Exhibit No.:
Issues: Straight Line Tax Depreciation; Deferred Income Tax; Accumulated Deferred Tax Reserve; FAS 106 OPEB Cost; Pension Cost; Pension Rate Base Treatment
Witness: Steve M. Traxler
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: ER-2007-0004
Date Testimony Prepared: January 18, 2007

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

STEVE M. TRAXLER

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

CASE NO. ER-2007-0004

Jefferson City, Missouri
January, 2007

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Aquila, Inc. d/b/a Aquila Networks-MPS and Aquila Networks-L&P, for authority to file tariffs increasing electric rates for the service provided to customers in the Aquila Networks-MPS and Aquila Networks-L&P service area.	)	Case No. ER-2007-0004

AFFIDAVIT OF STEVE M. TRAXLER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Steve M. Traxler, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 20 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Steve M. Traxler

Steve M. Traxler

Subscribed and sworn to before me this 10th day of January 2007.

Ashley M. Harrison

Notary Public

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

ASHLEY M. HARRISON
My Commission Expires
August 31, 2010
Cole County
Commission #06898978

TABLE OF CONTENTS

DIRECT TESTIMONY OF

STEVE M. TRAXLER

AQUILA, INC. d//b/a AQUILA NETWORKS-MPS-Electric

and d/b/a AQUILA NETWORKS-L&P-Electric

CASE NO. ER-2007-0004

DIRECT TESTIMONY

OF

STEVE M. TRAXLER

AQUILA,INC. d/b/a AQUILA NETWORKS-MPS-Electric

And d/b/a AQUILA NETWORKS-L&P Electric

CASE NO. ER-2007-0004

Q. What is your name and business address?

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

Q. By whom are you employed and in what capacity?

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

Q. What is your educational background?

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

Q. Please describe your employment history.

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

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

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

Q. Have you previously testified before this Commission?

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

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

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

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

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

Q. What are your principal areas of responsibility in Case No. ER-2007-0004?

A. As one of the Regulatory Auditor V's assigned to this case, I have oversight responsibility regarding areas assigned to other auditors on this case, an Application to increase rates filed by Aquila. In addition, my Direct testimony will address the specific areas listed below:

(1) Income Tax-Straight Line Tax Depreciation

(2) Income Tax – Current & Deferred

(3) Accumulated Deferred Tax Reserve

(4) Accumulated Deferred Tax Reserve – AAO's

(5) FAS 106 – Other Post Retirement Employee Benefit Costs (OPEB)

(6) Pension Expense & Rate Base Treatment

Q. What knowledge, skill, experience, training, or education do you have with regard to these specific areas?

A. I have approximately 30 years of experience in utility regulation. My experience includes 23 years with the Missouri Commission, four years with United Telephone Company of Kansas and three years as a regulatory consultant with the former Dittmer Brosch and Associates. I have provided expert testimony on regulatory matters in six other state jurisdictions. For most of my career, I have had the responsibility of supervising other auditors on major rate cases. With specific regard to my areas in this case, I have presented expert testimony on these issues in prior cases and have had responsibility for providing training on these areas for the Commission's Auditing Department.

EXECUTIVE SUMMARY

Q. In summary, what does your testimony cover?

A. My testimony addresses six primary areas:

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

Straight line tax depreciation is the tax deduction for book depreciation for a regulated utility. The deduction for straight line tax depreciation must reflect basis differences between the book basis and tax basis of depreciable plant. It must also match the proposed book depreciation rates used in calculating annualized book depreciation for rate recovery.

2) Calculation of current and deferred income tax.

The current and deferred income tax calculation reflects timing differences which result in a difference between pretax book accounting income and taxable income for IRS purposes. The deferred income tax component must also reflect the amortization of excess deferred taxes resulting from the reduction in the federal tax rate and the amortization of the investment tax credit (ITC) deferred prior to the 1986 Tax Reform Act.

3) Appropriate level of the Accumulated Deferred Tax Reserve to be reflected in rate base. The Accumulated Deferred Tax Reserve represents cost free capital provided by ratepayers. It is reflected as a reduction to rate base to allow ratepayers to earn the same rate of return on these funds as the utility.

4) Appropriate level of Accumulated Deferred Tax Reserve related to Aquila's prior Accounting Authority Orders (AAO's). Deferred taxes resulting from tax timing differences for costs included in prior AAO's should be reflected as a reduction to rate base.

