 A. Staff defines contributions in excess of the ERISA minimum as a “voluntary
7 contribution” (Traxler Direct, page 10, line 22-23). While simultaneously
8 acknowledging that the Company had good reason to contribute amounts in
9 excess of the ERISA minimum in this case, Staff also refers to these
10 contributions as “voluntary”. The Company made these contributions to avoid
11 penalties. FAS 87 imposes a financial reporting penalty. The PBGC imposes
12 a monetary penalty. Failure to contribute the ERISA minimum also imposes a
13 financial penalty. If the Company were willing to accept the ERISA penalty,
14 then one could also view the ERISA minimum as “voluntary”. These
15 contributions are only “voluntary” in the Staff’s eyes in that they are not
16 required by **their** currently proposed cost of service formula.

17 **Q. Do contributions in excess of the ERISA minimum benefit the**
18 **ratepayer?**

19 A. Yes. Contributions in excess of the ERISA minimum accrue interest and
20 directly reduce the amount of future ERISA minimums. The prior funding
21 credit amount is also integrated into the ERISA calculation in several places,
22 including the actual returns earned and the amortization charge calculation.

1 **Q. Does Staff adjust their ERISA minimum calculations to reflect prior**
2 **contributions greater than the required ERISA minimum?**

3 A. No. They recognize the benefit but disallow the cost that provides that
4 benefit.

5 **Q. How do prior contributions in excess of the ERISA minimum reduce the**
6 **ERISA minimum?**

7 A. See Schedule JMB-8 for an example. Suppose the ERISA minimum, without
8 voluntary contributions, were \$2,000 for Year 1 and \$2,000 for Year 2.

9 Suppose the Company were to contribute \$3,000 in Year 1. By the Company
10 contributing an extra \$1,000 in Year 1, the impact on Year 2 of that additional
11 \$1,000 contribution above the ERISA minimum produces a reduction of
12 approximately \$1,080 in Year 2 applied towards the ERISA minimum
13 calculation of \$2,000. So instead of an ERISA minimum of \$2,000 in Year 2,
14 the calculated ERISA minimum is \$920.

15 **Q. Under the Staff's currently proposed method, what would be the impact**
16 **to the Company?**

17 A. Not only would the \$1,000 contribution in excess of the ERISA minimum be
18 disallowed, but under Staff's proposal, Aquila would disallow any contribution
19 in excess of \$920 in Year 2. So instead of allowing recovery of \$4,000 over
20 the two years as initially calculated under the ERISA minimum without
21 "voluntary" contributions, only \$2,920 would be allowed. While the Company
22 would only be allowed to recover \$2,920, the Company would have provided

1 \$3,920 for the benefit of its employees towards \$4,000 in valid cost of service
2 for its customers.

3 **Q. Is there a way to easily adjust the ERISA minimum for prior**
4 **contributions in excess of the ERISA minimum?**

5 A. Although it does not account for all the impacts, it may be possible by adding
6 back to the ERISA minimum any reductions in the Funding Standard Account
7 Credits related to prior “voluntary” contributions and their interest not
8 previously allowed in rates.

9 **Q. Are you opposed to establishing rates on a contribution method?**

10 A. No, on the contrary, MPS proposed to adopt the contribution method in 1988,
11 1990, 1993 and 1997, however the Company believes the contribution
12 methodology should incorporating the following guidelines:

- 13 • No disallowance of prepaid pensions previously negotiated into regulated
14 assets.
- 15 • Allowing a range of acceptable contributions may produce less volatility than
16 using the ERISA minimum.
- 17 • No arbitrary disallowance of contributions in excess of the ERISA minimum.
- 18 • If actual contributions are not to be the primary basis for determining
19 allowable pension expense; then a procedure to recover contributions in
20 excess of the ERISA minimum should be implemented. The Company
21 proposes that these contributions in excess of the “adjusted” ERISA
22 minimum should be a) capitalized as a regulatory asset; and b) held as a

1 regulatory assets until i) they are be shown to have benefited the ratepayer
2 and ii) are then allowed full recovery in rates including a return from when
3 the funds were committed.

