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Issues:	Pensions and Other Post-Retirement Employee Benefits (OPEBs)
Witness:	Steve M. Traxler
Sponsoring Party:	MoPSC Staff
Type of Exhibit:	Surrebuttal Testimony
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

STEVE M. TRAXLER

UNION ELECTRIC COMPANY
d/b/a AMERENUE

CASE NO. EC-2002-1

Jefferson City, Missouri
April 2002

****Denotes Proprietary Information****

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

The Staff of the Missouri Public Service Commission,	)	
		Case No. EC-2002-1
Complainant,	)	
vs.	)	
Union Electric Company, d/b/a AmerenUE,		
	)	
Respondent.	)	

AFFIDAVIT OF STEVE M. TRAXLER

STATE OF MISSOURI
)
COUNTY OF COLE

Steve M. Traxler, is, of lawful age, and on his oath states: that he has participated in the preparation of the following Surrebuttal Testimony in question and answer form, consisting of 20 pages to be presented in the above case; that the answers in the following Surrebuttal 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

Subscribed and sworn to before me this 24th day of June, 2002.

Notary Public

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

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STEVE M. TRAXLER

UNION ELECTRIC COMPANY

D/B/A AMERENUE

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SURREBUTTAL TESTIMONY

OF

STEVE M. TRAXLER

UNION ELECTRIC COMPANY

D/B/A AMERENUE

CASE NO. EC-2002-1

Q. Please state your name and business address.

A. Steve M. Traxler, Noland Plaza Office Building, 3675 Noland Road, Independence, Missouri 64055.

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 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 Auditor V with the Commission's Accounting Department.

Q. What is the nature of your duties while in the employ of this 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 attached as Schedule 1 to this 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. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony will address the rebuttal testimony of AmerenUE (Company) witness Michael D. McGilligan on the issue of pension and other post-retirement employee benefit costs (OPEBs) calculated under Financial Accounting Standards Board (FAS) 87 and FAS 106, respectively.

My testimony will also address a change in the Staff's position from using FAS 87 to the Employee Retirement Income Security Act (ERISA) minimum contribution for determining the appropriate level of pension cost for setting rates.

<u>CALCULATION OF FAS 87 AND FAS 106</u>

Q. Please explain FAS 87 and FAS 106.

A. FAS 87 and FAS 106 are the Financial Accounting Standards Board (FASB) approved accrual accounting method for financial statement recognition of annual pension cost and other post-retirement employee benefit costs (OPEBs) over the service life of employees. The assumptions used in the calculation of FAS 87 and FAS 106 are similar in many respects. Since the primary issue between the Staff and AmerenUE relates to the appropriate level of pension cost for setting rates, my remaining testimony will deal primarily with pension cost calculated under FAS 87 and the pension contribution requirements under ERISA regulations.

Q. Please explain the specific components of AmerenUE's FAS 87 pension cost calculation for 2001.

A. AmerenUE's 2001 pension cost is reflected as follows:

	(Million's)	Description
Service Cost	** P----------**	Present value of pension benefits earned during the year.
Interest Cost	** P----------**	Increase in the projected pension liability due to the passage of time.
Expected Return on Assets	** **P-------------****	**Expected annual return from investing the pension fund assets.**
Amortization of:		
Transition Obligation	** P------------**	Amortization of transition asset as of the adoption date of FAS 87.
Prior Service Costs	** P-----------**	Amortization of plan amendments on prior service cost.
Net Unrecognized(Gain) / Loss	**** P------------****	**Amortization of net unrecognized gains over a 10-year period.**
-------------------------------------	-------------------	
Net Pension Cost – 2001	** P------------**	

Q. What are the primary differences between AmerenUE's proposed method of calculating pension cost under FAS 87 and the Staff's FAS 87 method presented in its direct filing in this case?

A. The difference between the Staff's direct case filed position and AmerenUE's rebuttal position are related to the two assumptions in bold print above, the Expected Return on Assets, i.e., the Expected Rate of Return assumption, and the Amortization of Net Unrecognized (Gains)/Losses.

Q. Please explain the difference in calculating the Expected Rate of Return assumption between the Staff's filed position and AmerenUE's proposed method.