5) Appropriate level of FAS 106 Other Post Retirement Employee Benefits (OPEB) cost to be included in cost of service in this case.

The 2005 test year for FAS 106 cost was replaced by the calendar year 2006 cost provided by Aquila's actuarial firm.

6) Appropriate level of pension cost and related rate base assets and/or liabilities to be included in cost of service in this case based upon the stipulation and agreement on pension cost in Case No. ER-2005-0436. The agreement reached in Case

No. ER-2005-0436 was a continuation of the settlement agreement on this issue in Case No. ER-2004-0034.

Aquila, the Staff, and other parties to the Stipulation and Agreement in Aquila's last rate case, Case No. ER-2005-0436, reached an agreement for calculating pension cost under the ERISA minimum contribution and a tracking mechanism to ensure that Aquila recovers the difference between its actual pension fund contributions and the level of pension fund contributions included in its rates.

STRAIGHT LINE TAX DEPRECIATION

Q. What is the relationship between book depreciation and straight-line tax depreciation?

A. Annualized book depreciation is a result of multiplying the plant investment at September 30, 2006, the end of the update period used by the Staff for this proceeding, by the book depreciation rates being recommended by Staff witness Rosella L. Schad of the Engineering and Management Services Department. Straight line tax depreciation represents the tax deduction for book depreciation for a regulated utility for ratemaking purposes.

The IRS allows a regulated utility, like all corporations, to use an accelerated depreciation method in calculating its current income tax liability. However, with regard to a regulated utility, Congress intended for the additional cash flow (lower current income tax), resulting from an accelerated depreciation method, to be retained by the utility. As a result, under IRS rules for a regulated utility, the additional deduction resulting from the use of an accelerated depreciation method cannot be reflected in rates. Ratepayers receive the tax deduction for depreciation expense over the same period used for book accounting purposes.

For example, a 10 year book life for recognizing book depreciation is also used to calculate the tax deduction for setting rates – straight line tax depreciation.

Differences between book depreciation and the corresponding tax deduction – straight line tax depreciation, occur as a result of the following:

1) The plant cost on the financial books (book basis) includes capitalized costs which were taken as a current tax deduction prior to the 1986 Tax Reform Act and

2) The book basis also includes the equity component of Allowance for Funds Under Construction (AFUDC), which is not deductible for tax purposes.

The tax basis of depreciable property is lower than the book basis for a utility primarily for these two reasons. Straight line tax depreciation is calculated by applying the book depreciation rate (10 year life = 10% annual rate) times the tax basis of the property.

Q. Can you illustrate the book basis and tax basis difference as well as the relationship of booked deprecation expense to (1) depreciation for federal income tax purposes and (2) the straight-line tax depreciation deduction allowed for setting rates for regulated utility?

A. Yes. Attached as Schedule 2, attached to this Direct testimony, is an example that illustrates these relationships.

Q. Would you please explain Schedule 2?

A. Prior to the Tax Reform Act of 1986, interest, pension cost, property taxes and payroll taxes, which were capitalized for financial accounting (included in the book basis), were treated as a current year deduction by the IRS. This resulted in a difference between the book basis and tax basis of the asset. Schedule 2, is a hypothetical example designed to illustrate this difference. Line 3, reflects the book basis of the asset, $10,000, which includes capitalized interest of $2,000. Line 4, reflects the tax basis of the asset of $8,000. Lines 3 and 4 differ because line 4 reflects that the $2,000 interest amount, line 2, was allowed as a current year deduction prior to 1986. Since 1986, the interest expense is capitalized for both financial accounting and IRS tax purposes which eliminated the difference between the book basis and tax basis of the asset.

Column A reflects annual depreciation of the book basis over the 10-year life of the asset - $1,000 / year. Column B reflects the basis difference for interest expense. The IRS allowed the $2,000 interest expense as a tax deduction in year 1. For financial accounting the interest cost was capitalized and included in the book depreciation in Column A at $200/year.

Column C reflects the federal income tax depreciation deduction using an accelerated 20% rate (20% X $8,000), $1,600/year. At the end of year 5, the asset is fully depreciated for federal income tax purposes - $2,000 in year 1 for the interest cost and $1,600/ year in tax depreciation (years 1-5) for a total tax deduction of $10,000 at the end of year 5.

