

Exhibit No.:

Issues: Pension,  
Deferred Taxes, &  
Cost of Removal

Witness: H. Davis Rooney

Sponsoring Party: Aquila Networks-MPS  
& L&P

Case No.: ER-2004-0034 &  
HR-2004-0024  
(Consolidated)

Before the Public Service Commission  
of the State of Missouri

FILED

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Rebuttal Testimony

of

H. Davis Rooney

MISSOURI  
PUBLIC SERVICE COMMISSION

Exhibit No. 39  
Case No(s) ER-2004-0034  
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H. DAVIS ROONEY  
AQUILA, INC. D/B/A AQUILA NETWORKS-MPS  
AND AQUILA NETWORKS-L&P  
CASE NOS. ER-2004-0034 AND HR-2004-0024  
(CONSOLIDATED)**

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**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI  
REBUTTAL TESTIMONY OF H. DAVIS ROONEY  
ON BEHALF OF AQUILA, INC.  
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P  
CASE NOS. ER-2004-0034 AND HR-2004-0024 (CONSOLIDATED)**

1 Q. Please state your name and business address.

2 A. My name is Davis Rooney. My business address is 10750 E. 350 Highway, Raytown,  
3 MO 64138.

4 Q. Are you the same Davis Rooney that has previously filed testimony in this case before the  
5 Missouri Public Service Commission ("Commission")?

6 A. Yes.

7 Q. What is the purpose of your rebuttal testimony?

8 A. The purpose of my testimony is to respond to the direct testimony of Commission Staff  
9 ("Staff") witnesses as to the ratemaking treatment of net salvage (salvage and cost of  
10 removal); and the ratemaking treatment of pensions.

11 **RATEMAKING ACCOUNTING TREATMENT OF NET SALVAGE**

12 Q. What issue does this section discuss?

13 A. This section discusses the Aquila, Inc's ("Aquila" or "Company") rebuttal as to **WHERE**  
14 net salvage is recorded in the regulated accounts. Other sections and witnesses will  
15 address **HOW MUCH** should be allowed in rates.

16 Q. What is meant by the terms cost of removal and salvage?

17 A. Inherent in the process of retiring or removing fixed capital assets from service is a cost.  
18 This cost is termed "cost of removal." Sometimes the utility is able to recycle or resell  
19 the removed property and the value is termed "salvage."

1 Q. Please explain your understanding of Staff's adjustments for cost of removal and salvage  
2 as contained in the Staff's direct testimony.

3 A. Staff witness Cary Featherstone states that the purpose of his adjustment S-93.1 in the  
4 Aquila Networks-MPS ("MPS") electric case, S-93.1 in the Aquila Networks-L&P  
5 ("L&P) electric case and S-42.1 in the L&P steam case is to reflect cost of removal and  
6 salvage costs to be included in the cost of service expense ("cost of service" method or  
7 "Staff's method").

8 Q. Do you agree with the accounting treatment proposed by Staff?

9 A. No. I believe that the traditional method of recording these items to the accumulated  
10 depreciation reserve (rate base treatment) is the best method for accounting and  
11 ratemaking.

12 Q. Why do you disagree with Staff's accounting treatment?

13 A. My key points are as follow:

- 14 • Rate base treatment has checks and balances that provide equal protection to both  
15 the ratepayer and the Company to ensure that all and only all actual net salvage  
16 incurred is paid by the ratepayer.  
17
- 18 • Both the Missouri Code of State Regulations and the Code of Federal Regulations  
19 require rate base accounting treatment for net salvage.  
20
- 21 • Rate base treatment is better regulatory policy.
- 22 • The amount of net salvage allowed for ratemaking treatment is a separate issue  
23 from its accounting treatment in the regulated chart of accounts.  
24
- 25 • Both the Missouri Code of State Regulations and the Code of Federal Regulations  
26 include net salvage in the definition of depreciation for rate-regulated entities.  
27
- 28 • Changing to the Staff's method may prevent the Company from collecting its  
29 actual costs, resulting in a disallowance.

30  
31 Rate Base Treatment Provides Equal Protection

1 Q. Why is it important that net salvage be recorded in accumulated depreciation and also  
2 included in the depreciation rate ("rate base method" or "rate base treatment")?

3 A. Unlike Staff's method, rate base treatment ensures that the ratepayer pays for all and only  
4 all the **actual** net salvage costs of the Company.

5 Q. How does the rate base method protect the ratepayer?

6 A. Under the rate base method, when cost of removal is collected from the customer through  
7 the authorized depreciation rates, the amount received is recorded in the depreciation  
8 reserve account. Upon removal of the property, the actual cost of removal is paid by the  
9 Company and charged to the depreciation reserve account. If the amount collected from  
10 the customer is greater than the amount spent by the Company, rate base is reduced. This  
11 rate base reduction is carried forward to future rate cases, reducing the revenue  
12 requirement until lower depreciation rates are established. The ratepayers receive the  
13 Company's cost of capital as return on any over collected money through the reduction of  
14 the Company's rate base until they receive return of their money through lower  
15 depreciation rates. Over time the ratepayer pays no more than what the Company paid  
16 and earns a return through reduced rates in the interim.

17 Q. How is the Company protected?

18 A. The same protection exists for the Company. When the cost of removal collected from  
19 the ratepayers is not enough to cover actual costs, rate base is increased until depreciation  
20 rates are increased. The Company receives its authorized cost of capital as return on the  
21 under collected money through the increase in rate base until it receives return of its  
22 money through higher depreciation rates. This approach is both fair and equitable to both  
23 the Company and the ratepayer.

1 Q. How do you reconcile the allegation that the ratepayer is protected with Staff witness  
2 Rosella Schad's statements that the depreciation reserve contains an over-accrual related  
3 to net salvage?

4 A. First, Staff testimony has not acknowledged the fact that the over-accrual is reducing rate  
5 base and thereby reducing current rates by over \$16 million per year (the "return on"  
6 component). This demonstrates the built in protection for the ratepayer that does not  
7 exist with Staff's cost of service method. Second, it must be pointed out that Staff has  
8 changed its position on this issue from accrual accounting in ER-97-394 to pay as you go  
9 accounting. This change in position contributes to Staff's current perception of an over  
10 accrual. Instead of ratepayers paying the cost or receiving the benefit of net salvage  
11 during the life of the property serving them, Staff's position is now that future ratepayers  
12 will pay for the cost of removing property that has been consumed while serving current  
13 ratepayers. Third, the reserve imbalance is not solely, or even primarily the result of net  
14 salvage. MPS has only had the higher net salvage rates referred to by Staff for the four-  
15 year period 1998-2001. Fourth, if the Company had not been on the rate base method,  
16 during those four years any over accrual related to net salvage might have been lost to the  
17 ratepayer. Thus demonstrating that the protection afforded by the rate base method  
18 works.

