Exhibit No.
Issue: FAS 87, OPEB / FAS 106
Witness: C. Kenneth Vogl
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District
Case No. ER-2006-0315

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

# REBUTTAL TESTIMONY

# OF

# C. KENNETH VOGL

**JULY 2006**

**REBUTTAL TESTIMONY**
**OF**
**C. KENNETH VOGL**
**ON BEHALF OF**
**THE EMPIRE DISTRICT ELECTRIC COMPANY**
**BEFORE THE**
**MISSOURI PUBLIC SERVICE COMMISSION**
**CASE NO. ER-2006-0315**

## I. INTRODUCTION

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A: My name is C. Kenneth Vogl. My business address is 101 South Hanley, Suite 900, St. Louis, Missouri 63105.

**Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

A. I am a Consultant with Towers Perrin. I serve as an actuary and employee benefits consultant to a number of clients in the firm's St. Louis office. Towers Perrin provides global human resource consulting and related services that help organizations effectively manage their investment in people. Employee benefits is one of many areas in which Towers Perrin offers client services.

**Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND, WORK EXPERIENCE AND DUTIES OF YOUR POSITION.**

A. I received a Bachelor of Science degree in mathematics from the University of Missouri-Columbia in 1988 and a Doctorate of Philosophy in mathematics from Washington University in 1994. I completed the examination requirements for designation as a Fellow of the Society of Actuaries and received such designation in August 2000. I completed both the examination and experience requirements for designation as an Enrolled Actuary under the Employee Retirement Income Security Act of 1974 ("ERISA") and received such designation in 1998.

I have been employed with Towers Perrin as a consulting actuary since 1995. From 1994 to 1995, I was employed by William Mercer, another human resources consulting firm, in St. Louis. I have substantial technical and consulting experience with regard to employee benefit plans — including the design, funding, accounting, and communication of pension and postretirement welfare programs.

**Q. PLEASE DESCRIBE THE PURPOSE OF YOUR TESTIMONY.**

A. The purpose of my testimony is to respond to the Pension ("FAS 87") and Other Post Employment Benefits ("OPEB / FAS 106") adjustments supported by Dana Eaves of the Staff. My testimony will expand on the proposed ratemaking treatment changes filed in Empire witness Laurie Delano's direct testimony that were not addressed by the Staff and to provide additional clarification regarding pension (FAS 87) cost recovery.

**Q. WHAT ARE THE ITEMS THAT WERE NOT ADDRESSED?**

A. A tracking mechanism for Other Post Employment Benefit ("OPEB / FAS 106") costs and regulatory asset treatment for minimum pension liability adjustments.

**Q. ARE YOU ADDRESSING ANY OTHER ITEMS?**

A. Yes. I am also addressing a change in methodology for the amortization of OPEB (FAS 106) costs to be consistent with the pension (FAS 87) methodology.

**Q. PLEASE DESCRIBE THE OPEB COST RECOGNITION METHOD THAT EMPIRE PROPOSES TO USE FOR REGULATORY PURPOSES.**

A. The new methodology is fully described in the attached Schedule CKV-1. There are several components to the new procedure:

1) Under the proposed method, a market-related value of assets will be used to determine annual cost instead of fair value. This market-related value will be determined by smoothing the investment gains/losses over a five-year period. (The initial value will be the fair value, but future gains/losses will be smoothed.) For example, the 2010 market-related value would be determined as follows:
   - Fair Value + [ 80% of the 2009 investment loss (gain) + 60% of the 2008 investment loss (gain) + 40% of the 2007 investment loss (gain) +20% of the 2006 investment loss (gain)].
2) Empire will determine the gain/loss amortization for the year with reference to the current unrecognized gain/loss account (i.e., the five-year averaging of gains/losses will be eliminated). This amount, excluding investment gains/losses not yet reflected in the market-related value of assets, will be subject to amortization.

3) The gain/loss amount will be amortized over a period of 10 years instead of over the current five-year amortization period.

