

Exhibit No.:
Issues: *Allocations; Revenue; Billing
Costs; Uncollectible Expense;
Pensions; Prepaid Pension
Asset; Other Post-Employment
Benefits (OPEBs)*
Witness: *Doyle L. Gibbs*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Direct Testimony*
Case No.: *ER-2004-0570*
Date Testimony Prepared: *September 20, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

DOYLE L. GIBBS

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

Jefferson City, Missouri
September 2004

1 A. Adjustment S-10.4 increases expense to reflect the additional billing costs
2 associated with the change in the number of customers and encompasses the expense related
3 to material stock for the billing statement, billing envelope, return envelope and postage. To
4 calculate the adjustment, the annualized number of bills (the number of customers at June 30,
5 2004 multiplied by twelve) was compared to the sum of the number of customers in each
6 month of the test year. The difference represents the additional number of bills the Company
7 would have to mail on an annual basis. The average combined cost per billing for the billing
8 statement, billing envelope, return envelope and postage was multiplied by the number of
9 additional bills to determine the additional billing costs the Company will incur.

10 **UNCOLLECTIBLE EXPENSE**

11 Q. Is the Staff proposing any adjustment to uncollectible expense?

12 A. No. Based on the Staff's review of the Company's expense accrual for
13 uncollectible accounts and the history of actual accounts written off, before and during the test
14 year, it was determined that an adjustment to uncollectible expense was not warranted.

15 **PENSION EXPENSE**

16 Q. Please identify the adjustment you are sponsoring to pension expense.

17 A. I am sponsoring adjustment S-14.4 to adjust pension expense to reflect the use
18 of the minimum pension contribution to the pension fund required by the Employee
19 Retirement Income Security Act of 1974 (ERISA).

20 Q. On what basis is pension expense reflected in the Company's rates currently in
21 effect?

22 A. In the Stipulation and Agreement from the Company's last case, Case
23 No. ER-2002-424, it was agreed that rates would include pension expense based on ERISA

1 minimum required pension contributions, and pension expense is currently reflected in
2 Empire's rates on that basis. The Staff's position in the current case is a continuation of the
3 use of ERISA minimum required pension contributions to establish pension expense for
4 ratemaking purposes.

5 Q. Adjustment S-14.4 appears to be a considerable reduction to test year pension
6 expense. Is this a reflection of the change in minimum ERISA?

7 A. No. Although the Company agreed to the use of ERISA minimum pension
8 contributions for setting rates, it has continued to record pension expense on its books using
9 the accrual accounting method, according to the Statement of Financial Accounting
10 Standard (FAS) 87.

11 Q. Historically, what has been Empire's required ERISA minimum pension
12 contribution?

13 A. From at least 1998 through 2002 the Company's annual ERISA minimum
14 pension contribution was zero. An ERISA minimum pension contribution of approximately
15 \$342,000 was required for 2003, of which, approximately \$256,000 would have been the
16 electric O&M portion if the contribution had been used as the basis for pension expense in the
17 financial statements of Empire. The Company's actuary has indicated that there will be no
18 ERISA funding requirement for 2004.

19 Q. With respect to the ERISA minimum pension contribution, what amount has
20 the Staff included in its test year for pension expense?

21 A. Based on the ERISA minimum contribution information provided by the
22 Company in response to Staff Data Request No. 414, the Staff's pension expense included in
23 this case is zero. However, the Staff is also proposing that, in the event that future ERISA

1 minimum pension contributions are required, Empire can record on its books a regulatory
2 asset for the difference between the ERISA minimum pension contribution and the amount
3 included in rates, currently zero. This regulatory asset will be included in rate base in the
4 Company's next case and amortized over a five-year period. Additionally, Empire can make
5 such entries on its books as are appropriate under FAS 71 to reflect that rates do not include
6 FAS 87 in cost of service.

7 **PREPAID PENSION ASSET**

8 Q. What is a prepaid pension asset?

9 A. A prepaid pension asset is a "paper" asset that is created when expense
10 recorded on the books, based on the FAS 87 accrual method, is less than the actual cash
11 contributions made to the pension fund. In the case of Empire, FAS 87 expense for a number
12 of years was negative. So, although cash contributions have been zero, an asset is still
13 reflected on its books because of the negative expense accrual.

14 Q. How does the prepaid pension asset affect ratemaking?

15 A. If rates are based on cash contributions, a prepaid asset has no relevance.
16 However, FAS 87 was used for ratemaking for Empire beginning August 15, 1994—the
17 effective date of rates from Case No. ER-94-174. Empire continued to have rates that
18 included pension expense based on FAS 87 until December 1, 2002—the effective date of the
19 rates established in Case No. ER-2002-424. As previously stated above, in its last rate case
20 Empire agreed to use ERISA minimum pension contributions to determine pension expense
21 for ratemaking purposes. During the time that Empire's rates included pension expense based
22 on FAS 87, ratepayers have benefited from the negative pension expense, which had a direct
23 impact on the magnitude of the prepaid pension asset. As a result, Empire is entitled to

Exhibit No.:
Issue: Pension Expense
Witness: Doyle L. Gibbs
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case No.: ER-2004-0570
Date Testimony Prepared: November 4, 2004

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

DOYLE L. GIBBS

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

Jefferson City, Missouri
November 2004

1 3) It is not consistent with Generally Accepted Accounting Principles
2 (GAAP) and, therefore, cannot be used for shareholder financial reporting
3 purposes;

4 4) It discourages funding policies that are consistent with good pension fund
5 management.

