

Exhibit No.:
Issues: FAS 87, FAS 88, FAS 106
Prepaid Pension Asset
Supplemental Pension
Environmental Cost
Safety Deferral
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

FILED

JUN 28 1999

Missouri Public
Service Commission

LACLEDE GAS COMPANY

CASE NO. GR-99-315

Jefferson City, Missouri
June, 1999

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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)?

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

3 Q. What is the purpose of your direct testimony?

4 A. My direct testimony will discuss the following items:

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

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

15 Q. Please list the adjustments you are sponsoring.

16 A. I am sponsoring the following adjustments:

17 Accounting Schedule 4 – Adjustments to Plant in Service

18 P-74.1 Capitalization of Computer Costs

19

20 Accounting Schedule 10 – Adjustments to Income Statement

21 S-12.7 and S-15.24 Elimination of Computer Costs

22 S-12.8 and S-15.25 Capitalization of Computer Costs

23 S-15.3 Annualization of Pension Expense FAS 87

24 S-15.4 Annualization of OPEB Expense FAS 106

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

4 **PENSION EXPENSE – FAS 87**

5 Q. Please provide a brief description of FAS 87.

6 A. FAS 87, Employers' Accounting for Pensions, provides the accrual
7 accounting method used in determining the annual expense and liability for providing
8 pensions. This statement was issued by the Financial Accounting Standards Board
9 (FASB) and is considered to be in conformance with Generally Accepted Accounting
10 Principles (GAAP) for financial reporting purposes.

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

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

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

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

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1 **SERP**

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

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

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

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

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

11 Q. Please explain Adjustment S-15.27.

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

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

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

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

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

4 **PREPAID PENSION ASSET IN RATE BASE**

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

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

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

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

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

22 ERISA regulations are intended to insure that defined benefit pension
23 plans are adequately funded. The ERISA minimum contribution is intended to fund the
24 pension liability while FAS 87 is intended to ratably charge the liability to expense over

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1 the service life of the employee. Since both ERISA and FAS 87 are concerned with the
2 same pension liability, differences between contributions under ERISA and expense
3 under FAS 87 can be viewed as a timing difference caused by the market performance of
4 the pension fund and the fact that the actuarial method used for FAS 87 is not the same
5 method used for funding measurements under ERISA regulations. Both actuarial
6 methods estimate the same pension liability, but they spread the liability differently over
7 the service life of the employee.

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

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

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

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1 should exclude the impact of all FAS 88 gains recognized from September 1, 1994 to
2 September 1, 1996.

3 **OPEBS – FAS 106**

4 Q. Please provide a brief explanation of FAS 106.

5 A. FAS 106, Employers' Accounting for Post-retirement Benefits Other Than
6 Pensions, provides the accrual accounting method used in determining the annual
7 expense and liability for providing OPEBs. This method was developed by the FASB
8 and is required under GAAP for financial reporting purposes.

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

11 A. In response to Staff Data Request No. 132, Laclede provided a copy of its
12 1999 actuarial valuation of OPEB costs under FAS 106 performed by Towers Perrin.
13 Adjustment S-15.4 increases the test year expense for OPEBS to reflect the 1999
14 actuarial valuation. As is the case with pension expense, the parameters used in the
15 calculation of the 1999 OPEBS expense is consistent with the Stipulation and Agreement
16 in Case No. GR-98-374.

17 **YEAR 2000 COMPUTER COST**

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

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

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1 incurred. Another portion was capitalized and will be booked to the appropriate plant
2 accounts when the modifications are completed and functioning as intended.

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

5 A. In accordance with GAAP, the Company is required to expense these costs
6 as incurred. However, in Case No. GR-98-374 the Commission approved an Accounting
7 Authority Order (AAO) that allowed the Company to defer these costs beginning on July
8 1, 1998. As a result, Laclede ceased expensing these costs and began capitalizing them
9 on July 1, 1998.

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

12 A. The Staff agrees with the Company's capitalization treatment and is
13 proposing two adjustments associated with the modification costs that were expensed
14 during the test year ending December 31, 1998. Adjustments S-12.7 and S-12.24
15 eliminate the test year amount expensed prior to March 1, 1998. Adjustments S-12.8 and
16 S-15.25 capitalize the test year amounts expensed from March 1, 1998 through June 30,
17 1998.

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

19 A. The test year in Case No. GR-98-374 included January and February of
20 1998. In that case the Staff made no adjustment to the costs associated with modifying
21 existing software included in test year expense. Therefore, the modification cost included
22 in January and February of 1998 is currently included in the cost of service and is being
23 recovered in rates.

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

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

3 **ENVIRONMENTAL COSTS**

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

6 A. The Staff recommends the use of a five-year average to determine a
7 normal level of expense associated with environmental clean-up costs. The cost incurred
8 during the five years ending March of 1999 has fluctuated between approximately
9 \$19,000 and \$216,000. The Staff's use of a five-year average includes a normal level of
10 expense in the cost of service associated with this fluctuating item.

11 **SAFETY DEFERRAL**

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

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

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

20 A. The Staff is proposing the treatment recently prescribed by the
21 Commission in its Order in Case No. GR-98-140 involving Missouri Gas Energy's safety
22 deferrals. In that case, the Commission approved (1) a ten-year amortization of the
23 deferrals and (2) no inclusion of the unamortized balance in rate base. In that case, the
24 Commission noted that in using a ten-year amortization period it was recognizing a

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1 shorter term than the twenty years the Staff had recommended and it had approved in
2 prior cases. Given this reduced amortization period, the Commission deemed it proper
3 for the ratepayers and shareholders to share the effect of regulatory lag by allowing the
4 Company to earn a return of, but not a return on, the deferred balance.

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

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

15 Q. Does this conclude your direct testimony?

16 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.)

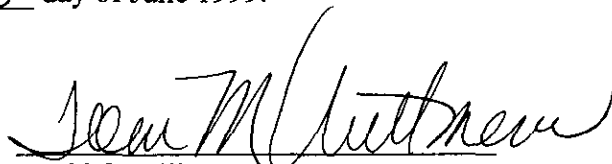
AFFIDAVIT OF STEPHEN M. RACKERS

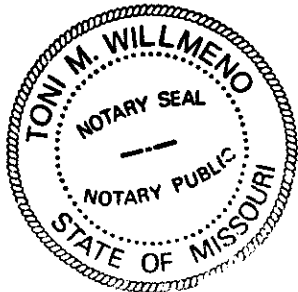
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

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

Subscribed and sworn to before me this 25th day of June 1999.


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



RATE PROCEEDING PARTICIPATION

STEPHEN M. RACKERS

| <u>Company</u> | <u>Case Number</u> |
|-------------------------------------|--------------------|
| 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 |

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