19 Rate Base Treatment Recommended by Missouri Code of State Regulations

20 Q. Where should net salvage be recorded in the regulated books and records?

21 A. The Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts  
22 ("USOA") requires that both salvage value and cost of removal, hence net salvage, be  
23 recorded in accumulated depreciation – Federal Energy Regulatory Commission

1 ("FERC") account 108 (Title 18 Code of Federal Regulations ("CFR"), Part 101  
2 instructions for account 108).

3 Q. What treatment does the Missouri State Code of Regulations ("MoCSR") require?

4 A. The MoCSR requires that the FERC Uniform System of Accounts ("USOA") be followed  
5 except as modified by the MoCSR.

6 Q. Does the MoCSR prescribe how net salvage shall be recorded?

7 A. Yes. The MoCSR specifically provides, separate and apart from the general instruction to  
8 follow the FERC Uniform System of Accounts, that upon retirement "each electrical  
9 corporation subject to the commission's jurisdiction shall...charge original cost less **net**  
10 **salvage** to account 108..." (4 CSR 240-20.030(2)(H)) (emphasis added).

11 Q. Is account 108 – accumulated depreciation – a component of rate base?

12 A. Yes.

13 Q. What do you conclude from this?

14 A. That both the FERC and the MoCSR direct that net salvage be recorded in accumulated  
15 depreciation account 108. Account 108 is a normal component of rate base.

16 Additionally, as a component of accumulated depreciation under Missouri regulations, it  
17 is appropriate to include net salvage in the depreciation rate. In light of the equal  
18 protection it provides the ratepayer and the Company, it is the most logical and prudent  
19 approach to advocate, and in my opinion, the ratemaking approach intended by the  
20 MoCSR accounting rules. This approach makes perfect sense.

21 Rate base Treatment as Policy

22 Q. Why is the Commission's policy toward the method of recording net salvage important?

1 A. Through rate base and depreciation, the Company's investment in assets is one of the  
2 largest drivers of electric utility revenue requirements. Changes to well established  
3 practices can result in significant harm to both the ratepayer and the Company.

4 Q. How can such harm arise?

5 A. The FERC USOA is a collection of rules that work together to balance the interests of the  
6 ratepayer with the interests of the Company. Replacing one isolated rule with another,  
7 without extensive study and consideration, may result in unintended consequences to  
8 either the ratepayer or the Company, or both. Additionally, such changes may tip the  
9 balance of protection either to the harm of the ratepayer or the harm of the Company.

10 Q. How can harm arise?

11 A. Utilities are generally granted rates of returns that reflect the level of stability created by  
12 regulation. Lenders and investors will note instability. This can lead to higher required  
13 costs of money and higher costs to ratepayers.

14 Q. Is net salvage noteworthy?

15 A. Yes. I believe that in this MPS electric rate case Ms. Schad has quantified her view of  
16 Staff's previous accrual recommendation for net salvage (from Case No. ER-97-394). She  
17 states that she believes the impact of accrual accounting vs. pay as you go accounting for  
18 net salvage to be around \$13 million. This amount did not include any amounts for  
19 Terminal Salvage of power plants. This accrual level of net salvage previously  
20 recommended by Staff is about 40% of Staff's recommended depreciation rates in this  
21 case. I believe a \$13 million per year change in cash flow and a 40% change in  
22 depreciation is noteworthy.

23 Q. If viewed from a pay as you go basis, is it still noteworthy?



1 A. Yes, annual net salvage amounts can fluctuate from close to zero up to \$3 million in any  
2 given year. By comparison our last rate case produced a \$4 million change in rates.

3 Q. How has net salvage been treated in the past?

4 A. Since before 1946, net salvage has been accounted for under the rate base method. I  
5 reviewed a 1946 Form 1 for St. Joseph Light and Power. I also reviewed various Form  
6 1's for Missouri Public Service and St. Joseph Light & Power Company for years from  
7 1955 to 2001. In all the forms I reviewed, salvage and cost of removal were accorded rate  
8 base treatment by being charged to account 108 – accumulated depreciation.

9 Q. Has the Commission supported rate base treatment of net salvage in recent MPS cases?

10 A. Yes. The Commission supported rate base treatment in Case Nos. ER-90-101, ER-93-37,  
11 and ER-97-394.

12 Q. Did the Commission discuss net salvage in these prior cases?

13 A. Yes. Rate base treatment was allowed in all these cases.

14 a) In the Case No. ER-90-101 order, the Commission stated “It is also customary  
15 to recover through the depreciation rates the estimated cost of ultimately removing the  
16 asset offset by the projected amount to be realized from its salvage price.” (Report and  
17 Order Case No. ER-90-101 page 36).

18 b) In Case No. ER-93-37, the issue was settled with rate base treatment of net  
19 salvage in depreciation rates.

20 c) In the order in Case No. ER-97-394, the depreciation rates also included a  
21 provision for net salvage. (Report and Order Case No. ER-97-394 page 25)

22 Q. What has been the Commission's policy in recent cases?

1 A. Mr. Featherstone includes a list of cases in which Staff recommended cost of service  
2 treatment. The Commission has at different times supported both rate base treatment of  
3 net salvage and cost of service treatment. The Commission supported rate base treatment  
4 in Case No. GR-99-315, Laclede Gas Company, and again in Case No. WR-2000-844, St.  
5 Louis County Water Company. A number of the cases on Mr. Featherstone's list were  
6 settled for dollar amounts without resolving this issue in favor of Staff. At least one case  
7 appears to still be ongoing.

8 However, in Case No. ER-2001-299 involving The Empire District Electric  
9 Company, the Commission moved away from rate base treatment. The Commission  
10 approved Staff's method in that case. In doing so, the Commission recognized that its  
11 position was out of the ordinary and stated that its "conclusion in this case should not be  
12 taken as an endorsement of Staff's approach."

13 Q. What is your view of the ratemaking policy of including net salvage in the depreciation  
14 rates?

15 A. I think there are several key considerations, all of which support rate base treatment vs.  
16 Staff's proposed cost of service treatment:

- 17 1. Rate base treatment is supported by the accounting rules of net salvage as  
18 established in both a federal and state process that resulted in published rules in  
19 both the Code of Federal Regulations and the Missouri Code of State Regulations.  
20
- 21 2. Rate base treatment of net salvage ensures that, over time, **all and only all** gross  
22 salvage received is returned to the ratepayer and that, over time, **all and only all**  
23 cost of removal paid by the Company is charged to the ratepayer.  
24
- 25 3. Rate base treatment of net salvage compensates, on an equal basis, the ratepayer  
26 and the Company for any delays in returning or collecting these amounts.  
27
- 28 4. Rate base treatment of net salvage ensures that when, not if, actual results vary  
29 from the estimates used, both the Company and the ratepayer receive return ON

1           their money at the same fair rate authorized by the Commission, the Company's  
2           rate of return.