As stated previously, IRS rules don't allow state regulatory commissions to reflect the additional depreciation deduction resulting from an accelerated method. For ratemaking purposes, the tax deduction for depreciation cannot be reflected in rates any quicker than the time period used in recognizing book depreciation for financial accounting – 10 years in our example. The straight line tax depreciation deduction for setting rates is reflected in Column D - $800/year (10% X $8,000) for 10 years. The ratepayer also received the $2,000 interest deduction in year 1 for a total deduction of $10,000 at the end of year 10.

Column E reflects the excess of the federal income tax deduction over the straight line deduction allowed for rates. The $800 difference results in positive deferred income taxes in years 1-5 (Column G). At the end of year 5, the Accumulated Deferred Tax balance in Column I reflects that ratepayers have paid $1,520 more in rates for income tax than the company's actual tax liability. Beginning in year 6 and continuing through year 10, the ratepayer continues to receive an $800/year tax deduction for ratemaking purposes. The utility's federal income tax deduction is $0 for years 6-10 as reflected in Column C. In summary, ratepayers paid $1,520 more in income tax in years 1-5 than the utility actually paid to the IRS , however, in years 6 – 10, the ratepayers paid $1,520 less in rates for income tax than the utility's tax liability. This tax "timing difference" has reversed by year 10 as reflected in Column I, for year 10.

Q. How does the Staff compute the straight line tax depreciation deduction for ratemaking purposes?

A. As reflected on Schedule 2, straight line tax depreciation is calculated by applying the book depreciation rate – 10% to the tax basis of the asset - $8,000 = $800/year. This result is the same if the tax basis to book basis ratio is applied to book depreciation as follows:

Book Depreciation Expense	$1,000
Tax Basis $8,000 / Book Basis $10,000 =	80%
Straight Line Tax Depreciation	$800 per year

This method is used by the Staff to make sure that the straight-line tax depreciation deduction, used in a rate case, is tied directly to the "annualized" book deprecation expense reflected in the Staff's cost of service. A historical amount for straight-line tax depreciation will not reflect a change in the book deprecation rates being recommended by the Staff or a full year's deduction for plant additions between the end of the test year and the known and measurable update period.

Q. Does an adjustment need to be made to the tax basis prior to calculating straight line tax depreciation for ratemaking purposes?

A. Yes. Retirements for vintage property depreciated under the Asset Depreciation Range (ADR) are not reflected in the tax basis until the entire vintage is fully depreciated. This results in a mismatch between the book basis and tax basis for these assets because the retirements are reflected in the book basis of depreciable property but not in the tax basis. Reducing the tax basis for ADR retirements eliminates this mismatch for calculating the straight line tax depreciation deduction.

Q. Does the Staff's method for computing straight-line tax depreciation result in a corresponding tax deduction for all assets accruing book depreciation for rate recovery?

A. Yes. The Staff and Aquila use mass asset accounting rules under Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USOA) for accruing depreciation expense for financial reporting and ratemaking purposes. Under mass asset accounting, individual assets, in a specific account, are not tracked for depreciation purposes. All assets in an account continue to accrue depreciation expense for accounting and ratemaking purposes until the entire account is fully depreciated. The Staff's method for calculating straight line tax depreciation results in a corresponding tax deduction for all assets accruing book depreciation for rate recovery. Ratepayers are entitled to a straight line tax deduction for all book deprecation included in rates.

DEFERRED INCOME TAX AND AMORTIZATIONS

Q. What is "deferred income tax" in the context of calculating income tax expense for setting the rates of a regulated utility?

A. There are "timing differences" between when specific costs are reflected in determining pretax accounting income and when they are reflected in determining current year taxable income for federal income tax purposes. In calculating federal income tax for ratemaking purposes, timing differences can be reflected consistent with how they are reflected under IRS rules (flow through treatment) or they can be reflected consistent with how they are reflected when determining pretax income for financial accounting purposes (normalization treatment). When timing differences are normalized for ratemaking purposes, a deferred tax adjustment is used to eliminate the timing of cost recognition under IRS rules. Deferred taxes are reversed in subsequent years (Column E & G, Schedule 2, years 6-10) consistent with the timing for recognizing the related costs for financial reporting purposes in determining pretax operating income. The deferral of the difference between accelerated tax depreciation and straight line tax depreciation in Column E & G of Schedule 2 is an example of normalization treatment for a tax timing difference.

Q. If a regulated utility is using an accelerated depreciation method under IRS rules, must that utility's federal depreciation deduction be normalized for ratemaking purposes?

