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|---|---|
| *Exhibit No.:* | |
| *Issues:* | *FAS 87, FAS 88, FAS 106*<br>*Prepaid Pension Asset*<br>*Supplemental Pension*<br>*Environmental Cost*<br>*Safety Deferral*<br>*Computer Cost* |
| *Witness:* | *STEPHEN M. RACKERS* |
| *Sponsoring Party:* | *MoPSC Staff* |
| *Type of Exhibit:* | *Direct Testimony* |
| *Case No.:* | *GR-99-315* |

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

# DIRECT TESTIMONY

# OF

# STEPHEN M. RACKERS



**LACLEDE GAS COMPANY**

**CASE NO. GR-99-315**

***Jefferson City, Missouri***
***June, 1999***

**DIRECT TESTIMONY**

**OF**

**STEPHEN M. RACKERS**

**LACLEDE GAS COMPANY**

**CASE NO. GR–99–315**

Q. Please state your name and business address.

A. Stephen M. Rackers, 815 Charter Commons Drive, Suite 100 B, Chesterfield, Missouri 63017.

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

A. I am a Regulatory Auditor V in the Accounting Department, in the St. Louis office, for the Missouri Public Service Commission (Commission).

Q. Please describe your educational background.

A. I graduated from the University of Missouri at Columbia, Missouri in 1978, from which I received a Bachelor of Science degree in Business Administration, majoring in Accounting. I have passed the Uniform Certified Public Accountant examination and am currently licensed in the state of Missouri.

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

A. I have supervised and assisted in audits and examinations of the books and records of public utility companies operating within the state of Missouri. I have listed cases in which I have previously filed testimony on Schedule 1.

Q. With reference to Case No. GR-99-315, have you made an investigation of the books and records of Laclede Gas Company (Laclede or Company)?

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

Q. What is the purpose of your direct testimony?

A. My direct testimony will discuss the following items:

1) The Staff's recommendation regarding plant and expense adjustments, included in Staff Accounting Schedules 4 and 10, for pension expense calculated according to Financial Accounting Standard (FAS) 87, supplemental pension expense (SERP), pension gains and losses as calculated according to FAS 88, other post retirement benefits (OPEBs) expense as calculated according to FAS 106, Year 2000 computer costs, environmental costs and amortization expense associated with the gas safety deferral.

2) The Staff's recommendation regarding the quantification of the rate base amounts, included in Staff Accounting Schedule 2, for the prepaid pension asset and the unamortized balance of the gas safety deferral.

Q. Please list the adjustments you are sponsoring.

A. I am sponsoring the following adjustments:

Accounting Schedule 4 – Adjustments to Plant in Service

| | |
|---|---|
| P-74.1 | Capitalization of Computer Costs |

Accounting Schedule 10 – Adjustments to Income Statement

| | |
|---|---|
| S-12.7 and S-15.24 | Elimination of Computer Costs |
| S-12.8 and S-15.25 | Capitalization of Computer Costs |
| S-15.3 | Annualization of Pension Expense FAS 87 |
| S-15.4 | Annualization of OPEB Expense FAS 106 |

| | |
|---|---|
| S-15.5 | Normalization of SERP Expense |
| S-15.27 | Normalization of Pension Gains FAS 88 |
| S-17.2 | Amortization of Safety Deferrals |

***PENSION EXPENSE – FAS 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 issued by the Financial Accounting Standards Board (FASB) and is considered to be in conformance with Generally Accepted Accounting Principles (GAAP) for financial reporting purposes.

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

A. In response to Staff Data Request No. 132, Laclede provided the 1999 calculation of pension expense under FAS 87. This calculation was performed by the actuarial firm of Towers Perrin. Adjustment No. S-15.3 decreases the test year pension expense to reflect the level for 1999, as calculated by Towers Perrin.

Q. Was the 1999 pension expense calculated in a manner consistent with the Stipulation and Agreement in Case No. GR-98-374, Laclede's previous rate case?

