Exhibit No.:
Issues: Payroll and Payroll Taxes
Pensions
Post-Retirement Benefits
Employee Incentive Plans
Legal Expenses
Corporate Franchise Taxes
Rate Case Expense
Witness: John M. Boczkiewicz
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: GR-2000-512

MISSOURI PUBLIC SERVICE COMMISSION

SERVICES DIVISION

DIRECT TESTIMONY

OF

JOHN M. BOCZKIEWICZ

CASE NO. GR-2000-512

Exhibit No. 9
Date 10-11-00 Case No GR-2000-512
Reporter KF

Jefferson City, Missouri
August 2000

****Denotes Highly Confidential Information****

NP

TABLE OF CONTENTS FOR

JOHN M. BOCZKIEWICZ DIRECT TESTIMONY

UNION ELECTRIC COMPANY

d/b/a AmerenUE

CASE NO. GR-2000-512

NP

DIRECT TESTIMONY

OF

JOHN M. BOCZKIEWICZ

UNION ELECTRIC COMPANY

d/b/a AmerenUE

CASE NO. GR-2000-512

Q. Please state your name and business address.

A. My name is John M. Boczkiewicz, 815 Charter Commons, Suite 100B, Chesterfield, Mo. 63017.

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

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

Q. Please describe your educational and employment background.

A. I graduated from Northeast Missouri State University in December 1991 with a Bachelors degree in Accounting. In May 1992, I passed the Uniform Certified Public Accountant (CPA) Examination and upon completion of the two-year experience requirement became licensed as a CPA in the state of Missouri. I commenced employment with the Commission Staff (Staff) in June 1992.

Q. What has been the nature of your duties while in the employ of 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.

NP

Q. Have you previously filed testimony before this Commission?

A. Yes. Please refer to Schedule 1, attached to this direct testimony, for a list of cases in which I have previously filed testimony.

Q. With reference to Case No. GR-2000-512, have you made an examination of the books and records of AmerenUE (UE or Company)?

A. Yes, in conjunction with other members of the Staff.

Q. What are your principal areas of responsibility in this case?

A. My primary areas of responsibility in this case are payroll, payroll taxes, pension expense, post-retirement benefits expense (OPEB), incentive compensation, legal expenses, corporate franchise taxes and rate case expense.

Q. What adjustments are you sponsoring?

A. I am sponsoring the following adjustments:

Payroll	S-6.2, S-7.1, S-8.1, S-9.3, S-10.2, S-11.1, S-12.7, and S-12.16.
Payroll Taxes	S-15.3
Incentive Compensation	S-12.9
Pensions expense	S-12.10, S-12.12, S-12.14
OPEB expense	S-12.11, S-12.13, S-12.15
Legal Expenses	S-12.25
Corporate Franchise Taxes	S-15.4
Rate Case Expense	S-12.8

PAYROLL

Q. Please explain adjustments S-6.2, S-7.1, S-8.1, S-9.3, S-10.2, S-11.1, and S-12.16.

NP

A. These adjustments represent the individual payroll annualizations to the production expense (S-6.2), transmission (S-7.1), distribution (S-8.1), customer accounts (S-9.3), customer service and information (S-10.2), sales (S-11.1), and administration and general (S-12.16).

Q. What are the different components that the Staff considered in calculating the annualized level of payroll?

A. The payroll annualization considered direct payroll expense specifically identifiable to the Company's Missouri gas operations. This includes the Southeast District (Cape Girardeau) and the districts in Regional West (Mexico, Jefferson City, Wentzville, and Columbia). The payroll annualization also includes payroll expense allocated from Ameren Services Company (Ameren Services) to Missouri gas operations. Ameren Services provides a variety of services to Union Electric including legal and accounting services.

Q. Please describe the methodology that you used to annualize payroll.

A. The Staff's annualized payroll expense is the sum of the direct payroll charges to Missouri gas operations and the payroll expense allocated to Missouri gas operations from Ameren Services. From the beginning of the test year (July 1998) through the update period (April 2000), Union Electric Company and Ameren Services lost in excess of 500 employees. As a result, payroll expense has been consistently decreasing through the update period. The Staff believes that using payroll expense for the 12 months ending April will most accurately reflect the Company's ongoing operations.