A. Pension cost under FAS 87 is reduced by the expected annual return earned from investing the existing pension fund assets. Pension cost under FAS 87 will only be positive to the extent that the additional annual costs, which are primarily for earned benefits during the year, i.e., Service Cost, and the accrued Interest Cost on the Accumulated Benefit Obligation (Pension Liability to Date) exceed the Expected Return on Assets assumption.

The expected rate of return is calculated by applying an assumed rate of return, 8.50% in 2001, times either: (1) the Market Value of Plan Assets at the beginning of the year; or (2) Market Related Value which is the Market Value adjusted upward or downward by a ratable recognition of gains and losses occurring during the current period not to exceed five years. Gains and losses represent differences between actual and expected results (difference between expected return on investments and actual return at the end of the year) and changes in other assumptions by the actuary, such as a change in the discount rate used in valuing the accumulated benefit obligation.

The Market Related Value method is a "smoothing" technique intended to mitigate: (1) significant annual fluctuation (volatility) in the Market Value of the plan assets; and (2) resulting impact on annual pension cost under FAS 87. AmerenUE's proposed FAS 87 calculation utilizes a Market Related Value method which adjusts the Market Value of Assets by a ratable recognition of gains and losses which have occurred in the most recent three-year period. The Staff's filed position used the actual Market Value of Assets in calculating the expected rate of return assumption.

Q. Please explain the difference between AmerenUE's proposed method for amortizing the Unrecognized Net (Gain)/Loss balance and the method reflected in the Staff's filed position.

A. All gains and losses under FAS 87 are eventually amortized (reflected) in annual pension cost under FAS 87 under the Staff's and AmerenUE's methods. FAS 87 allows considerable flexibility in the time frame selected for amortization. AmerenUE's proposed method amortizes the Unrecognized Net Gain/Loss balance, at the beginning of the plan year, over a 10-year period. Staff's amortization method uses a five-year average balance of the Unrecognized Net (Gain)/Loss balance and amortizes this average balance over five years.

HISTORICAL RATEMAKING TREATMENT – PENSION AND OPEBS COSTS

Q. When were the accrual accounting methods for Pension and OPEBs costs FAS 87 and FAS 106 adopted for ratemaking purposes?

A. House Bill 1405 (Section 386.315, RSMo) approved by the Missouri Legislature in 1994 required the adoption of FAS 106 for setting rates for OPEBs costs. In Commission cases following the date that House Bill 1405 became law, the Staff began recommending the use of the accrual accounting method for pension costs, FAS 87, in order to use a similar accrual accounting method for all post-retirement employee benefit costs.

Q. What method was used for setting rates for Pension and OPEBs costs prior to the requirement for using FAS 106 for OPEBs costs under House Bill 1405?

A. Prior to House Bill 1405, rates were set on a "pay as you go" or "cash" basis for both Pension and OPEBs costs. The Employee Retirement Income Security Act of 1974 (ERISA) minimum contribution was used for pension cost and the utility's actual paid claims for other post-retirement employee benefit costs was used for benefit costs addressed in FAS 106. The other post-retirement benefit costs addressed in FAS 106 include retiree medical, dental and life insurance costs.

Q. What is the purpose of the 1974 ERISA federal legislation?

A. The ERISA funding requirements are intended to ensure that Defined Benefit Pension Plans in the United States are adequately funded.

Q. Did the Commission approve Staff recommendations in prior cases for using the ERISA minimum contribution for the pension cost to be included in cost of service for setting rates?

A. Yes. Some of the cases in which the Commission adopted the use of the ERISA minimum contribution as the proper pension cost for setting rates are listed below:

Utility Company	Case No.
St. Joseph Light & Power Company	ER-93-41
Missouri Cities Water Company	WR-92-207
Capital City Water Company	WR-94-297

HISTORICAL ISSUES – STAFF VS. MISSOURI UTILITIES

Q. Since the change in the Staff's position in recommending the adoption of FAS 87 for determining pension cost for setting rates, has there been considerable difference of opinion between the Staff and utility companies regarding the proper assumptions to be used in calculating pension cost under FAS 87?

A. Yes. The methodology to be used in calculating pension cost under FAS 87 has been vigorously debated and tried in numerous cases involving the major electric, gas and water utility companies in Missouri.

Q. What have been the primary issues between the Staff and utility companies regarding the assumptions used in calculating pension cost under FAS 87?

