Exhibit No.:
Issue: Employee Benefits
Witness: Robert B. Browning
Sponsoring Party: UtiliCorp United Inc.
Case No.: EM-2000-292
Date Prepared: June 26, 2000

MISSOURI PUBLIC SERVICE COMMISSION
Case No. EM-2000-292

Surrebuttal Testimony

of

Robert B. Browning

Jefferson City, Missouri

Exhibit No. 16
Date 7-13-00 Case No. EM-2000-292
Reporter

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF ROBERT B. BROWNING
ON BEHALF OF UTILICORP UNITED INC.
CASE NO. EM-2000-292

Q. Please state your name, position, and business address.

A. My name is Robert B. Browning. I am employed by UtiliCorp United Inc. ("UtiliCorp"), within the Enterprise Support Functions division, as Vice President of Human Resources.

Q. Are you the same Robert Browning that previously filed Direct Testimony in this case?

A. Yes.

Q. What is the purpose of your Surrebuttal Testimony?

A. The purpose of my Surrebuttal Testimony is to respond to certain Rebuttal Testimony filed by the Missouri Public Service Commission Staff ("Staff").

Q. The Staff through the testimony of Steve Traxler, has taken the position that St. Joseph Light & Power Company ("SJLP") employee benefit costs will increase as a result of the merger. How do you respond?

A. The Staff is incorrect. Referring to my direct testimony, Schedule RBB-8 shows projected SJLP benefit cost savings for active employees in 2001 and 2002 of $764, 568 and $794,808, respectively.

Q. Why?

A. There are significant advantages in joining a larger corporation with more favorable benefit purchasing power. Such purchasing power can be used to obtain lower premium costs while improving coverage options for employees. In addition, Schedules RBB-4 through RBB-7 of my direct testimony reflect significant savings in FAS87 (pension) and FAS106 (retiree medical) expenses following the merger. The savings described in all schedules submitted in direct testimony are primarily as a result of reduced headcount, differences in pension benefit calculations, and retiree participation in medical premiums. Fundamentally, it is illogical to assume SJLP employee benefit costs could increase when the workforce will decrease by approximately one third.

Q. Do you agree with Mr. Traxler's $31 million adjustment to the projected costs associated with the conversion to UtiliCorp's benefit plans?

A. No. Mr. Traxler's $31 million adjustment to UtiliCorp's projected conversion costs is inappropriate because it assumes that my original schedules reflect a combined pension trust administration. However, my schedules, which were submitted with my original testimony, reflect **separate** accounting for the UtiliCorp and SJLP pension assets. Thus, Mr. Traxler has made an adjustment for something that is already reflected in the original schedules.

Q. Through the testimony of Steve Traxler, Staff claims that benefit plan savings of $32.7 million are significantly overstated because a) UtiliCorp will use the excess funds from the over-funded status of SJLP's pension plan for other purposes and, b) segregation of pension assets is necessary to direct potential savings to SJLP customers. How do you respond?

A. Staff has misinterpreted elements of my direct testimony that I will explain below.

Q. What has Staff misinterpreted?

A. Staff cites the Merger Restriction Statement ("M.R.S.") as indication that UtiliCorp has other plans for the excess funds in the SJLP pension plan. The M.R.S. language included in Form S-4 and filed with the Securities and Exchange Commission is standard language designed to protect a company's right to manage its business in the future in a manner most effective to remain competitive in a changing environment. It is not intended to guarantee or predict how UtiliCorp will deal with SJLP's pension plan or its excess assets. In addition, the federal government has imposed significant excise tax consequences for using pension plan surpluses for other purposes to discourage such actions. Surplus funds in the pension plan exist because actual historical market returns have exceeded expectations. Conversely, market returns could just as easily fall short of expectations. The surplus funds in the plan today are used to cushion these downturns and protect the overall viability of the plan.

Q. Does UtiliCorp have any intent to use excess assets in the pension plan for other purposes?

A. No.

Q. Is it required that pension assets be maintained separately to ensure that SJLP customers see the synergies projected by UtiliCorp?

A. No. It is possible to merge assets into one trust, but account for them separately. Such an approach would allow for allocation of investment returns and a separation of liabilities.

Q. Is it true, as claimed by Staff witness Steve Traxler, that UtiliCorp has not committed to keeping SJLP pension assets separate?

A. Yes, UtiliCorp has not committed to keeping SJLP pension assets separate, but this is not necessary to segregate the synergies.