A. Yes. The 1999 pension expense reflects the expected return on the actual market value of the pension fund assets, a five-year amortization of the unrecognized gains and losses used in calculating the market related value and a five-year average of the total Unrecognized Net Gain balance amortized over five years. The use of these parameters in the calculation of the 1999 pension expense is consistent with the Stipulation and Agreement in Case No. GR-98-374.

***SERP***

Q. Please explain the Staff's adjustment for SERP.

A. Adjustment S-15.5 increases the test year expense for SERP to reflect a five-year average of actual payments.

Q. Why has the Staff used a five-year average as the basis for its adjustment?

A. Over the last ten years the amounts of actual payments for SERP have fluctuated from $0 to approximately $4,000,000. The Staff's use of a five-year average includes a normal level of expense in the cost of service associated with this fluctuating item.

***PENSION GAINS AND LOSSES - FAS 88***

Q. Please explain Adjustment S-15.27.

A. Adjustment S-15.27 restates FAS 88 gains and losses recorded in the test year to reflect a five-year average of the FAS 88 gains and losses recognized by Laclede from 1994 through 1998.

Q. Please provide a description of FAS 88, as it pertains to Laclede.

A. FAS 88 applies to an employer that sponsors a defined benefit pension plan accounted for under the provisions of FAS 87 when all or part of the plan's pension benefit obligation is settled or the plan is curtailed. It also applies to an employer that offers benefits to employees in connection with their termination of employment. In Laclede's specific case, settlements have occurred under FAS 88 due to retirees taking lump sum cash payments for their pension benefits, as opposed to receiving those benefits annually after retirement.

Q. Why has the Staff used a five-year average as the basis for its adjustment?

A. Over the last ten years the amounts of actual payments have fluctuated from $0 to approximately $7,000,000. The Staff's use of a five-year average includes a normal level of expense in the cost of service associated with this fluctuating item.

***PREPAID PENSION ASSET IN RATE BASE***

Q. Please explain the term Prepaid Pension Asset as it applies to pension cost under FAS 87.

A. A Prepaid Pension Asset is established on the balance sheet when the cash contributions to the pension fund exceed the pension cost recorded on the income statement under FAS 87. The Prepaid Pension Asset is increased in subsequent years when the cash contributions to the fund exceed the FAS 87 expense on the income statement. The Prepaid Pension Asset will be reduced in subsequent years when the pension cost under FAS 87 exceeds the cash contribution to the pension fund.

Any gain or loss resulting from a FAS 88 transaction is also included under the FAS 87 pension cost in determining the net impact on the Prepaid Pension Asset in any given year.

Q. Why do the cash contributions to the pension fund differ from the pension expense calculated under FAS 87 for financial reporting purposes?

A. Funding requirements for defined benefit pension plans are provided for under ERISA and IRS regulations. ERISA regulations determine the minimum annual cash contribution that must be funded. IRS regulations govern the maximum cash contribution that is tax deductible.

ERISA regulations are intended to insure that defined benefit pension plans are adequately funded. The ERISA minimum contribution is intended to fund the pension liability while FAS 87 is intended to ratably charge the liability to expense over the service life of the employee. Since both ERISA and FAS 87 are concerned with the same pension liability, differences between contributions under ERISA and expense under FAS 87 can be viewed as a timing difference caused by the market performance of the pension fund and the fact that the actuarial method used for FAS 87 is not the same method used for funding measurements under ERISA regulations. Both actuarial methods estimate the same pension liability, but they spread the liability differently over the service life of the employee.

Q. Explain the relationship between Laclede's Prepaid Pension Asset at June 30, 1998 and their cost of service for this case.