A. The most important issue raised by the Staff addresses the use of assumptions by utility companies that do not accurately reflect the funded status of the pension plan. FAS 87 pension calculations that do not accurately reflect the funded status of the pension plan, result in pension costs that are excessive when compared to the actual cash funding requirements under ERISA regulations. Annual pension cost under FAS 87, which is significantly higher than the amounts actually required to be contributed to the pension fund, results in a cash windfall to the utility and excessive rates to ratepayers.

The second most important issue involving pension cost calculated under FAS 87 is whether the result is so volatile from year-to-year that it becomes inappropriate for setting rates. The primary argument used by the utility companies in challenging the Staff's recommended method for calculating FAS 87 is that it results in excessive annual volatility and is, therefore, inappropriate for setting rates.

While an important consideration, the "volatility" issue should never take precedence over the primary issue which is to make sure that the assumptions used to address volatility don't result in a pension cost which is significantly higher than the actual funding requirements of the plan, thereby resulting in excessive rates and a cash windfall to the utility.

Q. How does the funded status of the pension plan impact the pension cost calculated under FAS 87?

A. One of the assumptions used in FAS 87, previously discussed in my testimony, is the Expected Rate of Return assumption. The expected rate of return represents the annual income expected from investing the existing pension funds in debt and equity securities.

Annual pension cost under FAS 87 will only be positive when the annual earned returns from investing the funded assets is less than the additional annual costs including primarily service and interest costs related to additional benefits earned by employees and the annual interest on the accumulated benefit obligation.

Prior to the significant devaluation of the stock market in 2001 and 2002, most pension funds for major utilities, like AmerenUE's pension fund, were so well funded that pension cost under the Staff's FAS 87 method was a negative amount because the annual returns earned on the pension fund assets exceeded the expected returns, resulting in over-funded pension funds. The higher the value of the pension fund, the higher the expected rate of return assumption used in calculating FAS 87.

Q. What other factors can have a significant impact on pension cost under FAS 87 and on annual volatility in year-to-year results?

A. As discussed in my previous answer, significant differences often occur between “expected” results and “actual” results. These differences, as well as others described below, result in a gain or loss under FAS 87.

The expected rate of return assumption discussed in my last answer is an estimate based on an assumed long-range (20 to 30 years) return estimated by the Company’s actuary. AmerenUE’s actuary is currently using an expected rate of return of 8.5 %. Significant differences can and do occur between actual short-term returns and the expected rate of return assumption. These differences between expected and actual result in a gain (actual return exceeds expected) or a loss (actual return is less than expected). Changes in other assumptions made by the actuary for the discount rate and interest rate, for example, will also result in a gain or a loss under FAS 87.

The appropriate time frame to be used in recognizing gains and losses under FAS 87 has been a significant issue between the Staff and major utilities since FAS 87 has been adopted by the Commission for setting rates. FAS 87 provides for considerable flexibility in choosing the time period used in recognizing (amortizing) gains and losses in calculating pension cost. As discussed later in my testimony on page 11, AmerenUE’s proposed method reflects gains and losses over a 14-year period in calculating pension cost under FAS 87. The Staff’s FAS 87 method filed in its direct case reflects gains and losses over a five-year period. Reflecting gains and losses on a more timely basis under the Staff’s FAS 87 method filed in its direct case has more accurately reflected the over funded status of utility pension funds during the 1990's.

The Staff's FAS 87 method filed in its direct case also accurately reflects the impact of the significant devaluation of the stock market which has occurred in 2001 and 2002. The AmerenUE pension fund was over-funded as of January 1, 2001, which is the 2001 valuation date for calculating pension cost under FAS 87. If the Staff's FAS 87 method filed in its direct case had been used in 2001, a (negative) pension cost of ($11,469,105) would have resulted. AmerenUE's method produced a positive pension cost amount of $2,331,577. During 2001 and 2002, the value of AmerenUE's pension fund has dropped significantly as a result of the devaluation of the stock market. The Staff's FAS 87 method filed in its direct case for calculating FAS 87, if used for 2002, would result in a positive pension cost of $11,822,323 which represents an increase in one year of $23,291,428. This level of volatility in one year is unacceptable for setting rates no matter whose method is being used to calculate pension cost under FAS 87. As I will explain later in this testimony, the inability of FAS 87 to deal with the volatility caused by economic impacts beyond the control of management is the basis for the Staff's recommendation in this testimony to go back to the ERISA minimum contribution for determining pension cost for setting rates.

