Exhibit No.___________

Issue: OPEB Funding Deficiency
Deferred Income Taxes
South Harper Plant
Transition Costs
Corporate Restructuring
Witness: David J. Effron
Sponsoring Party: AARP
Case No. ER-2005-0436

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Before the Missouri Public Service Commission

Rebuttal Testimony

of

David J. Effron

November 18. 2005

Exhibit No. 87
Case No(s). ER-2005-0436
Date 1-08-0[illegible] **Rptr** [illegible]

I. PURPOSE OF TESTIMONY

Q. Please state your name.

A. My name is David J. Effron.

Q. Have you previously filed testimony in this docket?

A. Yes. I filed direct testimony on October 14, 2005. A statement of my qualifications and experience is included in that direct testimony.

Q. What is the purpose of this rebuttal testimony?

A. In my direct testimony, I stated that I intended to provide testimony on revenue requirement issues on behalf of AARP during the rebuttal and surrebuttal phases of the case. Since the preparation of my direct testimony, I have reviewed the direct testimony of the Missouri Public Service Commission Staff ("Staff"), including the revenue requirements of the Missouri Public Service ("MPS") and St. Joseph Light & Power (L&P) divisions of Aquila, Inc. ("Aquila" or "the Company") with regard to rate base and pro forma operating income under present rates. I have also reviewed Staff's workpapers supporting its proposed adjustments to rate base and operating income.

In this rebuttal testimony, I am proposing modifications to certain of the elements of rate base and pro forma operating expenses presented by Staff. At the time of the preparation of this testimony, I had not received all responses to data requests that had been submitted to the Company.

Therefore, it might be necessary to modify or amend this rebuttal testimony based on the responses to those outstanding data requests. In addition, it is my understanding that Staff is still in the process of analyzing the rate base and operating income of both MPS and L&P, and that there might be further modifications to its determination of rate base and operating income. To the extent that such future modifications affect any of the issues addressed in this rebuttal testimony, it may be necessary to adjust my quantification of the effect of those issues.

II. PR0POSED ADJUSTMENTS TO STAFF POSITION

A. OPEB Funding Deficiency

Q. Has Staff proposed an adjustment to test year operating expenses to eliminate the effect of the failure of MPS and L&P to fully fund their liability for postretirement benefits other than pensions or ("OPEB")?

A. Yes. MPS and L&P accrue their periodic OPEB costs pursuant to Statement of Financial Accounting Standards 106 ("FAS 106"). FAS 106 requires that the periodic OPEB cost be determined based on the right to receive future benefits accrued by employees during the year, rather than on actual cash disbursements paid to retired employees. As explained by Staff witness Traxler, Missouri statutes require public utilities that use FAS 106 to determine the OPEB expense included in their cost of service to use an external funding mechanism. That is, the utilities must fund the OPEB obligation as it is accrued, rather than just let the liabilities accumulate on their balance sheets. Neither MPS nor L&P fully complied with this requirement in the test year in this case or in the years immediately prior to the test year. Staff therefore adjusted the test year OPEB expense to eliminate the effect of the funding deficiencies caused by the failure to comply with the applicable statutes.

Q. How did Staff adjust the test year OPEB expense to eliminate the effect of the funding deficiencies?

A. Staff calculated the cumulative difference between the annual FAS 106 costs accrued and the amounts funded for the period from March 1998 through 2005 for MPS and for the period from January 2001 through 2005 for L&P. Staff then applied the assumed rate of return of 7.00% on OPEB funds to the cumulative funding deficiencies to calculate adjustments to the return components of the periodic OPEB costs. In effect, the Staff method calculates the effect on the OPEB cost as if the Company were to make up the cumulative funding deficiency with a cash contribution right now. The pro forma test year OPEB expense was then decreased by the adjustment to the return component of the OPEB cost. This method resulted in a pro forma reduction of $209,000 to the MPS test year OPEB expense and a pro forma reduction of $282,000 to the L&P test year OPEB expense.