A. Yes. As previously stated, if a regulated utility uses an accelerated depreciation method for federal income tax purposes the difference between federal tax depreciation and straight-line tax depreciation must be normalized (deferred) for ratemaking purposes. The tax deduction for depreciation cannot be reflected for ratemaking purposes any quicker than the timing for recognizing book depreciation in rates. The Staff's method for calculating straight-line tax depreciation complies with the IRS normalization requirements for a regulated utility. Staff adjustments S-96 reflect the deferred taxes resulting from normalizing the tax timing difference for accelerated tax depreciation, contributions in aid of construction and advances for construction for Aquila's MPS and L&P divisions.

Q. You mentioned previously that prior to the 1986 Tax Reform Act, there were tax timing differences for property taxes, interest, payroll taxes and pension cost. How were these timing differences reflected for ratemaking purposes prior to 1986?

A. In Missouri, unless the utility could demonstrate the need for additional cash flow to meet interest coverage ratios, these tax timing differences were flowed through (deducted in the current year) for ratemaking purposes.

Q. Does the Staff's income tax calculation include anything else?

A. Yes, it also reflects an amortization of excess deferred taxes resulting from a reduction in the federal tax rate. The 1986 Tax Reform Act reduced the federal tax rate for corporations from 46% to 34%. As a result, all the deferred taxes previously reflected in rates, which were based upon an assumed 46% tax rate, were overstated. The IRS allowed a regulated utility to flow back (amortize) the excess deferred taxes over the approximate depreciable book life of the property. The Staff's income tax calculation, for Aquila in this current case, reflects an amortization of excess deferred taxes resulting from the reduction in the federal tax rate in 1986. Adjustment S-97 reflects an annual amortization of the excess deferred taxes resulting from the reduction in the federal tax rate for Aquila's MPS and L&P divisions.

Q. Does the Staff's income tax calculation include anything else?

A. Yes, it also reflects an amortization of the investment tax credit. Prior to the 1986 Tax Reform Act, a utility received a permanent tax credit for investing in new capital additions. For ratemaking purposes, the IRS allowed the utility to amortize (flow back to ratepayers) the investment tax credit over the approximate depreciable book life of the related property. Adjustment S-98 reflects an annual amortization of the deferred investment tax credit which was in effect prior to the 1986 Tax Reform Act for the MPS and L&P divisions.

Q. Does the Staff's income tax calculation include anything else?

A. Yes, it includes an adjustment for a recent tax benefit from the American Jobs Creation Act of 2004. An additional tax deduction is available for income from qualified production facilities. The Staff's income tax calculation for Aquila, in this current case, reflects the Missouri jurisdictional share of the 2006 deduction.

ACCUMULATED DEFERRED INCOME RESERVE – RATE BASE

Q. What is "Accumulated Deferred Income Tax Reserve?"

A. "Accumulated Deferred Income Tax Reserve" is the accumulated balance of deferred income tax expense which has been recognized annually on a company's financial statements. Tax timing differences occur as a result of differences between when costs are recognized in determining pretax income on the financial statements and when these costs are recognized in determining taxable income for calculating the current federal income tax liability. When tax timing differences are reflected for ratemaking purposes consistent with the period used in calculating pretax accounting income, deferred taxes are recognized for financial reporting and ratemaking purposes. As previously discussed, this treatment is referred to as "normalization" of the tax timing difference. The credit balance in the Accumulated Deferred Tax Balance, shown on Schedule 2, reflects the fact that Aquila has been allowed to reflect tax timing differences more rapidly in calculating current federal income tax liability than the period used in recognizing these cost for determining pretax taxable income for financial reporting purposes. Normalization treatment for recognizing tax timing differences for ratemaking purposes results in additional cash flow to the utility which represents cost free capital provided by ratepayers. Reducing rate base by the Accumulated Deferred Income Tax Reserve allows the ratepayer to earn the same rate of return as the utility on additional funds provided by ratepayers to the utility.

Q. What balances has the Staff included in rate base for the Accumulated Deferred Tax Reserves for the MPS and L&P divisions?

A. The rate base for the MPS division has been reduced by approximately $130 million for the Accumulated Deferred Tax Reserve as of September 30, 2006. The rate base for the L&P division has been reduced by approximately $37 million for the Accumulated Deferred Tax Reserve as of September 30, 2006.

Q. What adjustment to the Accumulated Deferred Tax Reserve will be required when the Staff updates its case as of December 31, 2006?