A. Laclede's Prepaid Pension Asset at March 31, 1999 must be adjusted before putting it in rate base for this case. The Prepaid Pension Asset at March 31, 1999 represents the accumulated difference between FAS 87 & 88 pension cost and cash contributions to the pension fund since 1987, when Laclede adopted FAS 87 for financial reporting purposes. However, FAS 87 was not used for regulatory purposes for Laclede prior to the effective date of rates in Case No. GR-94-220 which was September 1, 1994. The Prepaid Pension Asset included in rate base should include only the accumulated cash flow difference between FAS 87 pension cost included in rates and the cash contributions to the pension fund since September 1, 1994.

The March 31, 1999 Prepaid Pension Asset must also be adjusted to exclude the impact of all FAS 88 gains recognized from September 1, 1994 through September 1, 1996. Prior to September 1, 1996, which reflects the effective date of the rates from Case No. GR-96-193, FAS 88 gains were not included in Laclede's cost of service in a rate case. Therefore, the Prepaid Pension Asset balance at March 31, 1999 should exclude the impact of all FAS 88 gains recognized from September 1, 1994 to September 1, 1996.

***OPEBS – FAS 106***

Q. Please provide a brief explanation of FAS 106.

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 OPEBs. This method was developed by the FASB and is required under GAAP for financial reporting purposes.

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. 132, Laclede provided a copy of its 1999 actuarial valuation of OPEB costs under FAS 106 performed by Towers Perrin. Adjustment S-15.4 increases the test year expense for OPEBS to reflect the 1999 actuarial valuation. As is the case with pension expense, the parameters used in the calculation of the 1999 OPEBS expense is consistent with the Stipulation and Agreement in Case No. GR-98-374.

***YEAR 2000 COMPUTER COST***

Q. Explain the Staff's adjustment for Year 2000 computer costs.

A. Laclede is addressing the Year 2000 problem through two methods. The first is through the purchase of new computer systems, both hardware and software. These new systems are designed to be Year 2000 compliant. The costs associated with these new systems will be booked to the appropriate plant accounts when the systems are completed and functioning as intended. The second method is to modify existing software to make it Year 2000 compliant. A portion of these costs was expensed as incurred. Another portion was capitalized and will be booked to the appropriate plant accounts when the modifications are completed and functioning as intended.

Q. Why were portions of the costs to modify existing software expensed and capitalized?

A. In accordance with GAAP, the Company is required to expense these costs as incurred. However, in Case No. GR-98-374 the Commission approved an Accounting Authority Order (AAO) that allowed the Company to defer these costs beginning on July 1, 1998. As a result, Laclede ceased expensing these costs and began capitalizing them on July 1, 1998.

Q. How is the Staff proposing to treat the cost of modifying existing software?

A. The Staff agrees with the Company's capitalization treatment and is proposing two adjustments associated with the modification costs that were expensed during the test year ending December 31, 1998. Adjustments S-12.7 and S-12.24 eliminate the test year amount expensed prior to March 1, 1998. Adjustments S-12.8 and S-15.25 capitalize the test year amounts expensed from March 1, 1998 through June 30, 1998.

Q. Why are expenses incurred prior to March 1, 1998 eliminated?

A. The test year in Case No. GR-98-374 included January and February of 1998. In that case the Staff made no adjustment to the costs associated with modifying existing software included in test year expense. Therefore, the modification cost included in January and February of 1998 is currently included in the cost of service and is being recovered in rates.

Q. Have you included the amount capitalized in plant in service?

A. Yes. Adjustment P-74.1 to Accounting Schedule 4, Adjustments to Plant In Service, includes the amount of capitalized software costs in plant.

***ENVIRONMENTAL COSTS***

Q. Please explain the Staff's treatment of the costs associated with the environmental clean up of manufactured gas sites.

A. The Staff recommends the use of a five-year average to determine a normal level of expense associated with environmental clean-up costs. The cost incurred during the five years ending March of 1999 has fluctuated between approximately $19,000 and $216,000. The Staff's use of a five-year average includes a normal level of expense in the cost of service associated with this fluctuating item.