**Q. PLEASE EXPLAIN THE MECHANICS OF THE OPERATION OF THE PROPOSED TRACKING PROCEDURE.**

A. A regulatory asset or liability will be established on the Company's books to track the difference between the level of FAS 106 expense during the rate period and the level of OPEB expense built into rates for that period. If the FAS 106 expense during the period is more than the expense built into rates for the period, the Company will establish a regulatory asset. If the FAS 106 expense during the period is less than the expense built into rates for the period, the Company will establish a regulatory liability. If the FAS 106 expense becomes negative, a regulatory liability equal to the difference between the level of OPEB expense built into rates for that period and $0 will be established. Since the actual FAS 106 cost will have been funded, this is a cash item and the regulatory asset or liability will be included in rate base as well as amortized over five years at the time of the next rate case.

**Q. HOW DOES THIS METHODOLOGY COMPARE TO WHAT EMPIRE IS USING FOR REGULATORY PURPOSES RELATIVE TO ITS PENSION COST?**

A. This is the same methodology that was approved in Case No. ER-2004-0570 for regulatory purposes relative to Empire's pension cost.

**Q. IS EMPIRE PROPOSING OTHER CHANGES TO ITS METHODOLOGY USED FOR REGULATORY PURPOSES?**

A. Yes. The Company receives reimbursement in rates for its FAS 87 and FAS 106 costs, including the amortization of unrecognized amounts. Therefore, the Company proposes to set up a regulatory asset to offset any charges that would otherwise be recorded against equity (e.g., decreases to other comprehensive income) due to those unrecognized amounts, resulting from the application of the provisions of FAS 87, FAS 106 or any other FASB statement or procedure that requires accounting adjustments due to the funded status or other attributes of the pension or OPEB plans. This asset should receive regulatory treatment that is similar to the treatment of the charges to other comprehensive income ("OCI") which it offsets. In other words, if the OCI charge against equity occurs and is reflected as a reduction in rate base, then this regulatory asset should be reflected as an increase in rate base. The purpose of the regulatory asset is to reverse the impact of the charge to equity, not to increase rate base. Finally, this regulatory asset, if created, should not be amortized into rates because it is expected to be recovered in future years' FAS 87 and FAS 106 expense. The regulatory asset will increase or decrease each year by the same amount that the equity charge increases or decreases.

**Q. IS EMPIRE PROPOSING ANY OTHER CHANGES TO ITS FAS 87 METHODOLOGY?**

A. Yes. Empire is proposing to clarify two items from our prior rate case, as described fully in Schedule CKV-2:

1) Additional contributions made to the pension trust per item 5 of the prior settlement will increase the FAS 87 prepaid pension asset. The prior settlement called for these additional contributions to be recovered in rates. To be consistent with the original intent of the agreement, these contributions will be added to rate base by increasing the prepaid pension asset, not explicitly amortized since it is expected that these contributions will be reimbursed in future levels of FAS 87 expense.

2) Since additional contributions made per the above provision represent pre-funding of future FAS 87 expense amounts, the additional prepaid pension asset that results will receive regulatory treatment as described in item 3 of the prior case. That is, such amounts will increase the prepaid pension asset and will delay the requirement to fund future FAS 87 costs until such time that the entire prepaid pension asset has been reduced to zero.

**Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes, it does.

**SCHEDULE CKV-1**

**EMPIRE DISTRICT OPEB PROPOSAL**

**July 2006**

The intent of this provision is to:

A. ensure that the amount collected in rates for OPEB cost is based on the FAS 106 cost recognized by the Company for financial reporting purposes, using methodology similar to that used to determine FAS 87 pension cost, as described below in item 2; and

B. ensure that all amounts expensed by the Company and contributed by the Company to the VEBA trust are recoverable in rates.

C. clarify the future treatment of any charges that would otherwise be recorded to equity (e.g., decreases to other comprehensive income) as required by FAS 106 or any other FASB statement or procedure relative to the recognition of OPEB costs and / or liabilities.

To accomplish these goals, the following items are included:

1. The Company's FAS 106 cost is currently recognized in rates and for financial reporting purposes.

2. FAS 106 cost will be calculated based on the following methodology:

a. A Market Related Value of assets will be used to determine FAS 106 cost, smoothing all asset gains and losses that occur on and after January 1, 2006 over a five-year period.

b. Unrecognized gains and losses will be amortized over a 10-year period without respect to the 10% Corridor described in FAS 106.