Q. Should there be another adjustment to test year expenses related to the OPEB funding deficiency?

A. Yes. Staff has not recognized the time value of money to Aquila from its failure to fund its OPEB obligation, as required by Missouri law. That is, by not making the required deposits to the OPEB funds, Aquila was able to retain those funds for general corporate purposes and to avoid the cost of capital that it would otherwise have incurred if the OPEB obligation had been properly funded. If this time value of money is not recognized in the determination of the OPEB funding deficiency, Aquila is better off for having failed to fund its OPEB obligation in a timely manner, as it would retain the time value of the lag in funding for itself. It is a basic principle of finance that a dollar paid a year from now or five years from now has less real economic cost to the party making the payment than a dollar paid today. Aquila should not be rewarded for violating the statutory funding requirement by being allowed to retain the time value of money from the delay in the proper funding of the OPEB obligation. The time value of money should be taken into account in the calculation of cumulative OPEB funding deficiency.

Q. How should the time value of money be taken into account?

A. As stated above, Aquila was able to avoid the cost of capital that it would otherwise have incurred if the OPEB obligation had been properly funded. Therefore, the time value of money should be calculated by applying the rate of return (grossed up for income taxes) to the net funds retained by Aquila (that is, the net of tax difference between the OPEB cost and the amount funded) from not funding the OPEB obligation. I show this calculation my Schedule DJE-1.

Q. What cumulative time value of money related to the OPEB funding deficiency have you calculated?

A. I have calculated a cumulative time value of $260,000 for MPS and $402,000 for L&P.

Q. How do you recommend that these amounts be treated in the determination of the MPS and L&P revenue requirements in this case?

A. The time value represents the value to Aquila of delaying its deposits to the OPEB funds. As this value was realized by failure to comply with applicable law, Aquila should not be permitted to retain any of this value for itself. I recommend that this value be returned to customers over three years, with interest. As shown on Schedule, this treatment results in a credit of $104,000 to the MPS cost of service and $161,000 to the L&P cost of service.

Q. Are you proposing any other adjustments to the Company's revenue requirements associated with the OPEB funding deficiencies?

A. Yes. The Company's practice of accruing, but not actually paying, the OPEB liability has caused a book-tax timing difference. That is, the Company can deduct the OPEB expense for income taxes based on what it pays, not what it accrues pursuant to FAS 106 as a future liability. As the accruals were greater than the payments, the amount deducted for income taxes was less than the amount recognized as an expense on the Company's books. Aquila recorded deferred income taxes on this book-tax timing difference. Because the book expense was greater than the tax expense, the recording of deferred taxes resulted in cumulative deferred tax debit balances, which are carried in Account 190. As the deferred tax debit balances in Account 190 reduce the rate base deduction for accumulated deferred income taxes, they are, in effect, additions to the Company's rate base.

If the Company had properly funded its OPEB liability, as required by law, the income tax deduction would equal the book expense, and there would be no book-tax timing difference related to this item. If there were no book-tax timing difference, no deferred income tax expense would be recorded, and there would be no deferred tax debit balances. In other words, if the Company had properly funded its OPEB liability, there would be no deferred tax debit balances related to OPEB included in rate base. Accordingly, the deferred tax debit balances related to OPEB should be removed from rate base. The removal of these deferred tax debit balances reduces the MPS rate base by $95,000 and the L&P rate base by $2,097,000 (Schedule DJE-2).

B. Accumulated Deferred Income Taxes – Account 190

Q. Are you proposing any other adjustments to the net accumulated deferred income taxes ("ADIT") deducted from plant in service in the determination of rate base, in addition to the elimination of the deferred tax debit balances related to OPEB?

A. Yes. The deferred tax debit balances included in Account 190 reduce the net balance of ADIT deducted from plant in service in the determination of rate base. Certain of these deferred tax debit balances should be eliminated because Staff has not recognized the accruals that give rise to these deferred taxes in the calculation of rate base.

Q. Have you summarized the deferred tax debit balances that you are proposing to remove from the ADIT deducted from rate base?

A. Yes. On Schedule DJE-2, I have identified certain deferred tax debit balances that are related to certain reserves, deferred credits, or accrued liabilities that are not recognized in the calculation of rate base. Staff has included these deferred tax debit balances in the Company's rate base, but each of these items should be removed. That is, if the accrued liabilities themselves are not deducted from plant in service in the determination of rate base, then the deferred tax debit balances that arise as a result of those accruals should not be added to rate base.

Q. Please describe these items, and explain why they should be removed from the ADIT that go into the determination of the Company's rate base.

A. With regard to MPS, the deferred tax balances related to allocated costs, employee bonus incentives, maintenance accruals, and supplemental retirement should be eliminated. Each of these items relates to accruals in excess of costs that can be deducted for income tax purposes. Staff has not deducted any of these accruals from rate base. Therefore, the deferred tax debit balances related to these items should be eliminated from the ADIT that goes into the calculation of rate base.