- 3  
4           5. Comprehensive use of rate base treatment for both net salvage and original cost  
5           provides an important compensating control on depreciation of original cost to  
6           ensure fair treatment of these important costs.

7  
8    Q.    What do you conclude?

9    A.    As a matter of policy for net salvage, rate base treatment balances the interests of the  
10        ratepayer and Company in a fair manner. The cost of service method does not. The  
11        Commission should decide in favor of its traditional method of handling this cost as a  
12        component of depreciation.

13        Amount Allowed is a Separate Issue

14   Q.    Does the recovery of an average annual amount spent, rather than an accrual amount,  
15        require cost of service treatment?

16   A.    No. For ratemaking the Missouri Commission has included both pay as you go and  
17        accrual levels in its depreciation rates. In Aquila's Case No. ER-90-101, Staff witness  
18        Melvin Love described in his Direct Testimony a methodology to recover a five-year  
19        average level of net salvage through the depreciation rate. The Commission adopted his  
20        recommendations. A similar method was recommended and adopted in our Case No.  
21        ER-93-37. In Case No. ER-97-394, Staff Witness Guy Gilbert, recommended accrual  
22        levels to be recovered through depreciation rates. The Commission also accepted this  
23        treatment.

24   Q.    What do you conclude?

25   A.    Although the Company has a clear preference for the accrual levels of net salvage  
26        proposed by Company witness Dr. Ronald E. White, the rate base treatment is not

1 dependent on the amount authorized for recovery. Rate base treatment is compatible with  
2 both the accrual amount and the average annual amount. As explained above, the rate  
3 base treatment provides balanced protection to the interests of both the ratepayer and the  
4 Company. The Commission should retain its traditional rate base treatment of net  
5 salvage regardless of the level of recovery it ultimately allows in rates.

6 Net Salvage is a Required Component of Depreciation

7 Q. Would you please provide a formal definition of net salvage value?

8 A. The MoCSR directs electrical corporations within the Commission's jurisdiction to use  
9 the uniform system of accounts prescribed by the FERC. The MoCSR points out that  
10 FERC's uniform system of accounts contains definitions relevant to electric utilities (4  
11 CSR 240-20.030(1)). The definition of net salvage can be found in the FERC Uniform  
12 System of Accounts.

13 "Net salvage value means the salvage value of property retired less the cost of  
14 removal" (18 CFR Part 101 Definitions (19)).

15  
16 Salvage value is sometimes referred to as "gross salvage value".

17 Q. Can you provide an example of net salvage?

18 A. Yes. Suppose the utility poles in an overhead electric distribution line has reached the  
19 end of its useful life and need replacement. In the process of replacing the poles, the  
20 Company will put up new poles and take down the existing utility poles. In doing this,  
21 the company will incur cost of removal to take down the existing poles. The Company  
22 may also salvage some of the materials taken down. To the extent the materials taken  
23 down are sold for cash, they will generate cash salvage. To the extent the materials are in  
24 good condition and can be reused, they will be returned to inventory and generate non-

1 cash salvage, also called reuse salvage. The difference between the cost of removal and  
2 the salvage value (both cash and non-cash) is net salvage.

3 Q. Would you please define depreciation?

4 A. As directed to FERC by the MoCSR, the definition can be found in the FERC Uniform  
5 System of Accounts. The FERC USOA defines depreciation as follows (emphasis  
6 added):

7 Depreciation, as applied to depreciable electric plant, means the loss in **service**  
8 **value** not restored by current maintenance, incurred in connection with the  
9 consumption or **prospective retirement** of electric plant in the course of service  
10 from causes which are known to be in current operation and against which the  
11 utility is not protected by insurance. Among the causes to be given consideration  
12 are wear and tear, decay, action of the elements, inadequacy, obsolescence,  
13 changes in the art, changes in demand and requirements of public authorities. (18  
14 CFR Part 101 Definitions (12))

15  
16 Just to clarify, "electric plant" means all the poles, towers, wires, transformers, meters,  
17 substations, etc., and not just the generating power plants.

18 Q. Would you please define service value?

19 A. Again, as directed to FERC by the MoCSR, the definition can be found in the FERC  
20 Uniform System of Accounts (emphasis added):

21 Service value means the difference between original cost and **net salvage value** of  
22 electric plant. (18 CFR Part 101)

23  
24 Q. Do you draw any conclusions from these definitions?

25 A. Depreciation, as it pertains to rate regulated entities, is a specially defined term. Based on  
26 the definitions prescribed by the MoCSR, one can conclude that net salvage value is an  
27 integral part of the determination of depreciation. One cannot estimate the loss to  
28 retirement without considering the value at retirement (net salvage). Both original cost

1 and net salvage are necessary to properly determine depreciation for ratemaking.

2 Therefore, it is appropriate to include net salvage in the depreciation rate.

3 Staff's Method Results In a Disallowance

4 Q. Is there any evidence that Staff's estimation method will not equal actual costs incurred  
5 over time?

6 A. Yes. I have prepared Schedule HDR-1 to analyze the results of this methodology. That  
7 schedule shows in the first column 20 years of net salvage data, extracted from MPS's  
8 FERC Form 1's. These amounts are representative of the fluctuations and trends in the  
9 Company's net salvage amounts. The next column labeled "Rate Recovery 5 yr Average"  
10 is the amount Staff's 5-year average estimation methodology would allow in rates. The  
11 foundation for the calculation is given that MPS had rate cases in 1990, 1993, and 1997.  
12 A 5-year average would have been implemented in 1990, recalculated in 1993 and again  
13 in 1997. The net result of actual incurred costs compared to the 5-year average that  
14 would have been allowed in rates by year is shown in the next column labeled "(Under)  
15 Over Recovery. Utilizing Staff's method retrospectively shows that MPS would have  
16 under-recovered \$3.9 million of the actual costs – more than what would have been  
17 incurred in any one year. In addition to the \$3.9 million, MPS would have been denied  
18 \$900,000 in return on the monies advanced by its debt holders and shareholders to pay  
19 those actual costs.

20 Q. Did you perform additional calculations to test your conclusion that Staff's pay as you go  
21 method does not even out over time?

1 A. Yes. I again utilized the 20 years of actual net salvage data shown. For the most recent  
2 15 years (the first five years are required to set the first five year average), I calculated  
3 another scenario (See Schedule HDR-2).

4 I used Staff's 5-year average methodology. I calculated the recovery that would  
5 result from a rate case every year. Theoretically, this should result in the closest  
6 approximation of "perfect" regulation. Over the fifteen years, this also resulted in a \$3.9  
7 million under-recovery of actual costs. Again, this is more than the actual cost in any one  
8 year. The under recovery grew to be more than a full year behind.