Q. Has AmerenUE's proposed method of calculating pension cost under FAS 87 accurately reflected the funded status of AmerenUE's pension fund for the years 1995 – 2001?

A. No. AmerenUE's historical pension cost for its Missouri operations under FAS 87 and the ERISA minimum contribution requirement from 1995 through 2001 are reflected below:

Year	AmerenUE-Missouri FAS 87 Pension Cost	AmerenUE-Missouri ERISA Minimum Contribution	AmerenUE-Missouri Voluntary Contributions
1995	** P-------------	P-	P------------**
1996	** P-------------	P-	P------------**
1997	** P-------------	P-	**
1998	** --------------	P -	**
1999	** P-------------	P-	**
2000	** P---------	P-	**
2001	** P-----------	P-	**
Total	** P--------------	P-	P------------**
Average	**** P--------------**	**P-**	**P-------------****

AmerenUE-Missuori's historical results reflect that on average, AmerenUE-Missouri has collected ** P----- ** million annually from ratepayers for pension cost from 1995 through 2001. However, under ERISA funding requirements, no funds were required to be deposited in the AmerenUE pension fund. AmerenUE made voluntary contributions totaling ** P-----** million in 1995 and 1996. In the Staff's view, a FAS 87 pension cost calculation which results in such a significant recurring disparity between pension cost collected in rates and the amount required to adequately fund the plan results in excessive rates for ratepayers and a cash windfall to the Company. As reflected above, UE has collected, on average, ** P-------** million annually for pension cost from 1995-2001. The average voluntary contribution during this same period has been only ** P------------- **. The cash to windfall to AmerenUE-Missouri has averaged * -------** million (** P------** P-------------------------** P--- -** million voluntarily contributed to the fund) annually since 1995.

Q Why has AmerenUE-Missouri's pension cost calculation under FAS 87 resulted in such a significant disparity when compared to the funding requirement under ERISA regulations?

A. Differences between "expected" results and "actual" results take approximately 14 years to be fully reflected in the pension cost calculation under

AmerenUE's methodology. Current year gains and losses are partially deferred in the Market Related Value calculation for four years. The remaining balance at the end of the first four-year period is not fully amortized (reflected) in the pension cost calculation for an additional 10 years. Prior to the devaluation of the stock market in 2001 and 2002, actual returns earned on funded assets were higher than the expected returns throughout the 1990's. Pension funds for most large utilities became so well funded that the Internal Revenue Service (IRS) would not allow a tax deductible contribution to be made. AmerenUE could not make a tax deductible contribution from 1997 - 2001.

AmerenUE's proposed methodology for calculating FAS 87 has routinely produced significant positive pension cost amounts as a result of deferring recognition of actual results, which have been better than expected (gains), over a 14-year time frame. The methodology applied by the Staff in filed rate cases or Staff earnings investigations reduced the time frame for gain/loss recognition from approximately 15 years for all other large Missouri electric, gas and water utilities to five years. AmerenUE's methodology has not been challenged prior to this case because the two approved experimental alternative regulations plans (EARPs) did not permit it.

Q. Please summarize AmerenUE witness Michael D. McGilligan's criticisms of the Staff's filed position for calculating Pension and OPEBs costs under FAS 87 and FAS 106.

A. Mr. McGilligan's criticisms are summarized as follows in his Executive Summary attached as an Appendix to his rebuttal testimony:

1) Staff's position, which reduces booked pension and OPEBs costs by $7 million does not eliminate expense but, rather, defers it to be paid by future ratepayers.

2) Staff's method increases the volatility of annual expense recognition.

3) Staff's method does not represent sound ratemaking policy.

4) Staff's method does not conform to Generally Accepted Accounting Principles (GAPP) – specifically to the requirements of FAS 87 and FAS 106.

5) Because of the poor asset return performance during 2000 and 2001, the average pension expense over the next five years will be more than $25 million greater than the test year under the Staff's proposed method.

Q. With regard to Mr. McGilligan's first criticism has the Staff met with AmerenUE to convey a change in position regarding the method to be used in calculating pension and OPEBs costs for setting rates?