3. In the case that FAS 106 expense becomes negative, the Company is ordered to set up a regulatory liability to offset the negative expense. In future years, when FAS 106 expense becomes positive again, rates will remain zero until the prepaid asset that was created by negative expense is reduced to zero. The regulatory liability will be reduced at the same rate as the prepaid asset. This regulatory liability is a non-cash item and should be excluded from rate base in future years.

4. A regulatory asset or liability will be established on the Company's books to track the difference between the level of FAS 106 expense during the rate period and the level of OPEB expense built into rates for that period. If the FAS 106 expense during the period is more than the expense built into rates for the period, the Company will establish a regulatory asset. If the FAS 106 expense during the period is less than the expense built into rates for the period, the Company will establish a regulatory liability. If the FAS 106 expense becomes negative, a regulatory liability equal to the difference between the level of OPEB expense built into rates for that period and $0 will be established. Since this is a cash item, the regulatory asset or liability will be included in rate base and amortized over 5 years at the next rate case.

5. The Company receives reimbursement in rates for its FAS 106 cost, including the amortization of unrecognized amounts. Therefore, the Company will be directed to set up a regulatory asset to offset any charges that would otherwise be recorded against equity (e.g., decreases to other comprehensive income) caused by applying the provisions of FAS 106 or any other FASB statement or procedure that requires accounting adjustments due to the funded status or other attributes of the OPEB plan. Such asset will be treated for regulatory purposes in a manner similar to the

treatment of the equity charge. If the equity charge is reflected as a decrease in rate base, the regulatory asset will be reflected as in increase in rate base. The purpose of the regulatory asset is to reverse the impact of any equity charges, not to result in an increase in rate base. This regulatory asset should not be amortized into rates because it is expected to be recovered in rates through future years' FAS 106 expense. The regulatory asset will increase or decrease each year by the same amount that the equity charge increases or decreases.

6. The regulatory assets/liabilities identified in this agreement will address all Rate Base amounts.

## SCHEDULE CKV-2

# EMPIRE DISTRICT PENSION PROPOSAL

**July 2006**

The intent of this provision is to:

A. clarify the rate base treatment of certain amounts described in item 5 of the prior agreement relative to pension costs that was part of Case No. ER-2004-0570; and

B. clarify the future treatment of any charges that would otherwise be recorded to equity (e.g., decreases to other comprehensive income) as required by FAS 87 or any other FASB statement or procedure relative to the recognition of pension costs and / or liabilities.

Item 5 of the agreement in Case No. ER-2004-0570 ("the prior case") reads as follows:

> "5. The Company will be allowed rate recovery for contributions made to the pension trust in excess of the FAS 87 expense for the following reasons: the minimum required contribution is greater than the FAS 87 expense level, avoidance of PBGC variable premiums, and avoidance of write-off of an existing prepaid pension asset (i.e. charge to other comprehensive income)."

To accomplish the above goals, the following items are agreed upon as part of this agreement:

1. Additional contributions made per item 5 of the prior case will increase the FAS 87 prepaid pension asset, so no special regulatory asset needs to be established and no special amortization treatment is necessary.
2. Since additional contributions made per the above provision represent pre-funding of future FAS 87 expense amounts, the additional prepaid pension asset that results will receive regulatory treatment as described in item 3 of the prior case. That is, such amounts will increase the prepaid pension asset and will delay the requirement to fund future FAS 87 costs until such time that the entire prepaid pension asset has been reduced to zero.

3. The Company receives reimbursement in rates for its FAS 87 cost, including the amortization of unrecognized amounts. Therefore, the Company will be directed to set up a regulatory asset to offset any charges that would otherwise be recorded against equity (e.g., decreases to other comprehensive income) caused by applying the provisions of FAS 87 or any other FASB statement or procedure that requires accounting adjustments due to the funded status or other attributes of the pension plan. Such asset will be treated for regulatory purposes in a manner similar to the treatment of the equity charge. If the equity charge is reflected as a decrease in rate base, the regulatory asset will be reflected as in increase in rate base. The purpose of the regulatory asset is to reverse the impact of any equity charges, not to result in an increase in rate base. This regulatory asset should not be amortized into rates because it is expected to be recovered in rates through future years' FAS 87 expense. The regulatory asset will increase or decrease each year by the same amount that the equity charge increases or decreases.