9 Q. Did you perform additional scenarios?

10 A. Yes. I used Staff's methodology to calculate the result of a rate case every 5 years. This  
11 resulted in an under-recovery of actual costs over the 15 years of \$5.1 million.

12 I also used Staff's methodology to calculate four additional scenarios with a rate  
13 case every five years but varying the starting year of the 5-year cycles. This resulted in  
14 under-recovery of actual costs between \$4.1 and \$5.1 million. In all cases, the under  
15 recovery grew to be more than one full year behind, that is more than a full year short of  
16 full recovery.

17 Q. What do you believe causes this result?

18 A. I believe Staff's method does not allow full recovery of the true expected test period costs  
19 for the following reasons:

- 20 1. Staff uses a 5- year average. This implicitly sets the price level at the level 2.5  
21 years ago. The last year of data used by Staff was for the year ended 2002. The  
22 midpoint of the first year of rates in this case is approximately December of 2004.  
23 This adds 2.0 additional years of price difference. In total, Staff's method

1 proposes that rates for 2004-2005 be determined from costs based on price levels  
2 4.5 years old.

3 2. Staff does not allow for the increase in plant. As plant balances grow from year to  
4 year, retirements also grow. The annual growth in plant 40 years ago drives  
5 retirements today. Just as Staff's method lags behind the price levels to remove  
6 plant, the method also lags behind the growth in the amount of plant that drives  
7 retirements.

8 3. The annual amounts are volatile (see Schedule HDR-1 showing annual amounts  
9 ranging from \$233,000 to over \$2.8 million). An averaging method may not be  
10 adequate to fairly address this volatility. Using a longer average will just increase  
11 the problems identified in points 1) and 2).

12 Q. What do you conclude?

13 A. I conclude:

- 14 • Staff's estimation method does not even out over a reasonable period of time.
- 15 • Staff's estimation method can result in a sizeable disallowance of actual costs.
- 16 • Staff's estimation method creates, rather than avoids, disallowances. Actual costs  
17 incurred are disallowed.
- 18 • No return is allowed on the annual differences, creating an additional disallowance of the  
19 return on monies the Company's debt holders and shareholders are required to invest to  
20 pay for those costs.
- 21 • The Commission should approve including net salvage in depreciation rates. As noted  
22 above, utilization of rate base treatment for net salvage, that is including net salvage in



1 depreciation rates, provides balanced protection to the ratepayer and Company, for  
2 problems such as this in the Staff's recommended estimation process.

3 Conclusion Regarding Ratemaking Accounting for Net Salvage

4 Q. What actions do you propose for this case?

5 A. I propose that: 1) the Commission approve depreciation rates that include net salvage;  
6 and 2) that net salvage be recorded for ratemaking and financial reporting in accumulated  
7 depreciation consistent with the state and federal codes of regulations.

8 ACCRUAL vs. PAY AS YOU GO AMOUNT OF NET SALVAGE

9 Q. What issue does this section of your testimony discuss?

10 A. This section discusses whether the amount of net salvage should be based on accrual or  
11 pay as you go amounts. As noted previously, the Company views this issue as separate  
12 from the issue of rate base or cost of service treatment.

13 Q. What is Staff's position on this issue?

14 A. Staff includes in revenue requirements only the five-year average annual amount of net  
15 salvage.

16 Q. Do you agree with this position?

17 A. No. The ratepayers should pay their share of the costs incurred to serve them regardless  
18 of when the Company is required to ultimately pay those costs.

19 Q. What are pay as you go amounts?

20 A. Pay as you go refers to the estimated amounts paid or received by the Company for net  
21 salvage in any one year.

22 Q. What are accrual net salvage amounts?

23 A. This refers to the estimated amounts consumed by ratepayers in any one year.

1 Q. Can you give an example?

2 A. When a distribution utility pole is installed, we know it will wear out over its useful life  
3 and ultimately be removed. During the life of that pole it serves the customer. At the end  
4 of its life it must be removed at some cost. In the Company's depreciation study  
5 presented by Dr. Ronald E. White, the cost of removing that pole is about 75% of the  
6 original installed cost of the pole. This percent is consistent with the percent calculated  
7 by Staff in MPS Case No. ER-97-394 (Guy Gilbert direct testimony Schedule 2, account  
8 364). If the pole cost \$1000 to install it will cost about \$750 to remove. Such a pole  
9 generally has little salvage value. The total cost of serving the customer is \$1750.

10 Q. Who will pay this cost?

11 A. The depreciation rates proposed by Staff will recover \$1000 of the cost over the life of the  
12 pole. That amount will be charged to the customers served by that pole.

13 Q. Who pays for the other \$750 dollars?

14 A. Staff proposes that the \$750 be charged to **future** customers that are not being served by  
15 that pole. This shifts part of the total cost of providing service from the current ratepayer  
16 and places the cost on the future ratepayer.

17 Q. What is Company's concern?

18 A. Besides the concern noted previously that the pay as you go amount proposed by Staff  
19 does not cover our actual pay as you go amounts, Company is concerned that:

- 20 1. Current customers are being granted lower rates at the expense of future  
21 customers (an intergenerational inequity); and,  
22 2. Recovery of this basic cost of serving current customers might be denied in the  
23 future if not collected now.

1 Q. Why is the Company concerned that net salvage might be denied in the future?

2 A. Staff's method allows recovery at retirement but not before. In contrast to this method of  
3 allowing the costs only at retirement, Public Counsel has, in at least one prior case (Case  
4 No. WR-2000-281) advanced an argument to disallow those same costs at retirement  
5 because the subject property is no longer used and useful. In essence, Staff argued the  
6 retirement costs should not be recovered during the revenue producing years and Public  
7 Counsel argued that any costs not allowed recovery during the revenue producing years  
8 should not be allowed any recovery after the revenue producing years. This produces an  
9 unusual result if depreciation rates do not include net salvage or the estimated lives are  
10 too long. Both undepreciated original cost and net salvage could be disallowed at  
11 retirement.

12 Q. What does the Company propose?

13 A. The Company should be allowed protection against this hidden disallowance. The  
14 Commission should allow, during the revenue producing years of the property, recovery  
15 of all property related costs required to serve the customer. The Commission should  
16 approve Company's recommended depreciation rates that include net salvage as  
17 presented in Company witness Dr. Ronald E. Whites' testimony.

