

Exhibit No.: _____
Issues: SFAS 106
Pension Tracker
Mechanism
Witness: John A. Davis
Sponsoring Party: Missouri Gas Energy
Case No.: GR-2009-0355
Date Testimony Prepared: September 28, 2009

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2009-0355

REBUTTAL TESTIMONY OF

JOHN A. DAVIS

Jefferson City, Missouri

September 2009

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REBUTTAL TESTIMONY OF

JOHN A. DAVIS

CASE NO. GR-2009-0355

September 2009

1 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?**

2 A. My name is John A. Davis, and my business address is 3420 Broadway, Kansas City,
3 Missouri 64111.

4

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

6 A. I am the Vice President, Controller of Missouri Gas Energy (“MGE” or “Company”), a
7 division of Southern Union Company.

8

9 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

10 A. I received a BBA in 1987 with concentrations in both Finance and Accounting from The
11 University of Texas at Austin. I also received an MBA from the University of Texas at
12 Austin in December 2003.

13

14 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.**

15 A. I began my career with Arthur Andersen as a staff auditor in 1988 in Houston, Texas. In
16 1991 I received my certification as a Certified Public Accountant. In 1992 I left Arthur
17 Andersen as an experienced senior auditor and moved to Austin to work for Southern
18 Union as a corporate accountant. I worked for Southern Union in various capacities

1 including financial reporting, gas accounting, customer billing and general ledger
2 accounting and finally as controller for the Southern Union Gas division in Austin, Texas
3 until it was sold in 2002. In 2003 I was controller of Energy Worx, a subsidiary of
4 Southern Union Company until I accepted the controller position at Missouri Gas Energy,
5 a division of Southern Union Company.

6
7 **Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?**

8 A. I will respond to portions of the Staff Report- Cost of Service regarding the Company's
9 treatment of Other Post-Employment Benefits ("OPEBs") under the Statement of
10 Financial Accounting Standards No. 106 ("SFAS106") as well as Office of the Public
11 Counsel ("OPC") witness Ted Robertson's direct testimony on this issue. I will also
12 respond to Staff's comments on MGE's pre-paid pension asset and pension tracker
13 language from the Staff Report – Cost of Service, which begins on p. 56.

14
15 **SFAS 106/OPEBS ISSUE**

16
17 **Q. HOW DO YOU ADDRESS TESTIMONY THAT THE COMPANY FAILED TO**
18 **PROPERLY FUND ITS EXTERNAL TRUST FUND MECHANISMS FOR OPEBS**
19 **CALCULATED ACCORDING TO SFAS 106 (PAGES 6 AND 94 OF THE STAFF**
20 **REPORT AND PAGE 3 OF OPC WITNESS ROBERTSON'S DIRECT**
21 **TESTIMONY)?**

22 A. First, I have been advised by counsel that – contrary to the assertions of the Staff and
23 OPC witness Robertson – the Missouri statute on the topic of SFAS106, as applicable to
24 MGE, does not require any particular funding level.

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Second, the Company recognized the proper amounts pertaining to SFAS106 related obligations on its books according to the actuarial reports provided by the Company's actuary. In other words, the Company has consistently booked a liability for each dollar that is owed to the Trust Fund in accordance with SFAS 106. The basis for the actuarial analysis is described in the testimony and attached schedules sponsored by MGE witness Michael Muth. The expense and liability of OPEBs have been - and continue to be - presented in conformity with Generally Accepted Accounting Principles ("GAAP") and are subjected to external audit each year by the Company's outside auditors, Pricewaterhouse Coopers. Additionally, OPEBs are funded to the external trust fund mechanism as these benefits are required to be paid regardless of what the level of rate relief might be received.

Third, although MGE has not funded the full extent of its SFAS 106 liability, it is not at all clear how much the Company has received in rates, which makes it difficult to compare that to the amount which was funded. In other words, in some rate cases the amount of SFAS 106 being included in rates is known, but in the case of GR-2001-292 which was a total "black box" settlement the money that MGE received from customers to pay for operating expenses has not been earmarked as to how much was intended to be applied toward OPEBs. Moreover, in most years, MGE's actual earnings fell short of its Commission-authorized level such that all of its costs, including SFAS 106 costs, were being under-recovered to some degree. It appears that both the Staff and OPC ignore this situation.