Q. Why?

A. Accounting separately for assets has not been UtiliCorp's past practice because moving to one pension trust and a common benefit formula has produced significant cost savings for ratepayers through reduced administration expenses. It also facilitates movement of talent around the organization to maintain and improve the quality of service provided to customers.

Q. The Staff, according to the testimony of Steve Traxler, believes that combining the UtiliCorp and SJLP pension assets is a detriment to SJLP customers due to a rise in SJLP pension expense. How do you respond?

A. Mr. Traxler has attempted to estimate the funded status of UtiliCorp's and SJLP's pension plans on a standalone basis and then on a combined basis and draws the conclusion that the overall funded status of the SJLP plan drops, when combined with UtiliCorp's pension plan. However, the fact remains the actual surplus dollars <u>are</u> in the combined plan and it is possible to account for the assets in the combined trust separately, so as to allocate liabilities and investment returns.

Q. Should the Staff's proposed condition requiring maintaining the pre-merger funded status of SJLP's pension fund for calculating FAS 87 pension cost, be adopted?

A. UtiliCorp's position is that the funds should be combined into one trust for the reasons described above. However, UtiliCorp will agree to account for the SJLP pension fund separately if the UtiliCorp regulatory plan is adopted. If the regulatory plan is not approved, this condition is not acceptable because our current proposed approach to pension plan administration, going forward, is an integral part of UtiliCorp's plan to freeze rates for at least five years. Should a different plan be proposed that does not guarantee frozen rates for at least five years, UtiliCorp will have to rethink its approach to not only the pension plan administration, but other aspects of plans designed to create the synergies necessary to ensure this transaction is successful for both companies, ratepayers and shareholders.

Q. Staff has suggested using adjusted 1998 costs as the base year for adjustments to proforma financial statements. Do you agree that this approach is appropriate for the treatment of benefits?

A. No. To start with adjusted 1998 costs would be inappropriate for several reasons. First, certain annual costs significantly fluctuate each year and cannot be projected using a simple inflationary rate applied to each year. This is especially true as it relates to specific inputs into the financial statement such as FAS87 (pension) and FAS106 (retiree medical) expenses. Second, I believe there are flaws in the 1998 base year assumptions related to SJLP's FAS106 expenses that should not be relied on in projecting future claims experience.

Q. What approach should be followed?

A. A more appropriate approach for the FAS87 and FAS106 inputs is to use year-by-year actuarial assumptions. Certain variables that UtiliCorp's actuaries factored into the annual projected FAS87 and FAS106 expenses for SJLP routinely change each year and cannot be adequately accounted for with a constant inflationary rate.

Q. Why?

A. It is more appropriate to project such expenses on a year-by-year basis.

Q. Why?

A. UtiliCorp projects higher investment returns on the assets in these two plans. Such returns can vary with the market on a year-to-year basis. Actuaries are required to apply unique retirement and pension accounting methods, which would cause projections to fluctuate each year. The service and interest costs of each plan vary each year as a result of factors other than mere inflation. Amortization of actuarial gains/losses have been prescribed by the commission (in SJLP's case) and these values actually <u>decline</u> each year. Finally, FAS87 transition amounts in SJLP's pension plan will be zero after 2001. It is obvious that the factors described above would cause the FAS87 and FAS106 expense projections to fluctuate each year in a manner that would not be adequately projected by simply applying a constant inflationary factor. Therefore, we have projected such expenses on a year-by-year basis for 10 years.

Q. Are there other issues, besides the application of simple inflation and the Staff's recommended base year for the financial projections?

A. Yes. I believe the base year is understated by approximately $900,000. This is because Staff's per capita retiree medical costs are substantially underestimated.

Q. Please explain.

A. Staff relied on a one-year experience of SJLP's actual current **retiree** population. However, this population is too small of a sample to be statistically sound and credible for accurate projections of future retiree medical costs. Since SJLP employs relatively few employees, each year, its actual claims experience can be substantially affected by 1 or 2 catastrophic claims and thus, subject the expense to significant fluctuations. The claims curve used to develop liabilities and expense should smooth out these variations because the expense calculations require projecting medical claims for up to 50 – 60 years into the future. The approach, which considers just one year of claims experience for a small sample, may not satisfy this principle.