18 **PENSIONS**

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

20 A. I will address the pension expense and prepaid pension asset testimony of Staff.

21 Q. What are your primary issues with Staff's testimony?

22 A. The following is a summary of my key issues:

- 1 • Staff proposes to disallow recovery of portions of the prepaid pension balance.  
2 The regulatory treatment of these balances was resolved in prior stipulated cases.  
3 The Commission should not disallow these amounts.
- 4 • ERISA authorizes a range of reasonable funding amounts. Staff proposes a  
5 pension method that provides only the absolute minimum funding amount. The  
6 Commission should allow for contributions within the range of reasonable  
7 funding amounts allowed by ERISA, not limit that funding to the absolute  
8 minimum.
- 9 • Staff does not propose to adjust the ERISA minimum calculation to remove the  
10 benefits provided to the ratepayer by disallowed “voluntary” contributions. The  
11 ERISA minimum used for ratemaking should exclude the benefits of prior  
12 contributions in excess of the ERISA minimum, unless those amounts in excess of  
13 the minimum have been expressly allowed in rates.
- 14 • Staff’s proposed method is based on annual amounts that appear even more  
15 volatile than Staff’s current method under Financial Accounting Standard 87  
16 (FAS 87).

### Prepaid Pension Asset

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

20 A. Yes, I have.

21 Q. What did you find noteworthy in your review?

22 A. I was most surprised to find that Staff failed to clearly identify in either their direct  
23 testimony or the listed accounting adjustments the disallowance of over \$16,600,000

1 (\$6,824,036 for L&P and \$9,782,554 for MPS) of the prepaid pension asset on the  
2 Company's books at September 30, 2003.

3 Q. Why did this surprise you?

4 A. Both L&P and MPS resolved this issue in prior cases. For L&P it was Case No. ER-94-  
5 163 and for MPS it was Case No. ER-93-41. Additionally, both L&P and MPS are  
6 currently on FAS 87 for ratemaking. Under FAS 87 this prepaid pension balance would  
7 be included in ratemaking cost of service.

8 Q. What is the prepaid pension balance?

9 A. The prepaid pension balance represents a prepaid expense under FAS 87. As a prepaid  
10 expense recorded on the balance sheet, it has not yet been charged to expense in the  
11 income statement. The prepaid expense will be charged to expense in the income  
12 statement under FAS 87 at some point in the future. Both L&P and MPS are currently on  
13 FAS 87 for ratemaking. This means that the expense determined under FAS 87,  
14 including any prepaid pension charged to expense, is currently used for ratemaking and  
15 would be included in rates if we remained on FAS 87. Therefore when Mr. Traxler  
16 proposes to transition the Company from FAS 87 to the contribution method, he should  
17 have included the prepaid pension balance as September 30, 2003 in rate base and in his  
18 calculation of amortization of prepaid pension costs.

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

20 A. The Staff's recommendation results in a disallowance of currently allowed costs.

21 Q. How would this occur?

22 A. Staff's position is that the entire prepaid pension balance should not be recoverable, but  
23 only that portion of the MPS prepaid pension balance since March 18, 1998 and that

1 portion of the L&P balance since June 15, 1994, is eligible for recovery in rates. As part  
2 of their proposed transition from FAS 87 to ERISA minimum contribution, Staff  
3 proposes recovery of this reduced prepaid pension balance by amortizing it to expense  
4 ("prepaid pension amortization").

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

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

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

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

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

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

25 Q. What happens to this timing difference over time?

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

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

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

7 Q. Is this the only analysis you performed to reach the conclusion that Staff was  
8 recommending an inappropriate disallowance?

9 A. No. I also researched each Company's ratemaking history regarding pension costs.

10 Q. Has this issue been addressed before?

11 A. Yes. I reviewed the rate orders for MPS and L&P. Both MPS and L&P resolved this  
12 issue in prior cases. Each company resolved the issue in a different manner, because each  
13 had unique facts. I found that this issue had been settled in specific language in  
14 stipulations approved by the Commission for both MPS and L&P.

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

16 A. For L&P, it was the result of two cases. The first order was in Case No. ER-93-41. This  
17 case ordered L&P onto ERISA minimum funding for ratemaking. The second order was  
18 in Case No. ER-94-163. That case ordered L&P back onto FAS 87. Contrary to the  
19 stated intent of the Commission in that case, Case No. ER-93-41 actually created a  
20 *difference between the ratemaking and financial prepaid pension balance*. This was  
21 corrected in Case No. ER-94-163 by the parties stipulating to the elimination of the  
22 *difference between the ratemaking and financial prepaid pension balance*.

1 Q. What was the order that showed MPS was on FAS 87 for ratemaking prior to March 18,  
2 1998?

3 A. For MPS the order was in Case No. ER-93-37. The stipulation states in part "Signatories  
4 agree that Company's accounts shall reflect pension costs equal to contributions made to  
5 its established pension funds, discontinuing its previous practice under FAS 87 effective  
6 June 29, 1993." (Case No. ER-93-37, Stipulation and Agreement attached to Report and  
7 Order.) This ratemaking order specifies the day on which MPS was to discontinue FAS  
8 87 and begin a contribution approach. This stipulation establishes ratemaking that  
9 preserved the financial reporting prepaid pension balance as of June 29, 1993 as a  
10 regulated asset.

11 L&P Prepaid Pension Asset

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

13 A. L & P was ordered onto the ERISA minimum contribution method in that case.

14 Q. What did the Commission conclude in that case?

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

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

24  
25 Q. How do you interpret this order?

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



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

2 A. L&P wrote off its FAS 87 Prepaid Pension balance to expense. L&P did this by  
3 recording a regulatory liability for its prepaid pension balance. L&P continued adjusting  
4 the regulatory liability to equal its prepaid pension balance until its next rate case

5 Q. How would you characterize this regulatory liability?

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

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

12 A. In Case No. ER-94-163, L&P was ordered back onto FAS 87 and allowed to reverse the  
13 existing regulatory liability. Since the regulatory liability represented the difference  
14 between the amount of prepaid pension asset on L&P's financial books and the prepaid  
15 pension asset allowed for ratemaking, the Commission order established that the financial  
16 prepaid pension balance was also the ratemaking prepaid pension balance. Additionally,  
17 by returning to FAS 87 for ratemaking, the order provided a mechanism (FAS 87  
18 expense) for recovery of the prepaid pension balance.

19 Q. What did the order say?

20 A. That order, in part, reads:

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

1           **B. In setting rates in future SJLP electric rate cases, the Commission shall**  
2           **not consider the following items existing on the books of SJLP as of the**  
3           **effective date of the tariff sheets authorized in this case:**  
4           **any regulatory liability balances related to FAS 87, and**  
5           the accumulated difference between (a) the recorded FAS 106..." (Case No. ER-  
6           94-163, Report and Order, Attachment 1, Item 3A and 3B(i)).  
7

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

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

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

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

12 Q.    What is the purpose of the regulatory liability?

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

15 Q.    What amount or prepaid pension balance is the Staff disallowing from recovery in this  
16       case (ER-2004-0024)?

17 A.    Staff reduced the prepaid pension balance in this case by the balance at June 15, 1994, or  
18       \$6,824,036.