- 4 • The Company further contends that the ERISA minimum to be used as the
5 measurement should be calculated without the inherent reduction caused by
6 “voluntary” contributions made by the Company, unless the voluntary
7 contributions have been explicitly included in rates. A simple adjustment to
8 the ERISA minimum may be sufficient to accomplish this.

9 **Cash Basis Ratemaking for Pensions**

10 **Q. Are there any other aspects of Staff’s testimony you wish to discuss?**

11 A. I believe Staff has misapplied the phrases “pay as you go” and “cash” basis to
12 describe pension funding. (Traxler Direct, page 5, lines 14-15). This use of
13 terminology incorrectly characterizes the historical accrual treatment of
14 pensions as a “pay as you go” method.

15 **Q. What do “pay as you go” and “cash” basis mean?**

16 A. These terms are generally reserved to describe non-accrual methods of
17 accounting.

18 **Q. Can you provide an example?**

19 A. Yes. Before the implementation of FAS 106, Staff correctly characterizes
20 other post-employment benefit costs (OPEBs) as pay as you go or cash
21 basis. The employees earned the right to post retirement health benefits
22 during their working years. The Company recognized the expense only when

1 the claims for benefits were filed and paid, after the employees retired.
2 Expense was matched with the payment of the obligation not with the period
3 in which the employee earned the benefit. With the implementation of FAS
4 106, the expense is recognized in the years of employment, not after
5 retirement when benefits are paid.

6 **Q. What would pay as you go or cash basis mean for pensions?**

7 A. Just as for OPEBs, it would mean recognizing expense when pension
8 benefits are paid to retirees, after their retirement. The expense would be
9 recognized when paid, not in advance when the employee is working. Under
10 this approach there would be no pension fund assets as only benefits actually
11 being paid would be funded. Just as prior to FAS 106, there were no OPEB
12 fund assets. In short, under a cash or pay as you go basis pension expense
13 is recognized after the employee retires. Under an accrual basis pension
14 expense is recorded before the employee retires.

15 **Q. Why are these terms inappropriate to describe pensions?**

16 A. Based upon the research of the Company, pension expense after 1966 has
17 not been recognized on a "benefits paid" basis either for financial reporting or
18 for rate making. Pension expense has been recognized on an accrual basis
19 since at least 1966.

20 **Q. What happened in 1966?**

21 A. APB 8 was implemented for pension accounting. This accounting standard
22 was the predecessor of FAS 87. This accounting standard, like FAS 87,
23 specified that pension expense be recorded on an accrual basis using an

1 acceptable actuarial cost method. Any differences between the APB 8
2 accrual expense and the amounts actually funded to the pension plan were
3 required to be recorded in the financial statements as accrued (liability) or
4 prepaid (asset) pension costs. ERISA is also an actuarially based accrual
5 calculation because it recognizes today the cost of pensions that will not be
6 paid to employees until after they retire. Therefore contributions, that are in
7 compliance with ERISA are “accrual” and not “cash basis” in nature.

8 **Q. Was ratemaking based on accrual expense amounts?**

9 A. Yes.

10 **Q. How do you know?**

11 A. Base upon exhaustive research by the Company and a review of prior MPS
12 annual reports and FERC Form 1’s. This review of MPS annual reports and
13 Form 1’s revealed no significant regulated prepaid or accrued pension
14 amounts. In fact prior to 1987, the footnotes in the MPS annual report state,
15 “The company’s policy is to fund current pension costs accrued and prior
16 service costs which are being amortized over 30 years.” (Missouri Public
17 Service Company 1984 Annual Report – Note 7 Retirement Plans). Similar
18 statements are in the years reviewed from 1983 through 1986. This indicates
19 that MPS was funding to the pension plan the accrual (APB 8) expense
20 amount. With some minor timing variances, the APB 8 pension expense and
21 the pension funding amounts (contributions to the pension plan) were the
22 same for years prior to 1987.