With regard to L&P, the deferred tax balances related to allocated costs and the supplemental retirement plan should be eliminated. Again, each of these items relates to accruals in excess of costs that can be deducted for income tax purposes, and Staff has not deducted either of these accruals from rate base. Accordingly, the deferred tax debit balances related to these items should also be eliminated from the ADIT that goes into the calculation of rate base.

Q. What is the effect of eliminating these deferred tax debit balances from rate base?

A. The effect is to reduce the MPS rate base by $6,591,000 and the L&P rate base by $2,415,000.

C. South Harper Plant

Q. Have you reviewed Staff's adjustment to rate base for the South Harper plant?

A. Yes. Staff adjusted the plant in service in the MPS rate base for the projected in service cost of the South Harper plant using an estimated unitization (allocation of the costs to plant in service accounts). I have reviewed the South Harper plant adjustment and the Staff workpapers supporting the plant costs and unitization.

Q. Are you proposing an adjustment to the Staff's quantification of the South Harper costs to be included in rate base?

A. Yes. I am proposing an adjustment that is of a mechanical nature. However, I have not reviewed the complete history of this project or the Staff's basic method of valuing the South Harper plant. Therefore, I am not endorsing Staff's method of valuing the South Harper plant or taking the position that other adjustments to the value of the South Harper plant included in the MPS rate base might not be appropriate. In fact, counsel for AARP has informed me that there are several legal issues related to the South Harper plant regarding whether it would even be lawful or reasonable for the Public Service Commission to include the costs of this plant in rate base. However, the scope of my testimony on this matter relates solely to one adjustment that should be made to Staff's basic method of valuation, assuming it is lawful to allow any rate base recognition of this plant.

Staff calculated a total South Harper project cost of $138,382,000. Of this amount, $26,160,000 was assigned to the transmission function, with the remainder assigned to the production function. The cost of land assigned to the production function was specifically identified, and the remaining costs were unitized to production plant accounts based on estimated percentages. In performing the production plant unitization, Staff, in effect, double counted the land. That is, Staff calculated the production plant costs to be unitized by subtracting the transmission plant from the total project cost, rather than subtracting the transmission plant and the land from the total project cost. The result is that the sum of the parts, $26,160,000 transmission plant plus $113,256,000 production plant, is greater than the total project cost of $138,382,000.

On my Schedule DJE-3, I have prepared a corrected unitization of the South Harper plant costs. The effect of this correction is to reduce the MPS jurisdictional rate base by $1,029,000. The reduction to depreciable plant in service also results in a reduction to pro forma jurisdictional depreciation expense by $42,000.

D. Merger Transition Costs

Q. Has Staff included the amortization of merger transition costs in pro forma test year operating expenses?

A. Yes. Staff has included $137,000 amortization of merger transition costs in the MPS revenue requirement and $46,000 amortization of merger transition costs in the L&P revenue requirement. This represents the amortization of $2,000,000 of transition costs incurred in the St. Joseph Power & Light merger over ten years, allocated to MPS and L&P electric operations.

Q. Should the amortization of merger transition costs be included in the MPS and L&P revenue requirements?

A. Not unless it can be established that the merger has resulted in savings at least as great as the costs being amortized, that the savings are directly attributable to the merger, and that the savings could not have been achieved in the absence of the merger. As far as I know, there is nothing in the record of this case that establishes that any of these criteria have been satisfied. Unless and until it is shown that the merger has resulted in tangible, quantifiable benefits to customers at least as great as the costs to be recovered, the amortization of the transition costs should be eliminated from the Company's revenue requirement. Doing so reduces MPS pro forma test year operating expenses by $137,000 and L&P pro forma test year operating expenses by $46,000.

Q. Are you aware of other issues regarding whether merger transition costs should be reflected in the rates for L&P?

A. Yes. Counsel for AARP has informed me that there are legal issues which have been raised regarding whether it is lawful or reasonable for these costs to be passed on to L&P area ratepayers. These legal issues are beyond the scope of my testimony but it is my understanding that these issues may be addressed in AARP's legal briefs.

E. Corporate Restructuring Adjustment

Q. Has Staff reflected a corporate restructuring adjustment in its determination of pro forma test year operating expenses?