A. Yes. A meeting was held with AmerenUE representatives in Jefferson City on May 30, 2002 for the purpose of notifying AmerenUE of a change in position by the Staff from FAS 87 to the ERISA minimum contribution for pension cost and additionally to make changes to the Staff's FAS 87 method filed in its direct case in the event that the Commission chose to continue with some form of FAS 87 for determining pension cost for ratemaking purposes. The Staff is no longer recommending a $7.4 million reduction to AmerenUE-Missouri's test year pension and OPEBs costs.

Q. Will the Staff's direct filing in the rate cases for Laclede Gas Company and The Empire District Electric Company also reflect pension costs based upon the ERISA minimum contribution?

A. Yes.

Q. What adjustment to AmerenUE-Missouri's test year pension cost is the Staff recommending now to reflect its change in position from FAS 87 to the ERISA minimum contribution?

A. AmerenUE-Missouri's ERISA minimum contribution from 1995 through 2002 is reflected below:

AmerenUE-Missouri
ERISA

Year	Minimum Contribution
1995	** P---**
1996	** P---**
1997	** P---**
1998	** P---**
1999	** P---**
2000	** P---**
2001	** P---**
2002	** P---**

If AmerenUE-Missouri's pension cost for ratemaking purposes had been based upon the ERISA minimum contribution from 1995 through 2002, the annual volatility would not be an issue in this case. The Staff's position at this date is that an adjustment should be made to AmerenUE-Missouri's test year to restate its booked pension cost to zero based on the historical analysis above. The Commission should note that the significant devaluation of the stock market discussed in this testimony and the rebuttal testimony of Mr. McGilligan has not resulted in a required contribution to the pension fund in 2002 which relates to a period 15 months beyond the September 30, 2001 test year established for this case.

Q. Assuming the Commission were to decide that some form of FAS 87 should continue to be used for determining pension cost for ratemaking purposes for AmerenUE-Missouri and other utilities in Missouri, is the Staff recommending changes to the Staff method of calculating FAS 87 as filed in its direct case?

A. Yes. Although it is clear in the Staff's view that neither the Staff's nor AmerenUE's FAS 87 method is suitable for setting rates as a result of the annual volatility resulting from economic impacts beyond the control of management, the Staff realizes that the Commission may decide to continue the use of FAS 87 for ratemaking purposes. The recent devaluation of the stock market has had such an extreme impact on FAS 87 calculations that additional smoothing mechanisms are necessary as follows:

1) The Market Related Value method for valuing the pension fund assets in calculating the Expected Rate of Return assumption should be adopted for both FAS 87 and FAS 106. This change will help mitigate the extreme volatility in the Market Value of the pension fund assets experienced in recent years by spreading the impact over a four-year period.

2) The Staff considers a negative pension cost under FAS 87 to be inappropriate for setting rates. Although a negative expense accurately reflects an over funded pension fund, this result should theoretically be only a temporary timing difference between pension expense under FAS 87 and the cash contributions required under ERISA funding. Prior to the recent devaluation of the stock market, reflecting the actual returns earned on the pension fund over five years under the Staff's approach resulted in a negative pension cost on a frequent basis. Since federal law does not allow a company to withdraw the excess pension funds for the cost of service reduction resulting from recognizing a negative pension cost in rates, the company is forced to make up the loss in cash flow from other means such as short-term borrowing. This result is not reasonable on a continuing basis. To eliminate this result, the Staff is proposing to limit gain recognition to an amount which results in a FAS 87 expense which does not go below zero.

3) If the FAS 87 result is still negative after reflecting 2), then the Expected Rate of Return assumption should be limited to an amount which does not result in a FAS 87 expense which is below zero.

Q. Please summarize the Staff's rationale for the recommended changes in calculating FAS 87 as discussed in your answer to the previous question.

A. The Staff's change in methodologies addressed in this surrebuttal testimony is an effort by the Staff to select a method which will not produce excessive pension costs under normal conditions and at the same time not be too volatile for setting rates. AmerenUE's proposed method will result in excessive pension costs and a cash windfall to the utility under normal circumstances. This result is clearly evident on page 10 of this testimony respecting the comparison between UE's FAS 87 methodology and to the ERISA minimum contribution from 1995 – 2002. Methods similar to AmerenUE's FAS 87 proposal advocated by other large utilities in Missouri produce a similar over collection of pension cost in rates.