23 **Q. Did the Company review other material to support this?**

1 A. Yes. The Company performed a review of Staff testimony. Staff testified in
2 1993:

3 "My understanding is, just about every authority I've looked at,
4 generally the determination of pension expense prior to FASB 87 was
5 equal to the funding amount in almost every case."... "In other words,
6 I've never seen any utility suggest the two weren't almost equal or
7 equal prior to FASB 87." (Case No. ER-93-41 Traxler Deposition, page
8 28, line 4-12)
9

10 **Q. How does Staff characterize pension expense prior to 1987?**

11 A. Staff states that pension expense equaled contributions.

12 **Q. Do you agree with this?**

13 A. No. This implies that whatever was contributed was expensed. For MPS, the
14 correct description would be to say that what was expensed (in accordance
15 with GAAP under APB 8) was contributed to the pension plan. The funding
16 policy was to contribute the amount of expense determined by GAAP. APB 8
17 was the generally accepted accounting principle (GAAP) for pensions before
18 1987. APB 8 was replaced by FAS 87.

19 **Q. What do you conclude?**

20 A. I conclude the following:

- 21 • Prior to 1987 MPS funding was based on the contribution of amounts
22 determined in accordance with GAAP.
- 23 • MPS kept its pension accounts prior to 1987 in accordance with GAAP
24 (APB 8) and this aligned with ratemaking.

- 1 • I am aware of no rate order for MPS prior to 1987 ordering a deviation
2 from GAAP for pensions. This would be expected since the GAAP
3 expenses determined funding levels.
- 4 • Staff's characterization of pension funding amounts as "cash basis"
5 ignores that ERISA, APB 8, and FAS 87 are all actuarially based accrual
6 methods.

7

8 **Q. Could you please summarize your testimony regarding pensions?**

9 A. My key points are as follows:

- 10 • The Staff seeks to disallow from rate recovery over \$16.6 million of
11 prepaid pension amounts being recovered under the current ratemaking
12 methodology (FAS 87).
- 13 • The issues regarding these amounts were previously resolved in
14 negotiated stipulated case agreements. Staff's attempt to overturn these
15 agreements more than 10 years later should be denied.
- 16 • If the Commission discontinues FAS 87 for ratemaking in favor of a
17 contribution approach, the contribution approach should allow for the
18 range of allowable contributions determined by ERISA between the ERISA
19 minimum and the ERISA maximum.
- 20 • If the Commission approves an ERISA minimum contribution approach, it
21 should use an ERISA minimum adjusted for any contributions in excess of
22 the ERISA minimum not explicitly allowed in rates. The ERISA minimum
23 calculation should not be the reduced level of funding created by actual
24 contributions that the Company made in excess of the minimum required
25 level of funding.
- 26 • Any use of the ERISA minimum, should allow for the future recovery of
27 contributions in excess of the ERISA minimum, including return on, when
28 such contributions are shown to have been required.
- 29 • The difference between the cash outlay the Company has made on behalf
30 of its employees and the amount allowed under the "adjusted" ERISA
31 minimum should be permitted to be capitalized as regulatory asset and
32 recovery should be permitted over time.

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ACCOUNTING AUTHORITY ORDERS (AAO)

Q. What is an AAO and what is its purpose?

A. An AAO is an order issued by the Commission that permits the requesting utility to defer certain costs on its books (outside of a rate case) with the opportunity to subsequently recover these costs through rates, as opposed to being required to expense these costs in the current period. The deferral of expenses lessens the impact of regulatory lag, or the time between expensing the costs and the recovery of those costs in rates.

Q. Please discuss the AAO's issued to MPS.

A. In Commission Case Nos. GO-90-115 and GO-91-359, MPS requested AAO's and received authorization from the Commission, to defer and book certain costs related to accelerated leak surveys and gas safety replacement projects.

GO-90-115: The beginning balance in this AAO was \$1,061,598. MPS has been amortizing this AAO per the Commission ordered term of two hundred forty (240) months, at approximately \$4,423 per month or \$53,080 annually. MPS began amortizing this project in November 1990, and over 155 months, or until the end of the update period in this rate case, September 30, 2003 has a remaining balance of \$375,982.

1 **GO-91-359:** The beginning balance in this AAO was \$1,652,589. MPS has
2 been amortizing this AAO per the Commission ordered term of two hundred
3 forty (240) months, at approximately \$6,886 per month or \$82,630 annually.
4 MPS began amortizing this AAO in September 1993, and over 120 months, or
5 until the end of the update period in this rate case, September 30, 2003 has a
6 remaining balance of \$819,440.