Q. Why didn't the Staff include any pay increases in its annualization?

NP

A. The Company granted pay increases on October 1, 1998, April 1, 1999, and October 1, 1999. Even with these increases, the total amount of payroll charged to Missouri gas operations still consistently decreased from July 1998 through April 2000. The Staff believes that this trend is likely to continue and that the April 1, 2000 pay increase will be offset by the reduction in payroll realized from the reduction in the number of employees. In fact, the Staff's analysis shows that payroll has continued to decrease through June, 2000.

Q. How did you determine the adjustments required for payroll?

A. The Staff's total payroll adjustment was allocated on a pro rata basis to production, transmission, distribution, customer accounts, customer service and information, sales, and administrative and general functions based on the test year payroll expense charged to each function.

Q. Please explain adjustment S-12.7.

A. Adjustment S-12.7 eliminates the Missouri gas operation's share of the nonrecurring charge for the Company's Targeted Separation Plan (TSP).

Q. Please describe the Targeted Separation Plan.

A. In March 1998, Ameren (the parent company of Union Electric) announced plans to reduce operating expenses, including plans to eliminate approximately 400 employee positions by mid-1999 through a hiring freeze and the TSP. In July 1998, Ameren offered separation packages to employees whose positions were to be eliminated through the TSP. During the third quarter of 1998, UE recorded a nonrecurring charge of nearly $18,000,000 representing the cost to implement the TSP. Approximately $29,000 of this charge was allocated to Missouri gas operations.

NP

Q. Why is the Staff recommending an adjustment for the TSP?

A. The Staff believes that this is a non-recurring cost that is not reflective of ongoing operations.

PAYROLL TAXES

Q. Please explain your adjustment to social security taxes, adjustment No. S-15.3.

A. This adjustment represents the annualization of the employer-paid portion of the Federal Insurance Contributions Act (FICA or social security). The Staff's adjustment to payroll expense was multiplied by the current 7.65% FICA tax rate to derive the adjustment for payroll taxes.

INCENTIVE COMPENSATION

Q. Please explain adjustment No. S-12.9.

A. This adjustment proposed to remove from the test year the cost of the Company's incentive compensation plans.

Q. Please describe the Company's incentive compensation plans.

A. The Company currently has the following incentive compensation plans in place:

1) **Ameren Incentive Plan (AIP)** - Rewards all union employees based on the level of Ameren's corporate earnings per share (EPS). Payout is based on a fixed percentage of each employee's year-end base earnings and can vary from **________** depending upon corporate EPS.

2) **Ameren Management Incentive Plan (AMIP)** - Rewards non-union employees below manager level based upon the level of Ameren's

corporate earnings per share (EPS). Payout is based on a fixed percentage of each employee's year-end base earnings and can vary from **_______** depending upon corporate EPS. **____**

3) **Executive Incentive Plan (EIP)** - Annually rewards executive employees based upon the level of Ameren's corporate earnings per share and the individual employee's performance.

Q. In past cases, has the Commission set minimum standards for an incentive compensation plan to qualify as an acceptable one?

A. Yes. In its Report and Order in Case Nos. EC-87-114 and EC-87-115, Union Electric Company, the Commission stated: "At a minimum, an acceptable management performance plan should contain goals that improve existing performance, and the benefits of the plan should be ascertainable and reasonably related to the plan."

Q. Does the Staff believe the current plans meet these criteria?

A. No. None of the plans aim to improve existing performance because the EPS targets remain the same from year to year. Also, the Staff believes that it is difficult, if not impossible to ascertain what the impact of any individual's performance was in relation to the level of EPS for any given year. The Staff believes that there is insufficient evidence to connect incentive compensation expense for a given employee with the Company's overall EPS performance. As a result, the Staff does not believe the costs associated with these plans should be included in the cost of service.

OPEB EXPENSE-FAS 106

Q. Please provide a brief explanation of Financial Accounting Standard No. 106 (FAS106).

A. FAS 106, "Employers' Accounting for Post-retirement Benefits Other Than Pensions", provides the accrual accounting method used in determining the annual expense and liability for providing Other Post-Employment Benefits (OPEBs). This method was developed by the Financial Accounting Standards Board (FASB) and is required under Generally Accepted Accounting Principles (GAAP) for financial reporting purposes.