A. Staff has reflected 3 hypothetical combustion turbines (CT's) in plant in service and in modeling fuel & purchase power cost for the MPS division. Two of these hypothetical CT's were assumed to be in service in Aquila's last case, ER-2005-0436. These two units would have generated additional deferred taxes. Staff will impute these additional deferred taxes based upon additional discovery and reflect the result in rate base when it updates its case through December 31, 2006.

ACCUMULATED DEFERRED TAX RESERVE – AAO'S

Q. Should MPS's rate base reflect the accumulated deferred tax reserve related to costs included in prior AAO's approved by the Commission?

A. Yes.

Q. Has Aquila calculated the level of accumulated deferred taxes related to costs included in prior AAO's approved by the Commission for the MPS division?

A. Yes. The accumulated deferred taxes related to prior AAO's for the MPS division is addressed in the Direct testimony of Aquila witness, Ronald A. Klote. Staff has accepted Aquila's calculation and reflected the balance in MPS's rate base – Schedule 2.

OTHER POST RETIREMENT EMPLOYEE BENEFIT COSTS – FAS 106

Q. What is Financial Accounting Standard (FAS) 106?

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

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

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

Q. What method was used for setting rates for OPEB costs before the effective date of House Bill 1405, codified as Section 386.315, RSMo?

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

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

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

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

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

A. Yes.

Q. Where do the Staff's adjustments for FAS 106 OPEB costs appear on the Staff's Accounting Schedules?

A. Adjustments S-84.3 and S-85.3 on Schedule 10 adjust Aquila's 2005 test year for FAS 106 OPEB costs to reflect the more current FAS 106 calculation for 2006 for Aquila's L&P and MPS divisions, respectively.

PENSION EXPENSE AND RATE BASE TREATMENT

Q. What is Financial Accounting Standard (FAS) 87?

A. FAS 87 is the accrual accounting method for calculating pension cost for financial reporting purposes.

Q. Is the Staff recommending the Commission determine Aquila's pension cost based on FAS 87 for purposes of Aquila's cost of service in this case, Case No. ER-2007-0004?

A. No. Both Staff and Aquila recommend continuation of the settlement agreement originally reached in Case No. ER-2004-0034 and continued in Case No. ER-2005-0436. The settlement agreement provides for the use of the minimum contributions required under the Employee Retirement Income Security Act (ERISA) for determining Aquila's pension cost for ratemaking purposes.

Q. What is the relationship between pension cost under FAS 87 and the funding requirements under ERISA regulations?

A. FAS 87 is accrual accounting method required by the accounting profession under Generally Accepted Accounting Procedures (GAAP) for financial reporting purposes. Under FAS 87 a company accrues (expenses) an employee's earned pension benefits over the service life of the employee. The total obligation to the employee for pension benefits is accumulated annually until retirement in the Accumulated Benefit Obligation (ABO). The ERISA regulations established by statute in 1976 are intended to ensure the funding of defined benefit pension plans in the United States. Both financial statement expense recognition under FAS 87 and the funding requirements under ERISA are based upon the same pension plan obligation to employees enrolled in the plan. While different assumptions are used for the timing of pension cost recognition during the service life of the employee, both FAS 87& and ERISA are intended to address the same total accumulated pension plan obligation (ABO) by the employee's retirement date. The Staff has historically used both FAS 87 and the ERISA minimum contributions for determining pension cost for ratemaking purposes.

Q. What have Aquila and the Staff agreed to in the past for the treatment of pension cost?

A. In Aquila's last general electric rate increase case, Case No. ER-2005-0436, they entered into a settlement agreement included the following provisions:

1) A Prepaid Pension Asset representing negative pension cost flowed through in rates in prior cases was agreed to in the stipulation and agreement in Case No. ER-2004-0034. This Prepaid Pension Asset is being amortized to cost of service over 5 ½ years for the MPS division and 9.25 years for the L&P division starting with the effective date of rates established in Case No. ER-2004-0034, April 222, 2004. The unamortized balance is included in rate base for the MPS and L&P divisions. This treatment was continued in the stipulation and agreement in Case No. ER-2005-0436.

2) Annual pension cost reflected in cost of service is to be based upon Aquila's ERISA minimum contributions requirements.