7 For the two MPS AAO's, Company has requested rate base treatment for the
8 total un-amortized balance of \$1,195,422 at September 30, 2003 with an
9 annual amortization of \$135,710.

10 **Q. What is Staff's position on the MPS AAOs in this case?**

11 A. Per Staff Witness Trisha Miller's direct testimony on page 8, she states her
12 agreement with the Company's proposed ratemaking treatment per the
13 following:

14 **RETURN ON:** "Unamortized AAO balances at September 30, 2003 were
15 included in rate base to reflect in the cost of service a **return on** the
16 unamortized balance of the AAO deferrals authorized by the Commission
17 ...(page 8, lines 8 to 10);

18 **RETURN OF:** "The Staff adopted the test year amortization amortization
19 periods of twenty years previously ordered by the Commission" (page 8, lines
20 15 to 18). Company would equate an amortization of the AAO to a **return of**
21 its deferred costs.

1 **Q. What is the position of OPC witness Ted Robertson regarding MPS'**
2 **Accounting Authority Orders?**

3 A. Mr. Robertson is in disagreement on two counts to the unified position of Staff
4 and Company regarding the appropriate ratemaking treatment of the two
5 AAOs referenced above. First there is disagreement as to the rate base
6 treatment of the un-amortized balance. Second, the level of annual
7 amortization expense is in dispute.

8 **Q. Regarding rate base treatment, is the OPC position contrary to**
9 **Commission approved orders on ratemaking treatment for these two**
10 **respective AAOs:**

11 A. Yes. First, as Mr. Robertson references in his direct testimony with respect to
12 Case No. GR-90-198, "allowed the Company to include in rate base" (page
13 18, line 12). Reflecting that this was a settled or "Stipulated" rate case the
14 amount included in rate base was \$818,578. Second, with respect to Case
15 No. GR-93-172, Mr. Roberson offers the following statement, "subsequent
16 rate case ... was a negotiated dollar settlement that did not define the amount
17 of deferred costs associated with AAO Case No. GO-91-359 that would be
18 included in cost of service" (page 19, line 2-4). In summary, at the origination
19 of the AAO and the first instance of Commission ratemaking decision on
20 recovery, the Commission allowed for an inclusion of AAOs in rate base
21 providing for a return on the cost of service of the Company. Company has
22 no information nor reason to believe that the negotiated settlement in the

1 second subsequent rate case decision on recovery would have been different
2 than in the first subsequent rate case decision, i.e. ratebase treatment and
3 amortization were included in both rate cases.

4 **Q. Does the Company believe that the Commission intended for rate base**
5 **treatment, in addition to amortization expense, to be the appropriate**
6 **ratemaking treatment for the AAOs?**

7 A. Yes. The OPC has not offered any evidence that the Commission should
8 have considered any other alternative ratemaking treatment at the time of the
9 origination of the AAOs. Given the applicable Commission orders at that time
10 -- which indicated agreement with rate base treatment in the first case and
11 silent in the second case -- to propose to change the rules of recovery, at
12 over ten years of past precedent and practice with respect to these two
13 specific AAOs, is patently unfair.

14 **Q. What disagreement does the Company find with the OPC's support of**
15 **its position on the amount of amortization via the correct level of**
16 **deferred costs included in the AAOs?**

17 A. In addition to a further review of the Stipulation Agreement for Case No. GR-
18 93-172, Mr. Robertson offers the following incorrect paraphrase, "Company
19 agreed not to file an application with the Commission for an accounting
20 authority order with respect to expenditures identified in **said case**". To
21 better appreciate the entire context of the Stipulation Agreement with respect

1 to this “said case”, a closer reading of the full applicable paragraph must be
2 read as found on page 5,

3 ‘Also, pursuant to the Commission’s Pipeline Safety Regulations,
4 specifically 4 CSR 240-40.030 (15) concerning Replacement
5 Programs, the Company intends, **after April 30, 1993**, to replace
6 approximately 35 to 50 miles of gas mains, as well as certain yard
7 lines, in accordance with its updated Pipe Replacement Program which
8 has been provided to designated Commission Staff personnel, a copy
9 of which is attached hereto as Attachment 3. The Company agrees
10 not to file an application with the Commission for an accounting
11 authority order (AAO) with respect to expenditures associated with the
12 replacement of **said** gas mains and yard lines.”