19 Q.    What does this indicate to you?

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

22 Q.    Who testified on behalf of Staff regarding pensions in Case No. ER-94-163 at the  
23       Stipulation and Agreement hearing?

24 A.    Although Charles R. Hyneman filed the Staff's direct testimony on pensions, Steve  
25       Traxler responded for Staff at the Stipulation and Agreement hearing to a question by

1 Commissioner McClure regarding pensions (Case No. ER-94-163, Stipulation and  
2 Agreement, Transcript dated May 31, 1994, page 24, lines 3-6).

3 Q. What was stated at that Stipulation and Agreement hearing?

4 A. Examiner Bensavage asked for clarification regarding the meaning of Section B  
5 subsection (i) (quoted above). In response Mr. Duffy stated in part:

6 "But I guess one way to put it would be that this would preclude the parties from  
7 going back and grabbing something that existed on June 15<sup>th</sup> and using it in a  
8 manner that's not intended by resolution of this case."  
9 -- (Case No. ER-94-163, Stipulation and Agreement, Transcript dated May 31,  
10 1994, page 31, lines 15-18).

11  
12 Q. Did your review find other pertinent facts?

13 A. Yes, I found that St. Joseph Light & Power Company (SJLP) orders apply also to Aquila  
14 Networks-L&P ("L&P").

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

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

18 Q. What do you conclude regarding L&P?

19 A. I conclude that:

- 20 • L&P wrote off its prepaid pension balance by establishing an offsetting regulatory  
21 liability as a result of Case No. ER-93-41.
- 22 • In Case No. ER-94-163, as part of the stipulation implementing FAS 87 for  
23 ratemaking, the prepaid pension balance was re-established as a recoverable  
24 ratemaking asset, allowing L&P to reverse the offsetting regulatory liability. This  
25 fulfilled the stated intent of the Commission in Case No. ER-93-41.

- 1           • In the current case Staff is going back and attempting to disallow the balance that  
2           existed at June 15, 1994 for current ratemaking in direct contradiction to the terms  
3           of the stipulation in Case No. ER-94-163. See Schedule-HDR-4 for Staff's work  
4           paper in this case showing the reduction of the L&P prepaid pension balance by  
5           the balance at June 15, 1994. This is precisely the same balance as the regulatory  
6           liability balance referred to in the stipulation to Case No. ER-94-163.
- 7           • Since the prepaid pension balance arose for ratemaking on June 15, 1994, the total  
8           balance at September 30, 2003 of \$40,898,260 should be amortized into rates over  
9           9.25 years at \$4,421,433 per year with appropriate adjustments for jurisdiction and  
10          capitalization of this expense.
- 11          • If the Commission upholds Staff's position, it would be confiscating a regulatory  
12          asset that L&P established through the ratemaking process in Case No. ER-94-  
13          163. L&P would be required to reestablish the regulatory liability that existed as  
14          of June 15, 1994 and which was reversed as a result of the stipulation in Case No.  
15          ER-94-163. This would be contrary to the plain language of the stipulation.

16    MPS Prepaid Pension Asset

17   Q.       How much of MPS's prepaid pension balance has Staff disallowed from current rate  
18              recovery?

19   A.       The amount of MPS's prepaid pension balance that has been excluded is \$9,782,554.

20   Q.       Is this entire amount in dispute?

21   A.       No. As indicated in my direct testimony and consistent with the stipulation in Case No.  
22              ER-93-37, MPS recorded an offsetting regulatory liability in the amount of \$2,309,530

1 during the period from 6/29/1993 to 3/18/1998; therefore only the prepaid pension  
2 balance at 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 prior to March 18,  
4 1998?

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

12 Q. What is the impact of this agreement?

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

21 Q. How did the stipulation fix and limit the balance of prepaid pensions as a regulatory  
22 asset?

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

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

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

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

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

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

6 A. No. There is no difference between the prepaid pension balance at June 29, 1993 and the  
7 net regulatory asset fixed and limited to that balance by this stipulation. The stipulation  
8 was a joint agreement to both fix and limit the net balance. MPS created and  
9 acknowledges its regulatory liability for the period this agreement was in force (Case No.  
10 ER-93-37 until Case No. ER-97-394). This regulatory liability upholds its agreement to  
11 limit the balance during this time. Staff seeks to set aside its agreement that fixed the  
12 balance.

13 Q. What was Staff's position on prepaid pensions at the time of the stipulation in Case No.  
14 ER-93-37?

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

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

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

22 Q. What is Staff's position on this issue in this case?

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

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

6 A. I conclude the following:

- 7 • MPS negotiated a stipulation in Case No. ER-93-37.
- 8 • This stipulation both established and limited the prepaid pension balance for  
9 ratemaking to the balance at June 29, 1993.
- 10 • The Staff now seeks to overturn that stipulation by reducing current prepaid pensions  
11 by a total of \$9,782,554. This is \$7,473,024 more than the \$2,309,530 reduction in  
12 prepaid pensions created by the stipulation in ER-93-37.
- 13 • It was neither the Staff's position at the time nor the Company's understanding when  
14 it negotiated this stipulation, that a write off of that balance was required.
- 15 • The Commission should reject this effort to disallow amounts negotiated over 10  
16 years ago and allow the amortization into rates of MPS's entire prepaid pension  
17 balance at September 30, 2003, of \$21,720,199, less the regulatory liability for  
18 pensions or \$2,309,530, created by the stipulation in ER-93-37, with appropriate  
19 adjustments for jurisdiction and capitalization of this expense.

20 Pension Expense

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

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

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



1 A. No. Company disagrees for the following reasons:

- 2 • Staff does not adjust the ERISA minimum for the benefits of what they term  
3 “voluntary” contributions that they propose to disallow.
- 4 • The ERISA minimum is likely to be as volatile as the FAS 87 amounts.
- 5 • The ERISA minimum places unnecessary limitations on management’s discretion in  
6 determining the timing and amount of pension contributions.
- 7 • The ERISA rules provide for a range of allowable funding levels. Staff has chosen to  
8 focus on the lowest possible funding level.

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

10 A. Yes. Staff notes that the FAS 87 amounts for 2001 and 2003 increased from  
11 (\$15,267,120) to \$8,427,028, an increase of \$23.7 million in two years (Traxler Direct,  
12 page 9, line 12-13). In contrast, take note that the ERISA minimum in 2002 was \$0 and  
13 the projected 2004 ERISA minimum was \$37 million, an increase of \$37 million. This  
14 greater volatility in the annual amount of ERISA minimums is why Mr. Traxler finds the  
15 annual amounts unacceptable and resorts to using a 5-year average to attempt to address  
16 this volatility.