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Q. IS IT ACCURATE TO SUGGEST THAT THE COMPANY RECEIVED EXACTLY \$23.7 MILLION IN RATES PERTAINING TO SFAS106 BENEFITS?

A. No. As stated previously in my rebuttal testimony, some rate cases are “black box” settlements and a number is not attached to a particular expense or rate base item. In the most recent cases, the Commission did not specify the level of recoveries pertaining to SFAS106 benefits in the Report and Order because there was no difference in the Staff reconciliation of the issues between Company and Staff for SFAS 106 expense. Therefore, it is difficult to ascertain what specific amount is theoretically recovered in rates.

Q. WOULD A TRACKER MECHANISM, AS PROPOSED IN THE STAFF’S TESTIMONY, BE A MORE APPROPRIATE METHOD FOR RECOVERY OF SFAS106 EXPENSES?

A. Yes, a tracker mechanism that is based upon an agreed to level of recovery in rates and an agreed to level of expense for the Company would be the most appropriate way to ensure amounts recovered through rates are reconciled back to the amounts expensed per the books. The Company uses similarly structured tracker mechanisms for its gas cost filings.

PENSION EXPENSE

Q. HOW DOES MGE CURRENTLY TRACK PENSION EXPENSES FOR PURPOSES OF RATE RECOVERY?

1 A. The Company currently uses a “pension tracker” that was established by stipulation in a
2 prior rate case, GR-2004-0209.

3

4 **Q. DO YOU HAVE ANY PROPOSED CHANGES TO THE CURRENT PENSION**
5 **TRACKER LANGUAGE?**

6 A. Yes, in response to Staff’s testimony filed in its Staff Report-Cost of Service on this
7 issue, Staff and MGE engaged in discussions regarding possible revisions to MGE’s
8 current pension tracker mechanism. MGE would agree to the following revised language
9 to the pension tracker mechanism:

10 1. The parties agree that the rates established in this case for MGE include an
11 allowance of \$10,000,000 for pension expense, exclusive of the amortizations of
12 the prepaid pension asset and tracker mechanism regulatory assets/liabilities. (All
13 amounts are stated prior to the transfer rate.) The Company shall be authorized to
14 record as a regulatory asset/liability, as appropriate, the difference between the
15 pension expense used in setting rates and pension expense as recorded for
16 financial reporting purposes as determined in accordance with GAAP pursuant to
17 FAS 87 and FAS 88 (or such standard as the FASB may issue to supersede,
18 amend or interpret the existing standards), and that such difference shall be
19 subject to recovery from or return to customers in future rates. The difference
20 between the amount of pension expense included in MGE’s rates and the amount
21 funded by MGE shall be included in the Company’s rate base in future rate
22 proceedings.

23
24 2. The Company shall be allowed rate recovery for contributions it makes to its
25 pension trust that exceed the ERISA minimum for the purpose of avoiding
26 Pension Benefit Guarantee Corporation (PBGC) variable premiums. Additional
27 contributions made pursuant to this paragraph will increase MGE’s rate base by
28 increasing the prepaid pension asset and/or reducing the accrued liability, and will
29 receive regulatory treatment as described in paragraph 1 of this Agreement. MGE
30 shall inform the Staff and Public Counsel of contributions of additional amounts
31 to its pension trust funds pursuant to this Paragraph in a timely manner.

32
33 3. The provisions of FAS 158 require certain adjustments to the prepaid pension
34 asset and/or accrued liability with a corresponding adjustment to equity (i.e.,
35 decreases/increases to Other Comprehensive Income). The Company will be
36 allowed to set up a regulatory asset/liability to offset any adjustments that would
37 otherwise be recorded to equity caused by applying the provisions of FAS 158 or

1 any other FASB statement or procedure that requires accounting adjustments to
2 equity due to the funded status or other attributes of the pension plan. The parties
3 acknowledge that the adjustments described in this paragraph will not increase or
4 decrease rate base.
5

6 4. Due to the Pension Protection Act of 2006 (PPA), MGE may be required to
7 make contributions in excess of the ERISA Minimum amount in order to avoid
8 benefit restrictions under the PPA. Such contributions will be examined in the
9 context of future rate cases and a determination will be made at that time as to the
10 appropriate and proper level recognized for ratemaking as a Net Prepaid Pension
11 Asset.
12

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

14 **A. Yes, at this time.**