Q. Is the Commission required to use GAAP accounting methods for rulemaking purposes?

A. As a general rule, no. However, as a result of legislation passed in Missouri in 1994, the Commission is required to adopt SFAS 106 for ratemaking purposes as long as the assumptions are considered reasonable and the amounts collected in rates are funded by the utility.

Q. Is the Commission required under GAAP or Missouri law to adopt Financial Accounting Standard No. 87 (FAS 87) for determining pension expense for ratemaking purposes?

A. No. However, since the adoption of FAS 106 has been required by state law beginning in 1994, the Staff has taken the position that consistent treatment of retirement costs requires the use of FAS 87 for determining pension expense for rate-making purposes.

Q. Are the methods used in calculating pension expense under FAS 87 and OPEB expense under FAS 106 similar in many respects?

A. Yes. Many of the same actuarial and financial assumptions are used for both. Some of the assumptions used for both include:

<u>Actuarial Assumptions</u>

Employee Mortality
Employee Turnover
Retirement Age

<u>Financial/Accounting Assumptions</u>

Income Earned on Plan Assets
Future Salary Increases
Time Value of Money (Discount Rate)
Amortization Period for Gains and Losses
Use of Corridor Approach for Gain/Loss Recognition

Q. Why have you classified assumptions used in calculating FAS 87 and FAS 106 as either actuarial or financial?

A. The purpose of FAS 87 and FAS 106 is to provide uniform financial statement recognition of a company's total estimated liability for pensions and OPEBs and to reflect the annual cost of these benefits in the income statement ratably over the service life of the employee.

Actuarial assumptions required for these calculations, such as employee mortality, must be developed by a qualified actuary. All of the financial assumptions could be developed by someone with a financial and/or accounting background. For example, a decision as to the number of years to use for gain/loss amortization or use of the corridor

NP

approach for gain/loss amortization is a judgment to be made based upon the impact on the financial statements and/or impact on utility rates as is the case with a regulated utility company.

Q. What is the basis for the Staff's recommended level of OPEB expense for this case?

A. In response to Staff Data Request No. 141, the Company provided a copy of the 1999 actuarial valuation of Ameren's OPEB costs under FAS 106. Staff adjustment S-12.15 adjusts OPEB costs in the test year to reflect the Missouri gas share of OPEB costs calculated in Ameren's 1999 actuarial valuation. Staff adjustment No. S-12.13 adjusts the OPEB expense calculated in the 1999 actuarial valuation to reflect a five-year amortization of the Unrecognized Net Gain balance. Staff adjustment No. S-12.11 restates the expected return on pension fund assets to reflect the use of the actual Market Value of the OPEB assets instead of the Market "Related" Value used by Ameren. The rationale for adjustment Nos. S-12.13 and S-12.11 will be addressed in detail in my discussion of the Staff's recommended pension expense level for this case.

PENSION EXPENSE-SFAS 87

Q. Please provide a brief description of FAS 87.

A. FAS 87, Employers' Accounting for Pensions, provides the accrual accounting method used in determining the annual expense and liability for providing pensions. This statement was also issued by the FASB and is considered GAAP for financial reporting purposes.

Q. What is the basis for the Staff's recommended pension expense level in this case?

NP

A. In response to Staff Data Request No. 50, UE provided a copy of the 1999 actuarial valuation of Ameren pension costs under FAS 87. This calculation was done by the actuarial firm of Towers Perrin. Staff adjustment No. S-12.14 adjusts the test year pension expense to reflect the Missouri gas share of pension expense calculated in Ameren's 1999 actuarial report. Adjustment No. S-12.10 restates the expected return on pension fund assets to reflect the use of the actual Market Value of the pension fund assets instead of the Market "Related" Value used by Ameren. Adjustment No. S-12.12 adjusts the pension expense calculated in the 1999 actuarial valuation to reflect a five-year amortization of the Unrecognized Net Gain balance.

Q. Please explain Adjustment No. S-12.14.

A. Adjustment No. S-12.14 restates the Company's 1999 FAS pension cost valuation to reflect an expected rate of return assumption using the actual Market Value of the pension fund assets instead of the Market Related Value used by Ameren.

Q. Please define the term, Market Related Value, and how it is used in calculating pension cost under FAS 87.

A. The components of Ameren Corporation's 1999 FAS 87 pension costs are reflected below.

AMEREN PENSION COST SFAS 87 1999

COMPONENTS	AMOUNT	EXPLANATION
Service Cost	$33,196,439	Present value of pension benefits earned during the year.
Interest Cost	$90,330,145	Increase in the projected pension liability due to the passage of time.