17 Q. How does the ERISA minimum limit management discretion?

18 A. Management may desire to limit the potential volatility of the annual ERISA minimum.  
19 One method may be through averaging its contributions, much as Staff proposes an  
20 averaging of the ERISA minimum for ratemaking. Management may also desire to  
21 provide employees with some amount of funding “cushion” against market downturns.  
22 As we have seen recently, failure to have an adequate buffer during a market downturn  
23 puts employee pensions at risk, increases exposure to unnecessary Pension Benefit

1 Guarantee Corporation (PBGC) variable premium costs, and can result in unnecessary  
2 financial statement instability. The ERISA rules also provide for a maximum allowable  
3 contribution. Exclusive use of the ERISA minimum limits the Company and its  
4 employees to the minimum protection. This approach can increase the volatility of the  
5 ERISA minimum since only the minimum buffer exists to soften the impact against  
6 market movements. Staff proposes to disallow any contribution above the minimum.

7 Q. How is Staff seeking to disallow recovery of future contributions in excess of the ERISA  
8 minimum?

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

19 Q. Do contributions in excess of the ERISA minimum benefit the ratepayer?

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

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

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

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

6 A. See Schedule HDR-3 for an example. Suppose the ERISA minimum, without voluntary  
7 contributions, were \$2,000 for Year 1 and \$2,000 for Year 2. Suppose the Company were  
8 to contribute \$3,000 in Year 1. By the Company contributing an extra \$1,000 in Year 1,  
9 the impact on Year 2 of that additional \$1,000 contribution above the ERISA minimum  
10 produces a reduction of approximately \$1,080 in Year 2 applied towards the ERISA  
11 minimum calculation of \$2,000. So instead of an ERISA minimum of \$2,000 in Year 2,  
12 the calculated ERISA minimum is \$920.

13 Q. Under the Staff's currently proposed method what would be the impact to the Company?

14 A. Not only would the \$1,000 contribution in excess of the ERISA minimum be disallowed,  
15 but under Staff's proposal Staff would also disallow any contribution in excess of \$920 in  
16 Year 2. So instead of allowing \$4,000 over the two years as initially calculated under the  
17 ERISA minimum without "voluntary" contributions, only \$2,920 would be allowed.

18 While the Company would only be allowed to recover \$2,920, the Company would have  
19 \$3,920 for the benefit of its employees towards \$4,000 in valid cost of service for its  
20 customers.

21 Q. Is there a way to easily adjust the ERISA minimum for prior contributions in excess of  
22 the ERISA minimum?

1 A. Although it does not account for all the impacts, it may be possible by simply adding  
2 back to the ERISA minimum any reductions in the Funding Standard Account Credits  
3 related to prior "voluntary" contributions, and the interest on those contributions, not  
4 previously allowed in rates.

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

6 A. No, on the contrary, MPS proposed to the Staff and Commission to adopt contribution  
7 methods in 1988, 1990, 1993 and 1997. However the Company believes the contribution  
8 methodology should be appropriately applied incorporating the following guidelines:

- 9 • No disallowance of prepaid pensions previously negotiated into regulated assets.
- 10 • Allowing a range of acceptable contributions may produce less volatility than using the  
11 ERISA minimum.
- 12 • No arbitrary disallowance of contributions in excess of the ERISA minimum.
- 13 • If actual contributions are not to be the primary basis for determining allowable pension  
14 expense, then a procedure to recover contributions in excess of the ERISA minimum  
15 should be implemented. The Company proposes that these contributions in excess of the  
16 "adjusted" ERISA minimum should be a) capitalized as a regulatory asset; and b) held as  
17 a regulatory assets until i) they are be shown to have benefited the ratepayer and ii) are  
18 then allowed full recovery in rates including a return from when the funds were  
19 committed.
- 20 • The Company further contends that the ERISA minimum to be used as the measurement  
21 should be calculated without the inherent reduction caused by "voluntary" contributions  
22 made by the Company, unless the voluntary contributions have been explicitly included in  
23 rates. A simple adjustment to the ERISA minimum may be sufficient to accomplish this.

Accrual Basis Ratemaking for Pensions

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

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

Q. What do "pay as you go" and "cash" basis mean?

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

Q. Can you provide an example?

A. Yes. Before the implementation of FAS 106, Staff correctly characterizes other post-employment benefit costs ("OPEBs") as pay as you go or cash basis. The employees earned the right to post retirement health benefits during their working years. The Company recognized the expense only when the claims for benefits were filed and paid, after the employees retired. Expense was matched with the payment of the obligation not with the period in which the employee earned the benefit. With the implementation of FAS 106, the expense is recognized in the years of employment, not after retirement when benefits are paid.

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

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

1 pension expense is recognized after the employee retires. Under an accrual basis pension  
2 expense is recorded before the employee retires.

3 Q. Why are these terms inappropriate to describe pensions?

4 A. To my knowledge pension expense after 1966 has not been recognized on a "benefits  
5 paid" basis either for financial reporting or for ratemaking. Pension expense has been  
6 recognized on an accrual basis since at least 1966.

7 Q. What happened in 1966?

8 A. APB 8 was implemented for pension accounting. This accounting standard was the  
9 predecessor of FAS 87. This accounting standard, like FAS 87, specified that pension  
10 expense be recorded on an accrual basis using an acceptable actuarial cost method. Any  
11 differences between the APB 8 accrual expense and the amounts actually funded to the  
12 pension plan were required to be recorded in the financial statements as accrued (liability)  
13 or prepaid (asset) pension costs. ERISA is also an actuarially based accrual calculation  
14 because it recognizes today the cost of pensions that will not be paid to employees until  
15 after they retire. Therefore contributions that are in compliance with ERISA are  
16 "accrual" and not "cash basis" in nature.

17 Q. Was ratemaking prior to 1987 based on accrual expense amounts?

18 A. Yes.

19 Q. What is the basis for this conclusion?

20 A. I reviewed prior MPS annual reports and FERC Form 1's. My review of MPS annual  
21 reports and Form 1's revealed no significant regulated prepaid or accrued pension  
22 amounts. In fact prior to 1987, the footnotes in the MPS annual report state, "The  
23 company's policy is to fund current pension costs accrued and prior service costs which

1 are being amortized over 30 years.” (Missouri Public Service Company 1984 Annual  
2 Report – Note 7 Retirement Plans). Similar statements are in the years I reviewed from  
3 1983 through 1986. This indicates that MPS was funding to the pension plan the accrual  
4 (APB 8) expense amount. With some minor timing variances, the APB 8 pension  
5 expense and the pension funding amounts (contributions to the pension plan) were the  
6 same for years prior to 1987.