A. Yes. Staff's corporate restructuring adjustment eliminates 50% of the expenses incurred by selected corporate departments in the test year in this case, on the grounds that these expenses relate to the restoration of the financial condition of Aquila, which had been impaired as the result of ventures into non-utility activities. The elimination of these expenses is reasonable, as such expenses are not related to the provision of utility service.

Q. Are you proposing an adjustment to Staff's quantification of the restructuring disallowance?

A. Yes. As stated above, Staff has eliminated 50% of the costs incurred by certain selected corporate departments. Based on Staff's description, this appears to be a reasonable quantification of the direct costs related to corporate restructuring. However, Staff has not taken account of any indirect costs that should logically follow the costs that are being eliminated. For example, as part of its restructuring disallowance, Staff eliminated 50% of the Chairman and Chief Executive payroll allocated to MPS and L&P. As the payroll department is responsible for the administration of payroll matters, a portion of the cost of the payroll department should be allocated to the payroll costs that are being eliminated. Similarly, other corporate overhead expenses are at least indirectly connected to the departments from which Staff has eliminated costs related to corporate restructuring and should be loaded onto the restructuring costs that are being disallowed.

Q. How have you calculated the corporate overhead expenses that should be allocated to the disallowed restructuring costs?

A. I have calculated the restructuring expenses eliminated by Staff as a percentage of the total of the expenses allocated to MPS and L&P. I then applied that percentage to the total of the corporate service departments not specifically adjusted by Staff to calculate the total of indirect costs that should be eliminated in association with the corporate restructuring adjustment.

The MPS corporate restructuring disallowance should be increased by $307,000 and the L&P corporate restructuring disallowance should be increased by $92,000 for allocable corporate overheads. The calculations of these adjustments are shown on Schedule DJE-4, Page 1, and the allocations of these adjustments to operation and maintenance expense accounts (accounts 557 – 931) and non- operating accounts are shown on Schedule DJE-4, Page 2.

Q. Does this conclude your rebuttal testimony?

A. Yes.

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

County of Fairfield

State of Connecticut

Affidavit of David J. Effron

David J. Effron, being first duly sworn, states that he is the witness who sponsors the accompanying testimony and that said testimony was prepared by him; that if inquiries were made as to the facts in said testimony and schedules, he would respond as set therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

David J Effron
David J. Effron

Subscribed and sworn to me on this 16 day of November, 2005.

Linda A. Sarbello
Notary Public

My commission expires:

6/30/2010

Schedule DJE-1

AQUILA NETWORKS
CASE NO ER-05-436A
OPEB FUNDING DEFICIENCY
($000)

MPS

Year	Accrued	Funded	Deficiency	Net of Taxes	Cum. Balance	Average Balance	Return	Cum. Return
1998	581	620	(39)	(24)	(24)	(12)	(1)	(1)
1999	721	706	15	9	(15)	(20)	(2)	(3)
2000	885	822	63	39	24	5	0	(3)
2001	1,131	1,070	61	38	62	43	4	1
2002	964	938	26	16	78	70	7	8
2003	610	-	610	376	453	265	27	35
2004	943	-	943	581	1,034	744	76	111
2005	1,303	-	1,303	803	1,837	1,436	149	260
	7,138	4,156	2,982					

Annual Credit over 3 Years, with Return $104

L&P

Year	Accrued	Funded	Deficiency	Net of Taxes	Cum. Balance	Average Balance	Return	Cum. Return
2001	1,545	1,173	372	229	229	115	11	11
2002	611	604	7	4	234	231	24	35
2003	766	-	766	472	705	469	49	84
2004	1,191	-	1,191	734	1,439	1,072	112	195
2005	1,699	-	1,699	1,047	2,486	1,963	207	402
	5,812	1,777	4,035					

Annual Credit over 3 Years, with Return $161

Combined Income Tax Rate	38.39%
Complement	61.61%
Pre-Tax Rate of Return	9.92%

Sources: Schedule SMT 4-2
ROR is Staff Mid-point, equity component grossed up for taxes

Schedule DJE-2

AQUILA NETWORKS
CASE NO ER-05-436A
DEFERRED TAX DEBIT BALANCES - ACCOUNT 190
($000)