6 Q. Does the Staff agree with the volatility issue, the first reason cited by
7 Mr. Vogl, in his direct testimony?

8 A. No it does not. There is a volatility issue, but Staff contends that it is FAS 87
9 that is the more volatile method.

10 Q. Have you prepared an analysis comparing the historical volatility of pension
11 costs as calculated according to FAS 87 and the ERISA minimum methodologies?

12 A. Yes. As shown on Schedule 1 attached to this rebuttal testimony, FAS 87 has
13 been much more volatile than the ERISA minimum.

14 Q. In addition to the volatility concerns included in the first reason cited by
15 Mr. Vogl to change EDE's accounting methodology to reflect FAS 87, he also states that
16 ERISA calculations can create test year costs significantly higher or lower than the actual
17 costs incurred during the recovery period. How has the Staff addressed the aspect of ERISA
18 minimum contribution changes that would result in costs different from what was used in the
19 determination of rates?

20 A. The Staff proposed in its direct filing, starting on page 10 and continuing onto
21 page 11 of my direct testimony, that any variation in future ERISA minimum contributions
22 from that included in rates developed from this case be set up as a regulatory asset for
23 recovery in subsequent rate cases. This protects the ratepayer and the Company from over or

1 under recovery of the pension expense that is actually incurred compared to the level of
2 recovery included in rates. On the other hand, if FAS 87 is used to determine pension
3 expense for ratemaking purposes, to the extent that FAS 87 exceeds the ERISA minimum, it
4 creates a positive cash flow that could be used for any purpose the Company desires. There
5 would be no assurance that this cash would be available to make contributions in the future.

6 Q. Discussed in his direct testimony and illustrated in Schedule 2 attached thereto,
7 Mr. Vogl attempts to demonstrate the cost difference between FAS 87 and ERISA under
8 different scenarios and how those cost differences show that ERISA is more volatile than
9 FAS 87. Do you have any reservations with regards to the ERISA contributions and the
10 FAS 87 pension costs reflected in Schedule 2 attached to Mr. Vogl's direct testimony?

11 A. Yes. Displayed in his Schedule 2, Mr. Vogl has calculated the costs for both
12 FAS 87 and the ERISA minimum under the assumptions that he describes as adverse, volatile
13 and stable returns. However, history has shown that what actually occurs can be, and often is,
14 considerably different from the assumptions that are used in the calculation of FAS 87. As
15 recently as 2002, the ERISA minimum was still zero and FAS 87 was a negative, rather than a
16 positive, expense. Calculations can certainly be made to show what the result would be given
17 certain assumptions. The problem is that there is no assurance that the assumptions will
18 reflect anything close to what actually occurs.

19 Q. The second reason cited in Mr. Vogl's testimony for changing its accounting
20 methodology to FAS 87 is that the ERISA minimum contributions will create inequities
21 between generations of ratepayers. Will the use of ERISA minimum cause generational
22 inequity?

Exhibit No.:
Issues: Pension Expense;
Customer Growth
Witness: Doyle L. Gibbs
Sponsoring Party: MoPSC Staff
Type of Exhibit: Surrebuttal Testimony
Case No.: ER-2004-0570
Date Testimony Prepared: November 24, 2004

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

DOYLE L. GIBBS

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

Jefferson City, Missouri
November 2004

Surrebuttal Testimony of
Doyle L. Gibbs

1 set to recover the enterprise's cost of service can be charged and collected from its customers.
2 These criteria certainly apply to Empire. Additionally, there needs to be reasonable assurance
3 of future recovery of the asset created through the application of FAS 71.

4 Q. Is there reasonable assurance of future recovery of the asset created through
5 the application of FAS 71?

6 A. Yes, the Company's own actuary provides this reasonable assurance. As
7 Mr. Vogl states on page 13 and 19 of his direct testimony, since the total cost over the life of
8 the pension plan represents the benefits paid, the cost recognized will be the same under either
9 FAS 87 or minimum ERISA. Therefore, it is reasonable to assume that any asset that is
10 accumulated during the life of the pension plan that represents the difference between FAS 87
11 and minimum ERISA will be recovered over the life of the pension plan.

12 Q. Has the Commission shown by its past actions, that it provides for the recovery
13 of regulatory pension assets?

14 A. Yes. The Commission has approved stipulations and agreements in several
15 cases that have recognized recovery of regulatory pension assets. In Empire's last rate case
16 an amortization of the prepaid asset was established to recognize the accumulated difference
17 between FAS 87, which was being recognized in rates and minimum ERISA contributions. In
18 the recent Aquilla rate case a mechanism was established to track and recover any difference
19 between the amount included in rates and the actual ERISA minimum contributions. The
20 Staff is proposing this same mechanism in this case. This mechanism will assure the
21 Company that it will be able to collect through its rates the actual pension cost represented by
22 the actual cash contributions required to fund its pension plan.