3) A tracking mechanism tracks the difference between the pension cost included in rates and Aquila's actual pension fund contributions during the period that existing rates are in effect. The resulting regulatory asset (actual fund contributions exceed rate recovery) and/or regulatory

liability (actual fund contributions are less than rate recovery) are included in rate base and amortized to cost of service over 5 years.

The rate base amounts and cost of service adjustments the Staff has reflected in this current case, Case No. ER-2007-0004, are based on continuation of the agreements reached in the stipulation and agreements reached in Case Nos. ER-2004-0034 and ER-2005-0436.

Q. What is the unrecovered balance of the prepaid pension asset reflected in the Staff's rate base for the MPS and L&P Divisions?

A. The Staff's rate base includes a Missouri jurisdictional balance of $6.5 million and $22.8 million for the MPS and L&P divisions, respectively, as of September 30, 2006. This amount will be updated through December 31, 2006, in the true up audit for this case.

Q. What is the amount of the regulatory liability the Staff has reflected in rate base for the MPS division related to the tracking mechanism previously discussed?

A. As of September 30, 2006, Aquila has collected 1.4 million more in rates for its MPS division than the actual contributions made to the pension fund. This regulatory liability is reflected as a reduction to MPS's rate base and amortized as a reduction to pension cost over 5 years.

Q. What is the amount of the regulatory asset the Staff included in rate base for the L&P division?

A. As of September 30, 2006, Aquila has collected 325,000 less in rates for its L&P division than the actual contributions made to the pension fund. This regulatory asset is reflected as an addition to L&P's rate base and amortized as an increase to pension cost over 5 years.

Q What is the purpose of adjustment S-85.5?

A. Adjustment S-85.5, on Schedule 10, adjusts the 2005 test year for the MPS division to reflect the 5 year amortization of the regulatory liability representing the excess of Aquila's pension cost recovered in rates over the actual ERISA pension fund contributions through September 30, 2006.

Q What is the purpose of adjustment S-84.4?

A. Adjustment S-84.4, on Schedule10, adjusts the 2005 test year for the L&P division to reflect the 5 year amortization of the regulatory asset representing the excess of Aquila's actual pension fund contributions over the ERISA pension cost recovered in rates through September 30, 2006.

Q. Where in Staff's Accounting Schedules has the Staff made adjustments to pension cost to reflect the new ERISA minimum contribution?

A. Adjustment S-84.5 and S-85.6, in Schedule 10, adjust the 2005 test year pension cost for the L&P and MPS divisions, respectively, to reflect a normalized level of contributions to the pension fund

Q. Are there any other adjustments in Staff's Accounting Schedules Directly related to pension costs?

A. Yes. Adjustment S-85.7, in Schedule 10, adjusts MPS's test year 2005 pension cost to reflect the correct amortization amount for the Prepaid Pension Asset included in the stipulation and agreement in Case No. ER-2005-0436.

<u>LEGAL, EQUIPMENT RENTAL, STORAGE AND BONUS COSTS – SOUTH HARPER PLANT.</u>

Q. Has the Staff made any expense adjustments related to Aquila's South Harper Plant?

A. Yes. Adjustment S-82.3, in Staff Accounting Schedule 10, eliminates 2005 test year legal costs related to Aquila's South Harper Plant litigation costs included in a settlement agreement in Case No. ER-2005-0436, Adjustment S-85.4, in Staff Accounting Schedule 10, eliminates 2005 test year discretionary bonus costs related to Aquila's South Harper Plant included in a settlement agreement in Case No. ER-2005-0436, and Adjustment S-90.2, in Staff Accounting Schedule 10, eliminates 2005 test year equipment rental and storage costs related to Aquila's South Harper Plant included in a settlement agreement in Case No. ER-2005-0436.