	MPS	L&P
Other Post Retirement Benefits	$ 95	$ 2,097
Other Deferred Tax Debit Balances:		
Allocated Costs	3,936	744
Employee Bonus Incentive	1,682	
Maintenance Accruals	845	
Supplemental Retirement Plan	128	1,671
Total Adjustment to Deferred Taxes	$ 6,591	$ 2,415

Source: Staff Workpapers - Rate Base Offset

AQUILA NETWORKS
CASE NO ER-05-436A
SOUTH HARPER PLANT
($000)

Total South Harper Plant Costs		138,382
Assigned to Transmission		26,160
Assigned to Production		112,222
Production Land and Land Rights		1,034
Depreciable Production Plant		111,188
Structures and Improvements	5.001%	5,561
Fuel Holders	3.778%	4,201
Prime Movers	55.886%	62,139
Generators	24.051%	26,742
Accessory Electrical Equipment	11.150%	12,397
Miscellaneous Power Plant Equipment	0.134%	149
	100.000%	

	Plant	Staff Plant	Adjstmt	Alloc Factor	Juris. Adjstmt
Structures and Improvements	5,561	5,612	(51)	0.9951	(51)
Fuel Holders	4,201	4,240	(39)	0.9951	(39)
Prime Movers	62,139	62,717	(578)	0.9951	(576)
Generators	26,742	26,990	(248)	0.9951	(247)
Accessory Electrical Equipment	12,397	12,513	(116)	0.9951	(115)
Misc. Power Plant Equipment	149	150	(1)	0.9951	(1)
Total Depreciable Plant	111,188	112,222	(1,034)		(1,029)

Sources: Staff Workpapers - SH RB Analysis
SH Estimated Unitization
Staff Accounting Schedule 3 -2

AQUILA NETWORKS
CASE NO ER-05-436A
SOUTH HARPER PLANT - DEPRECIATION EXPENSE
($000)

	Juris. Adjstmt	Deprec Rate	Deprec Adjstmt
Structures and Improvements	(51)	1.75%	(1)
Fuel Holders	(39)	3.09%	(1)
Prime Movers	(576)	4.81%	(28)
Generators	(247)	3.80%	(9)
Accessory Electrical Equipment	(115)	2.85%	(3)
Misc. Power Plant Equipment	(1)	3.57%	(0)
Total Depreciable Plant	(1,029)		(42)

Sources: Schedule DJE-3, Page 1
Staff Accounting Schedule 5-2

AQUILA NETWORKS
CASE NO ER-05-436A
RESTRUCTURING ADJUSTMENT
($000)

MPS	
Restructuring Costs Eliminated by Staff	$ 561
Allocated Costs Prior to Restructuring Disallowance	13,103
Departments from Which Staff Eliminated Restructuring Expenses	1,122
Remaining Costs	$ 11,981
Percentage of Costs Eliminated by Staff	4.68%
Total Corporate Service Department Costs	$ 7,605
Departments from Which Staff Eliminated Restructuring Expenses	1,038
Remaining Costs	$ 6,567
Adjustment to Staff Restructuring Disallowance	$ 307
L&P	
Restructuring Costs Eliminated by Staff	$ 160
Allocated Costs Prior to Restructuring Disallowance	3,745
Departments from Which Staff Eliminated Restructuring Expenses	320
Remaining Costs	$ 3,425
Percentage of Costs Eliminated by Staff	4.67%
Total Corporate Service Department Costs	$ 2,270
Departments from Which Staff Eliminated Restructuring Expenses	296
Remaining Costs	$ 1,974
Adjustment to Staff Restructuring Disallowance	$ 92

Source: Staff Workpapers - Corporate ESF IBU by Dept

AQUILA NETWORKS
CASE NO ER-05-436A
ALLOCATION OF INCREMENT TO RESTRUCTURING ADJUSTMENT
($000)

	Expense Account		Adjstmt.
MPS	BTL	0.18%	$ 1
	408	-1.95%	(6)
	557	3.80%	12
	870	0.27%	1
	903	19.76%	61
	921	21.88%	67
	923	28.00%	86
	931	28.07%	86
		100.00%	$ 307
L&P	BTL	0.38%	$ 1
	408	-0.75%	(2)
	557	4.15%	13
	870	0.14%	0
	903	14.62%	45
	921	23.66%	73
	923	31.59%	97
	931	26.20%	81
		100.00%	$ 92

Sources: Schedule DJE-4, Page 1
Staff Workpapers - Income Stmt Distribution