Under the present circumstances, the fairest and least complicated methodology in the Staff's view is the ERISA minimum contribution methodology which is tied directly to the amount of cash contributed to the fund. No cash windfall or shortfall will result under this approach.

Q. Mr. McGilligan's second criticism of the Staff's filed FAS 87 method was that it increases annual volatility. How do you respond to this criticism?

A. My previous answer clearly reflects an admission that the Staff's filed FAS 87 method needs further refinements in an attempt to address the recent significant volatility in FAS 87 calculations. The Staff's principal position of changing its recommendation to the ERISA minimum contribution methodology and the Staff's secondary position of recommending changes to the Staff's FAS 87 calculation are a direct result of the Staff addressing the significant volatility resulting from economic events beyond AmerenUE's control. However, it is somewhat ironic that Mr. McGilligan is suggesting that AmerenUE's method results in "acceptable" annual volatility while the Staff's method does not. A clear examination of the results since 1999 indicate in Staff's view that AmerenUE's method also results in annual volatility which is unacceptable for setting rates for a regulated utility. AmerenUE's FAS 87 calculations and resulting annual volatility since 1999 are reflected as follows:

Year	AmerenUE Calculation of FAS 87 Pension Cost	Annual Volatility	Volatility as Percent
1999	** P--------------**		
2000	** P--------------**	($ 21,291,980)	1885 %
2001	** P--------------**	$ 1,202,128	106 %
2002	** P--------------**	$ 13,285,688	570 %
Average Annual Volatility		**$ 11,926,599**	

AmerenUE's FAS 87 pension cost results since 1999 clearly reflect excessive annual volatility. Thus, the question which applies to AmerenUE's FAS 87 methodology, in addition to the Staff's FAS 87 methodology as filed in the Staff's direct case is: How do you establish rates for a regulated utility on FAS 87 calculations which are subject to change annually from 106% to 1885%? If AmerenUE and Mr. McGilligan consider the results of the AmerenUE FAS 87 method as acceptable, then I think the Staff and AmerenUE have a significant difference of opinion on what level of annual volatility is acceptable for setting rates for a regulated utility. All expenses as a practical matter are subject to annual volatility to some degree, but it is unacceptible to allow volatility to the degree reflected above for AmerenUE's FAS 87 pension cost calculations since 1999.

Q. Mr. McGilligan's third criticism of the Staff's FAS 87 method filed in its direct case is that it does not represent sound ratemaking policy. How do you respond to this criticism?

A. The Staff does not disagree. Any cost of service method which results in the annual volatility levels generated under AmerenUE's present FAS 87 method and Staff's previously filed direct case position are unacceptable for setting rates for a regulated utility. Given the demonstrated impact of the recent devaluation of the stock market on FAS 87 calculations, the Staff's ERISA minimum contribution method is less volatile than

AmerenUE's FAS 87 calculation method and is tied directly to the cash required to adequately fund the AmerenUE plan. The possibility of a significant cash windfall or shortfall is virtually eliminated when rates for pension costs are set based upon the ERISA funding requirements.

Q. Mr. McGilligan's fifth criticism of the Staff's direct case position on FAS 87 is that his projections for the next five years reflect pension cost amounts which are $25 million higher than the negative result reflected in Staff's direct filing. How do you respond to this criticism?

A. First, as previously stated, the Staff is no longer recommending a negative pension cost in this case. Staff's primary recommendation in this testimony is that pension cost be included at $0 under the ERISA minimum contribution method. If the Commission rejects the Staff's ERISA minimum contribution recommendation, then the Staff's method for calculating FAS 87, with the smoothing revisions addressed above, would also result in a $0 pension cost for this case.

Q. Should Mr. McGilligan's projected FAS 87 pension costs five years into the future be used as a basis for accepting UE's FAS 87 methodology in this case?

A. Certainly not. The extreme volatility experienced in recent years is a result of a significant devaluation of the stock market. I don't believe anyone can state with any degree of certainty whether the depressed market will continue or rebound in the next five years. However, it is known with certainty that AmerenUE is not required to make a pension contribution in 2002. If a significant contribution becomes a requirement in 2003, AmerenUE can address that in a rate case request at that time assuming revenue growth is insufficient to cover the cash flow impact. In any event, pension cost in this case should not be premised on anyone's projections about what AmerenUE's pension fund valuation and resulting FAS 87 pension cost will be for the next five years.