Q. Does this conclude your Direct testimony?

A. Yes, it does.

Steve M. Traxler

SUMMARY OF RATE CASE INVOLVEMENT

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

Year	Case No.	Utility	Type of Testimony	
1990	Case No. ER-90-101	UtiliCorp United Inc., Missouri Public Service Division (electric)	Direct Surrebuttal	Contested
1991	Case No. EM-91-213	Kansas Power & Light - Gas Service Division (natural gas)	Rebuttal	Contested
1993	Case Nos. ER-93-37	UtiliCorp United Inc. Missouri Public Service Division (electric)	Direct Rebuttal Surrebuttal	Stipulated
1993	Case No. ER-93-41	St. Joseph Light & Power Co.	Direct Rebuttal	Contested
1993	Case Nos. TC-93-224 and TO-93-192	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal Surrebuttal	Contested
1993	Case No. TR-93-181	United Telephone Company of Missouri	Direct Surrebuttal	Contested
1993	Case No. GM-94-40	Western Resources, Inc. and Southern Union Company	Rebuttal	Stipulated
1994	Case Nos. ER-94-163 and HR-94-177	St. Joseph Light & Power Co.	Direct	Stipulated
1995	Case No. GR-95-160	United Cities Gas Co.	Direct	Contested
1995	Case No. ER-95-279	Empire Electric Co.	Direct	Stipulated
1996	Case No. GR-96-193	Laclede Gas Co.	Direct	Stipulated
1996	Case No. WR-96-263	St. Louis County Water	Direct Surrebuttal	Contested
1996	Case No. GR-96-285	Missouri Gas Energy	Direct Surrebuttal	Contested
1997	Case No. ER-97-394	UtiliCorp United Inc. Missouri Public Service (electric)	Direct Rebuttal Surrebuttal	Contested
1998	Case No. GR-98-374	Laclede Gas Company	Direct	Settled
1999	Case No. ER-99-247 Case No. EC-98-573	St. Joseph Light & Power Co.	Direct Rebuttal Surrebuttal	Settled
2000	Case No. EM-2000-292	UtiliCorp United Inc. and St. Joseph Light & Power Merger	Rebuttal	Contested
2000	Case No. EM-2000-369	UtiliCorp United Inc. and Empire Electric Merger	Rebuttal	Contested

Year	Case No.	Utility	Type of Testimony	
2000	Case No. EM-2000-369	UtiliCorp United Inc. and Empire Electric District Co.	Rebuttal	Contested
2001	Case No. TT-2001-328	Oregon Mutual Telephone Co.	Direct	Settled
2002	Case No. ER-2001-672	UtiliCorp United Inc.	Direct, Surrebuttal	Settled
2002	Case No. EC-2002-1	Union Electric Company d/b/a AmerenUE	Surrebuttal	Settled
2003	Case Nos. ER-2004-0034 and HR-2004-0024 (Consolidated)	Aquila, Inc., d/b/a Aquila Networks-MPS and Aquila Networks-L&P	Direct	Settled
2004	Case Nos. ER-2005-0436 HR-2005-0450	Aquila, Inc. d/b/a Aquila Networks – MPS and Aquila Networks-L&P	Direct Surrebuttal	Settled
2006	Case No. ER-2006-0314	Kansas City Power & Light Co.	Direct Rebuttal Surrebuttal True-Up Direct True-Up Rebuttal	Contested

Line No.			
1	Asset Cost	$	8,000
2	Interest Capitalized in Book Basis (Deducted in Current Year for IRS Tax)	$	2,000
3	**Total Book Basis for Asset**	**$**	**10,000**
4	**Tax Basis for Asset**	**$**	**8,000**
5	Accelerated Tax Depreciation Rate - 5 years = 20%		
6	Book and Straight Line Tax Depreciation Rate - 10 years = 10%		

		Book Depreciation	Interest Deduction	Accelerated Tax Depreciation	Straight Line Tax Depreciation	Tax Deprec. to be Deferred	Effective Tax Rate	Deferred Tax Expense	Accumulated Deferred Income Tax
		(A)	(B)	(C)	(D)	(E) (C) - (D)	(F)	(G) (E) X (F)	(I)
7	Year 1	$1,000	$2,000	$1,600	$800	$800	38%	$304	$304
8	Year 2	$1,000	$0	$1,600	$800	$800	38%	$304	$608
9	Year 3	$1,000	$0	$1,600	$800	$800	38%	$304	$912
10	Year 4	$1,000	$0	$1,600	$800	$800	38%	$304	$1,216
11	Year 5	$1,000	$0	$1,600	$800	$800	38%	$304	$1,520
12	Year 6	$1,000	$0	$0	$800	($800)	38%	($304)	$1,216
13	Year 7	$1,000	$0	$0	$800	($800)	38%	($304)	$912
14	Year 8	$1,000	$0	$0	$800	($800)	38%	($304)	$608
15	Year 9	$1,000	$0	$0	$800	($800)	38%	($304)	$304
16	Year 10	$1,000	$0	$0	$800	($800)	38%	($304)	$0
17	Total	$10,000	$2,000	$8,000	$8,000	$0		$0	$0