***SAFETY DEFERRAL***

Q. Please explain the Company's deferral associated with the replacement of gas lines and mains.

A. In Case No. GR-94-220, the Commission approved an AAO allowing Laclede to defer the depreciation, property tax and carrying cost associated with the replacement of gas service lines and mains. This authority was subsequently renewed in Case Nos. GR-96-193 and GR-98-374.

Q. How is the Staff proposing to treat the costs deferred according to the AAOs previously approved?

A. The Staff is proposing the treatment recently prescribed by the Commission in its Order in Case No. GR-98-140 involving Missouri Gas Energy's safety deferrals. In that case, the Commission approved (1) a ten-year amortization of the deferrals and (2) no inclusion of the unamortized balance in rate base. In that case, the Commission noted that in using a ten-year amortization period it was recognizing a shorter term than the twenty years the Staff had recommended and it had approved in prior cases. Given this reduced amortization period, the Commission deemed it proper for the ratepayers and shareholders to share the effect of regulatory lag by allowing the Company to earn a return of, but not a return on, the deferred balance.

Q. Is the Staff recommending that the Commission authorize another AAO for the continued deferral of costs related to the replacement of service lines and mains?

A. Yes. The Staff recommends that the Commission authorize an AAO for the deferrals of depreciation, property taxes and carrying cost associated with service line and main replacements. The current AAO should cease at the end of the true-up period in this case. The new AAO should begin following the true-up in this case and continue through the later of the end of the test year, up-date period or true-up period in the next case. As with previous AAO's for Laclede's Safety Deferral, for the deferrals to be considered for possible future recovery, the Company should be required to file a case within twenty-four months following the effective date of the order in this case.

Q. Does this conclude your direct testimony?

A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of | ) | |
| Laclede Gas Company's Tariff | ) | Case No. GR-99-315 |
| to Revise Natural Gas Rate Schedules. | ) | |

AFFIDAVIT OF STEPHEN M. RACKERS

| | | |
|---|---|---|
| STATE OF MISSOURI | ) | |
| | ) | ss. |
| COUNTY OF COLE | ) | |

Stephen M. Rackers, 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 10 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.

Stephen M. Rackers

Stephen M. Rackers

Subscribed and sworn to before me this 28 day of June 1999.

Toni M. Willmeno

TONI M. WILLMENO
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI

Toni M. Willmeno
Notary Public, State of Missouri
County of Callaway
My Commission Expires June 24, 2000

## RATE PROCEEDING PARTICIPATION

## STEPHEN M. RACKERS

| Company | Case Number |
|---|---|
| Bowling Green Gas Company | GR-78-218 |
| Central Telephone Company | TR-78-258 |
| Empire District Electric Company | ER-79-19 |
| Fidelity Telephone Company | TR-80-269 |
| St. Louis County Water Company | WR-80-314 |
| Union Electric Company | ER-81-180 |
| Laclede Gas Company | GR-81-245 |
| Great River Gas Company | GR-81-353 |
| Union Electric Company | ER-82-52 |
| Laclede Gas Company | GR-82-200 |
| St. Louis County Water Company | WR-82-249 |
| Union Electric Company | ER-83-163 |
| Union Electric Company | ER-84-168 |
| Arkansas Power and Light Company | ER-85-20 |
| Kansas City Power and Light Company | ER-85-128 |
| Arkansas Power and Light Company | ER-85-265 |
| Union Electric Company | EC-87-114 |
| Union Electric Company | GR-87-62 |
| Southwestern Bell Telephone Company | TC-89-14 |
| St. Louis County Water Company | WR-89-246 |
| Laclede Gas Company | GR-90-120 |
| Missouri Cities Water Company | WR-91-172 |
| St. Louis County Water Company | WR-91-361 |
| Laclede Gas Company | GR-92-165 |
| Missouri Pipeline Company | GR-92-314 |
| St. Louis County Water Company | WR-92-204 |

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|---|---|
| St. Louis County Water Company | WR-94-166 |
| St. Louis County Water Company | WR-95-145 |
| St. Louis County Water Company | WR-96-263 |
| St. Louis County Water Company | WR-97-382 |