SUMMARY

Q. Please summarize AmerenUE witness Michael D. McGilligan's rebuttal testimony.

A. Mr. McGilligan's primary objections to the Staff's filed position on calculating pension cost under FAS 87 are:

1) Staff's filed adjustment reducing AmerenUE-Missouri's pension cost by $7 million is inappropriate for setting rates. Pension cost for 2002 under "AmerenUE's method" is expected to be $15.6 million.

2) The Staff's filed method for calculating pension cost under FAS 87 results in excessive volatility and is, therefore, inappropriate for setting rates for AmerenUE-Missouri in this case.

Q. Please summarize the Staff's response to Mr. McGilligan's rebuttal testimony.

A. 1) As a result of the significant impact that the most recent devaluation of the stock market has had on FAS 87 pension cost results for AmerenUE-Missouri and other utilities in Missouri, the Staff informed UE on May 30, 2002 that it was changing its position on pension cost in this case and other pending cases for ratemaking purposes from the Staff's originally filed method under FAS 87 to the ERISA minimum contribution method. The Staff is no longer recommending a $7 million reduction to AmerenUE-Missouri's test year pension cost. In the Staff's case, AmerenUE's-Missouri's test year pension cost has been adjusted to reflect $0 pension cost consistent with AmerenUE's 2002 ERISA minimum contribution.

2) Upon serious review and analysis, the Staff concluded that the Staff's filed method for calculating pension cost under FAS 87 results in excessive volatility for ratemaking purposes. Staff's change in position to the ERISA minimum contribution for determining pension cost for ratemaking purposes is intended to

address the volatility issue and eliminate the possibility of a "negative" pension cost for AmerenUE-Missouri and other Missouri utilities which can, and has, occurred under FAS 87 calculations.

3) Mr. McGilligan's rebuttal testimony suggests that the excessive volatility issue applies only to the Staff's filed method for calculating FAS 87. However, an examination of AmerenUE's FAS 87 results since 1999 shown on page 16 of my surrebuttal testimony clearly shows that AmerenUE's method is subject to excessive annual volatility to a level unacceptable for setting rates. On the other hand, the ERISA minimum contribution method for 1995 through 2002 indicates no volatility and is, therefore, a much more stable method for determining pension cost for a regulated utility.

4) The historical results of AmerenUE-Missouri's proposed FAS 87 method shown on page 10 of my surrebuttal testimony reflects that AmerenUE-Missouri's method has resulted in an excessive pension cost recovery since 1995. AmerenUE-Missouri has collected ** P-------**million in rates for pension cost since 1995. AmerenUE-Missouri's has made voluntary contributions to the pension fund totaling ** P------** million during the same period. The difference between pension cost collected in rates and the amount contributed to the pension fund, **P------ ** million, represents a cash windfall to AmerenUE-Missouri to be used for whatever purposes it chooses.

Annual differences, to some extent, between the FAS 87 method and ERISA funding requirements is expected because the methods are not the same. However, a FAS 87 method which averaged ** P----- ** million annually from 1995-2002 when the ERISA minimum contribution was ** P--** reflects excessive pension cost recovery which can be fairly characterized as a cash windfall to AmerenUE-Missouri.

5) Assuming the Commission desires to continue using some form of FAS 87 to determine pension cost for setting rates, the Staff has recommended three changes to its FAS 87 method filed in its direct case in an attempt to mitigate the excessive volatility in FAS 87 results in recent years. These recommended changes are described on pages 14 and 15 of this surrebuttal testimony.

Q. Does this conclude your surrebuttal 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
1990	Case No. ER-90-101	UtiliCorp United Inc., Missouri Public Service Division (electric)	Direct Surrebuttal	Contested

Year	Case No.	Utility	Type of Testimony	
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 Serrebuttal	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
2000	Case No. EM-2000-369	UtiliCorp United Inc. and Empire Electric District Co.	Rebuttal	Contested

Year	Case No.	Utility	Type of Testimony	
2001	Case No. TT-2001-328	Oregon Mutual Telephone Co.	Direct	Settled
2002	Case No. ER-2001-672	UtiliCorp United Inc.	Direct, Surrebuttal	Settled