7 Q. Did you review other material to support this?

8 A. Yes. I reviewed Staff testimony. Staff testified in 1993:

9 “My understanding is, just about every authority I’ve looked at, generally the  
10 determination of pension expense prior to FASB 87 was equal to the funding  
11 amount in almost every case.”...”In other words, I’ve never seen any utility  
12 suggest the two weren’t almost equal or equal prior to FASB 87.” (Case No. ER-  
13 93-41, Traxler Deposition, page 28, line 4-12)

14  
15 Q. How does Staff characterize pension expense prior to 1987?

16 A. Staff states that pension expense equaled contributions.

17 Q. Do you agree with this?

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

23 Q. What do you conclude?

24 A. I conclude the following:

- 25 • Prior to 1987 MPS funding was based on the contribution of amounts determined in  
26 accordance with GAAP.

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

### FINAL CONCLUSIONS

9 Q. Could you please summarize your testimony regarding Net Salvage?

10 A. My key points are as follows:

- 11 • Net Salvage should be included in depreciation rates (rate base treatment) regardless  
12 of whether pay as you go or accrual amounts are ultimately allowed in rates.
- 13 • Rate base treatment provides fair and equitable protections to both the ratepayer and  
14 the Company. These protections are not available under the cost of service treatment  
15 proposed by Staff.
- 16 • Staff's five-year average lags pricing and increases in plant resulting in a significant  
17 under recovery of actual costs incurred.
- 18 • Accrual amounts as proposed by the Company should be approved in order that the  
19 full cost of serving current ratepayers be paid by current ratepayers and not transferred  
20 to future ratepayers. Staff's pay as you go approach transfers costs of serving current  
21 ratepayers to future ratepayer.

22 Q. Could you please summarize your testimony regarding pensions?



1 A. My key points are as follows:

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

1 Q. Does this conclude your rebuttal testimony?

2 A. Yes it does.

**Retrospective Analysis of Staff's Method**

**New Rates in 1990, 1993, 1997, 2002**

Year	Net Salvage*	Rate Recovery 5 Year Average	(Under)/Over Recovery	10% Lost Return
1982	(\$285,184)			
1983	(\$233,229)			
1984	(\$487,664)			
1985	(\$719,089)			
1986	(\$594,983)			
1987	(\$1,345,466)			
1988	(\$492,778)			
1989	(\$958,871)			
1990	(\$2,834,552)	(\$822,237)	(\$2,012,315)	(\$201,231)
1991	(\$1,383,104)	(\$822,237)	(\$560,867)	(\$76,210)
1992	(\$2,393,160)	(\$822,237)	(\$1,570,923)	(\$184,836)
1993	(\$1,458,895)	(\$1,612,493)	\$153,598	(\$30,868)
1994	(\$1,077,688)	(\$1,612,493)	\$534,805	\$4,166
1995	(\$2,078,493)	(\$1,612,493)	(\$466,000)	(\$95,498)
1996	(\$268,029)	(\$1,612,493)	\$1,344,464	\$75,999
1997	(\$812,005)	(\$1,612,493)	\$800,488	\$29,201
1998	(\$544,714)	(\$1,139,022)	\$594,308	\$11,503
1999	(\$1,087,801)	(\$1,139,022)	\$51,221	(\$41,655)
2000	(\$2,690,620)	(\$1,139,022)	(\$1,551,598)	(\$206,103)
2001	(\$2,309,712)	(\$1,139,022)	(\$1,170,690)	(\$188,622)
Total			(\$3,853,508)	(\$904,156)

\*Source: MPS FERC Form 1

## Retrospective Analysis of Staff's Method

### New Rates Each Year

Year	Net Salvage*	Rate Recovery 5 Year Average	(Under)/Over Recovery	10% Lost Return
1982	(\$285,184)			
1983	(\$233,229)			
1984	(\$487,664)			
1985	(\$719,089)			
1986	(\$594,983)			
1987	(\$1,345,466)	(\$464,030)	(\$881,436)	\$0
1988	(\$492,778)	(\$676,086)	\$183,308	(\$88,144)
1989	(\$958,871)	(\$727,996)	(\$230,875)	\$9,516
1990	(\$2,834,552)	(\$822,237)	(\$2,012,315)	(\$30,950)
1991	(\$1,383,104)	(\$1,245,330)	(\$137,774)	(\$212,189)
1992	(\$2,393,160)	(\$1,402,954)	(\$990,206)	(\$45,954)
1993	(\$1,458,895)	(\$1,612,493)	\$153,598	(\$135,793)
1994	(\$1,077,688)	(\$1,805,716)	\$728,028	(\$34,992)
1995	(\$2,078,493)	(\$1,829,480)	(\$249,013)	\$18,952
1996	(\$268,029)	(\$1,678,268)	\$1,410,239	(\$76,857)
1997	(\$812,005)	(\$1,455,253)	\$643,248	\$81,383
1998	(\$544,714)	(\$1,139,022)	\$594,308	\$12,822
1999	(\$1,087,801)	(\$956,186)	(\$131,615)	\$9,210
2000	(\$2,690,620)	(\$958,208)	(\$1,732,412)	(\$62,461)
2001	(\$2,309,712)	(\$1,080,634)	(\$1,229,078)	(\$228,787)
Total			(\$3,881,994)	(\$705,614)

\*Source: MPS FERC Form 1

**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

Work Paper of Steve Traxler

**Prepaid Pension Asset and Amortization**

Case Number ER 2004-0034

**Prepaid Asset & Amortization - L&P Division**

		L & P	
Prepaid Pension Asset -	Sept. 30, 1993 <sup>1003</sup>	\$ 40,898,260	L&P Workpaper - WC 20 A
Prepaid Pension Asset -	June 15, 1994	\$ 6,824,036	DR 476 - ER 94-163
Prepaid Asset since adopting FAS 87		\$ 34,074,224	
Electric Allocation	93.70%	\$ 31,927,548	L&P
Steam Allocation	3.71%	\$ 1,284,154	L&P
Gas Allocation	2.59%	\$ 882,522	
<b>Total</b>	<b>100.00%</b>	<b>\$ 34,074,224</b>	

**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 <sup>L&amp;P S-94.6</sup>
Steam	\$ 136,665	81.47%	\$ 111,341 <sup>L&amp;P S-31.4</sup>
Gas	\$ 95,408	81.47%	\$ 77,729
<b>Total</b>	<b>\$ 3,683,700</b>		<b>\$ 3,001,110</b>

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

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

Case No. ER-2004-0034

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

Case No. HR-2004-0024

County of Jackson )  
State of Missouri )

ss

AFFIDAVIT OF H. DAVIS ROONEY

H. Davis Rooney, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of H. Davis Rooney;" that said testimony was prepared by him and 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.

H. Davis Rooney  
H. Davis Rooney

Subscribed and sworn to before me this 23<sup>rd</sup> day of January, 2004.

Terry D. Lutes  
Notary Public  
Terry D. Lutes

My Commission expires:

8-20-2004