Expected Return On Assets	$(103,660,112)	Expected annual return earned on pension fund assets.
Amortization of Unrecognized Transition Asset And Amortization Of Prior Service	$5,527,562	Amortization of transition asset as of the adoption date of SAFS 87 and impact of plan amendments related to prior service
Amortization of Unrecognized Net (Gain)/Loss	(2,972,905)	Five year amortization of net (gain) loss balance resulting from assumption changes and differences between actual and expected results
Net Periodic Pension Cost	$22,421,129	Total of above components

Line 3 reflects the expected return on the pension fund assets. Under FAS 87, this amount can be calculated by applying an estimated rate of return of 8.5% to either the actual Market Value of pension fund assets or to the Market Related Value of the assets. Market Related Value is an arbitrary calculation which reduces or increases the market value of the assets by gains and losses which have occurred in the most current five year period. Its only purpose is to smooth out annual fluctuations (reduce volatility) in annual gain/loss activity. The Market Value of Ameren's assets is $1,371,848,467 while the Market Related Value is $1,254,372,340 for a difference of $117,476,127.

Q. Why is the Staff opposed to using the Market Related Value for valuing Ameren's pension fund assets?

A. Staff opposes the use of Market Related Value for pension fund asset valuation for the following reason: all large utility companies in the State of Missouri have well funded pension plans. Annual investment gains are the rule rather than the

NP

exception because the expected rate of return is usually significantly lower than the actual return earned resulting in a significant "unrecognized" gain at the end of the year. Since the large utilities in Missouri, including Ameren, use an expected rate of return which is significantly less than the actual returns earned, large annual gains occur routinely. The Market Related Value approach results in a continual understatement of the value of the pension fund assets and, consequently, an overstatement of pension cost under FAS 87.

Q. What is the revenue requirement impact of Adjustment No. S-12.10 to restate Ameren's 1999 expected return on plan assets based upon the Market Value of the pension fund assets instead of the Market Related Value used by Ameren.

A. Adjustment No. S-12.10 reduces Union Electric's Missouri gas pension expense by $121,000.

Q. Please explain adjustment No. S-12.12.

A. Adjustment S-12.12 amortizes the Unrecognized Net Gain balance over a five-year period.

Q. What flexibility does the Company have in determining the number of years to be used in amortizing the net gain/loss balance under FAS 87 and FAS 106?

A. Paragraph 33 of FAS 87 explains the wide flexibility allowed in choosing the amortization period for gains and losses.

> Any systematic method of amortization of unrecognized gains and losses may be used in lieu of the minimum specified in the previous paragraph provided that (a) the minimum is used in any period in which the minimum amortization is greater (reduces the net balance by more), (b) the method is applied consistently, (c) the method is applied similarly to both gains and losses, and (d) the method used is disclosed.

NP

Q. What is the basis for the Staff's recommendation to amortize all of Ameren's gains and losses over five years?

A. An examination of the Unrecognized Net Gain/Loss balance for Ameren and most of the large utilities in Missouri shows that the unrecognized balance is a net gain. This net gain is due primarily to the fact that expected return on plan assets used in calculating pension expense under FAS 87 is usually substantially less than the actual return earned on the pension fund assets.

It is the Staff's position that pension and OPEB expense included in cost of service should be calculated based upon the most accurate information available. Timely recognition of the actual income earned on fund assets is required to meet this objective. Deferred recognition of actual earned returns on fund assets for a period exceeding five years does not result in accurate pension and OPEB expense under FAS 87 and FAS 106, for rate making purposes.

Q. Please explain why the Staff is recommending an amortization period of five years.

A. The Staff's recommendation of five years for amortizing gains and losses under FAS 87 and FAS 106 is based upon three factors:

1) Timely recognition of actual results and assumption changes is necessary for accurate pension and OPEB expense for ratemaking purposes. The Staff considers five years to be a reasonable time period to meet this primary objective.

2) The federal government enacted legislation in 1987 that reduced the amortization period for asset gains and losses from fifteen years to five years

NP

for pension funding requirements. This was the Omnibus Budget Reconciliation Act of 1987. Section 412 (b)(2)(B) of the Internal Revenue Code requires that gains and/or losses from pension plan assets be amortized over a five-year period. A five-year amortization would treat asset gains and losses consistently for pension expense under FAS 87 and funding requirements under ERISA/Internal Revenue Service (IRS) Regulations.