13 **Q. What is the correct understanding of this paragraph in the Stipulation**
14 **Agreement in Case No. GR-93-172?**

15 A. The “said” reference was to Company’s investment in gas mains and yard
16 lines for projects **after** April 30, 1993 not to “said” AAOs (GO-90-115 & GO-
17 91-359) included in the rate case. And also, Mr. Robertson correctly states in
18 his direct testimony, “to my knowledge, Company never requested any other
19 AAO for gas safety related costs” (page 19, lines 7-8). Simply put, there are
20 no other AAOs for which MPS has requested AAO treatment for the
21 anticipated “35 to 50 miles of gas mains, as well as certain yard lines”, i.e.
22 projects **after** April 30, 1993. The AAO 91-359 as accounted for on the books

1 of MPS includes costs related to projects **before** April 30, 1993 as agreed to
2 by Company in the Stipulation Agreement as approved by the Commission.

3 **Q. Is additional investigation required in order to better understand the**
4 **OPC position?**

5 A. Yes. Company has issued a data request to the OPC to better understand its
6 position of Commission precedent on AAOs. Company would like to reserve
7 the right to introduce supplemental information in surrebuttal testimony as
8 may be needed. In addition, Mr. Robertson indicates in his direct testimony
9 (page 22, lines 11 to 15), "If additional information regarding a material
10 changeI will inform the Commission of such in either my rebuttal or
11 surrebuttal testimony".

12 **Q. Does this conclude your surrebuttal?**

13 A. Yes it does.

*Staff Workpaper
Traxler*

Prepaid Pension Asset and Amortization
Case Number ER 2004-0034

Schedule JMB=7

Prepaid Asset & Amortization - L&P Division

Rebuttal Testimony:
Joseph M. Bahr

		L & P
Prepaid Pension Asset -	Sept. 30, 1993	\$ 40,898,260
Prepaid Pension Asset -	June 15, 1994	\$ 6,824,036
Prepaid Asset since adopting FAS 87		\$ 34,074,224
Electric Allocation	93.70%	\$ 31,927,548
Steam Allocation	3.71%	\$ 1,264,154
Gas Allocation	2.59%	\$ 882,522
Total		\$ 34,074,224

L&P Workpaper - WC 20 A
DR 476 - ER 94-163

Amortization of Prepaid Asset

9.25 years June 15, 1994 - Sept. 30, 2003

Annual Amortization		Exp %	Expense Adjustments
	Electric	\$ 3,451,627	81.47% \$ 2,812,040
	Steam	\$ 136,665	81.47% \$ 111,341
	Gas	\$ 95,408	81.47% \$ 77,729
Total		\$ 3,683,700	\$ 3,001,110

Prepaid Asset & Amortization - MPS Division

		MPS
Prepaid Pension Asset -	Sept. 30, 1993	\$ 21,720,199
Prepaid Pension Asset -	March 18, 1998	\$ 9,782,554
Prepaid Asset since adopting FAS 87		\$ 11,937,645
Electric Allocation	86.80%	\$ 10,362,353
Electric Jurisdictional	99.39%	\$ 10,298,625
Gas Allocation	13.20%	\$ 1,575,292
Total		\$ 11,873,917

MPS Workpaper - WC 20 A
DR 476 - ER 97-394 effective date

Payroll North/South Eastern
88.73% 11.27%
\$ 1,397,725 \$ 177,567

Amortization of Prepaid Pension Asset

5.5 years Mar. 18, 1998 - Sept. 30, 2003
ER 97394 Effective Date

Amortization of Prepaid Asset

Annual Amortization		Exp %	Expense Adjustments
	Electric	\$ 1,872,477	75.98% \$ 1,422,708
	Gas	\$ 286,417	75.98% \$ 217,619
Total		\$ 2,158,894	\$ 1,640,328

Schedule JMB-8

Rebuttal Testimony:
Joseph M. Bahr

Impact of Voluntary Contributions on ERISA Minimum

Year	ERISA Minimum without Voluntary Contributions	ERISA Minimum with Voluntary Contributions	Actual Contributions
1	\$2,000	\$2,000	\$3,000
2	2,000	920	920
Total	\$4,000	\$2,920	\$3,920