Q. Please explain UtiliCorp's approach.

A. Following the guidance provided in the Statement of Financial Accounting Standards No. 106, paragraph 38; Actuarial Standard Board, Actuarial Compliance Guide No.3 – For SFAS No. 106; and Actuarial Standard Board, Actuarial Standard of Practice No. 25 – Credibility Procedures Applicable to Accident and Health, Group Term Life, and Property/Casualty Coverages, Pricewaterhouse Coopers (PwC), under the direction of UtiliCorp, relied on actuarial assumptions developed from the experience of both SJLP and large employers with similar benefits. PwC's methodology relies on actual detailed claims experience for about 130,000 lives, adjusted and verified for aggregate claims experience from additional large clients that pushes the total to over one million lives. Under this approach, the claims for a plan providing benefits similar to SJLP, obtained from the database, were further adjusted for the actual experience at SJLP.

Q. How would you characterize this approach which you just described?

A. This methodology is a far more accepted practice in the profession and by companies seeking to more accurately plan for future retiree medical expenses.

Q. Are there other generally accepted approaches?

A. Another generally accepted method is to develop claims costs based on COBRA rates, which represent the average cost of health care coverage the company charges employees who terminate employment. The 1999 COBRA rate at SJLP was $2,145.96 for single coverage. This is significantly higher than $1,497.00 assumed by the SJLP's FAS 106 service provider. Now, adjusting $2,145.96 by the SJLP's morbidity factor of 2.158 (see footnote below), we get $4,630.98 as an annual claim cost at age 62. This amount is close to the one derived utilizing PwC methodology.

The table below compares the expected per capita claims costs under SJLP assumptions with the two generally accepted methodologies:

	SJLP Assumptions	Claims Based on COBRA Rates	PwC Methodology
Average active cost	$1,497.00	$2,145.96	Not developed
Average age 62 claim cost	$3,230.00	$4,630.98(1)	$4,426.00
Average age 70 claim cost	$997.00	$1,643.76	$1,571.00

(1) Reflects SJLP morbidity factor as developed by SJLP service provider. This factor adjusts the average cost of active participants for higher utilization after retirement.

Q. How will UtiliCorp, post merger, reflect savings of costs associated with the SJLP pension plan?

A. We believe the most effective and appropriate way to reflect savings or costs associated with the SJLP pension plan following the merger is to calculate the impact of changes in assumptions or other impacts on the plan on a standalone basis. In addition, we attempted to conform accounting assumptions within the SJLP pension plan such as discount rates and expected returns to those that UtiliCorp would use following the merger, so that any costs or savings within the standalone plan would be compared against a baseline that used UtiliCorp accounting assumptions and would reflect only true, tangible merger-related synergies.

Q. How do you respond to the claim made by Mr. Philip K. Williams of Staff that employee reductions is a detriment to the average employee of SJLP, and to the community?

A. I do not agree.

Q. Why?

A. UtiliCorp has worked very hard to create many different options for every current SJLP employee. First, all positions that remain in the SJLP service territory will be offered to qualified SJLP employees. SJLP employees will be permitted to apply for open positions throughout the UtiliCorp organization. Some SJLP employees will be taking early retirement and UtiliCorp has committed to a one-year period for employees to do so under current SJLP benefits. For those employees, whose position is eliminated, a generous severance package is available to maintain an income stream while they seek employment elsewhere. In some cases, eligible employees may actually be able to take early retirement and receive a severance package as well. Each affected employee will be given 45 days notice prior to any severance being implemented.

Q. What about present SJLP employees who stay with UtiliCorp?

A. Employees who remain with UtiliCorp will enjoy broader benefit coverage and options as well as the opportunity to explore career opportunities throughout the U.S. and international operations.

Q. Does this conclude your Surrebuttal Testimony at this time?

A. Yes it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company for Authority to Merge St. Joseph Light & Power Company with and into UtiliCorp United Inc., and, in Connection Therewith, Certain Other Related Transactions.	)	Case No. EM-2000-292

County of JACKSON)
)
State of MISSOURI)

AFFIDAVIT OF Robert Browning

ROBERT BROWNING, **being first duly sworn,** deposes and says that he/she is the witness who sponsors the accompanying testimony entitled surrebuttal testimony; that said testimony was prepared by him/her and or under his/her direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he/she would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his/her knowledge, information, and belief.

Robert Browning

Subscribed and sworn to before me this 19th day of JUNE, 2000.

Nancy J. Manion
Notary Public

My Commission expires:

NANCY J. MANION
NOTARY PUBLIC STATE OF MISSOURI
JACKSON COUNTY
MY COMMISSION EXPIRES 7/31/2001