3) Using a five-year amortization period is consistent with this Commission's long standing precedent for amortizing abnormal, significant, expenses/losses over five years for rate making purposes.

Q. Are any other Missouri utility companies using a five-year amortization period for unrecognized gains/losses under SFAS 87 and SFAS 106?

A. Yes. All major utility companies in Missouri which have had rate cases since legislation was passed in Missouri in 1994 requiring the adoption of FAS 106 for rate making purposes are amortizing gains and losses under FAS 87 and FAS 106 over a five-year period.

Q. Is the Staff's recommendation in this case similar to its recommendation in other recent rate cases?

A. Yes, with one exception. In most recent proceedings the Staff has restated the Unrecognized Net Gain Balance, subject to amortization, to reflect the average balance of the five most recent years. This method is used to reduce the effect of any significant volatility that the Unrecognized Net Gain Balance may experience.

Q. Why has the Staff not recommended this method in Case No. GR-2000-512?

NP

A. Prior to 1999, Towers Perrin completed an annual actuarial report for Union Electric Company. However, beginning in 1999, an actuarial report was prepared only for Ameren Corporation as a whole, which includes both Union Electric Company and Central Illinois Power Company. Therefore, only one year of data is available to compute an Unrecognized Net Gain Balance. The Staff recommends that in future cases, as soon as five years worth of data becomes available, a five-year average of Unrecognized Net Gain Balances be used for ratemaking purposes.

LEGAL EXPENSES

Q. Please explain adjustment No. S-12.26.

A. Adjustment No. S-12.26 annualizes the amount the Company pays in legal expenses.

Q. How has the Staff annualized legal expenses?

A. The test year provision for legal expenses was considerably higher than the amount of legal expenses actually incurred. The Staff believes the test year actual payment for legal expenses more accurately reflects the ongoing level of these costs.

CORPORATE FRANCHISE TAXES

Q. Please explain adjustment No. S-15.4.

A. Adjustment No. S-15.4 annualizes the amount the Company must pay in corporate franchise taxes. In May of 1999, the Missouri Legislature passed a bill reducing the franchise tax rate by approximately one-third. As a result, the Staff has reduced the test year amount of corporate franchise taxes paid by one-third in order to reflect a more appropriate ongoing level of expense.

NP

RATE CASE EXPENSE

Q. Please explain adjustment No. S-12.8.

A. This adjustment increases administrative and general expenses to reflect the estimated cost of processing this rate case. The majority of the rate case expense estimate relates to the Cost of Capital witness used by the Company in this proceeding. The Company has estimated that it will file rate cases approximately every three years. Therefore, the Staff has amortized the estimated cost of the Cost of Capital witness over a three-year period to reflect an annualized level of expense.

Q. Does this conclude your direct testimony?

A. Yes, it does.

NP

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In The Matter Of Union Electric Company, d/b/a AmerenUE, For Authority To File Tariffs Increasing Rates For Gas Service Provided To Customers In The Company's Missouri Service Area	)))))	Case No. GR-2000-512

AFFIDAVIT OF JOHN M. BOCZKIEWICZ

STATE OF MISSOURI)
) **ss**
COUNTY OF COLE)

John M. Boczkiewicz, of lawful age, on his oath states: that he has participated in the preparation of the foregoing written testimony in question and answer form, consisting of 16 pages of testimony to be presented in the above case, that the answers in the attached written testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true to the best of his knowledge and belief.

John M. Boczkiewicz

Subscribed and sworn to before me this 4th day of August, 2000.

Notary Public

My commission expires____________________

SHARON S WILES
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. AUG. 23,2002

SUMMARY OF RATE CASE INVOLVEMENT

JOHN M. BOCZKIEWICZ

COMPANY	CASE NO.
Southwestern Bell Telephone Company	TC-93-224
Laclede Gas Company	GR-94-220
St. Louis County Water Company	WR-95-145
St. Louis County Water Company	WR-96-263
Missouri-American Water Company	WR-97-237
St. Louis County Water Company	WR-97-382
Laclede Gas Company	GR-98-374
Laclede Gas Company	GR-99-315
Union Electric Company	EC-2000-975