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Issue: Pension Expense
Witness: Doyle L. Gibbs
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case No.: ER-2004-0570
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

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REBUTTAL TESTIMONY

OF

DOYLE L. GIBBS

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

Jefferson City, Missouri
November 2004

Exhibit No. 42
Case No(s). ER-2004-0570
Date 12-06-04 Rptr KF

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In The Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service Provided to Customers in its Missouri Service Area.	)))))	Case No. ER-2004-0570

AFFIDAVIT OF DOYLE L. GIBBS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Doyle L. Gibbs, being of lawful age, on his oath states: that he has participated in the preparation of the following rebuttal testimony in question and answer form, consisting of 8 pages to be presented in the above case; that the answers in the following rebuttal 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.

Doyle L. Gibbs

Doyle L. Gibbs

Subscribed and sworn to before me this 3rd day of November 2004.

Toni M Charlton

Notary

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

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

REBUTTAL TESTIMONY

OF

DOYLE L. GIBBS

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

Q. Please state your name and business address.

A. Doyle L. Gibbs, 1845 Borman Court, Suite 101, St. Louis, Missouri 63146.

Q. Are you the same Doyle L. Gibbs that previously filed direct testimony in this case?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Empire District Electric Company's (Empire, EDE or Company) witness C. Kenneth Vogl regarding pension expense.

PENSIONS

Q. Please summarize Empire's and the Staff's positions on the pension issue.

A. The Company is proposing the use of Statement of Financial Accounting Standard (FAS) 87 as the basis to determine pension expense in cost-of-service and the Staff is proposing to use the minimum required pension contribution required by the Employee Retirement Income Security Act of 1974 (ERISA).

Q. What is the basis of pension expense that is included in the Company's current rates?

A. In the Stipulation and Agreement from the Company's last rate case, Case No. ER-2002-424, Empire agreed to use ERISA minimum contribution to establish the level of current pension expense. Additionally, the Stipulation and Agreement provided that the Company's cost of service included an amortization of the prepaid pension asset that had accumulated during the time frame that pension expense was based on FAS 87 for ratemaking purposes. The Staff's position on pension expense in this case is a continuation of the methodology agreed to in that prior case.

Q. What is the value of this issue?

A. The Staff's pension expense, based on the ERISA minimum and an amortization of the prepaid pension asset is $2,944,347. The Company's position is to include a lesser amount of pension expense of $2,045,250 based on FAS 87. The difference in pension expense between the two positions is $899,097 on a total company basis.

Q. What are the reasons cited in Mr. Vogl's testimony to support changing the pension cost recognition methodology from the ERISA minimum contribution, as agreed to in the last rate case, to FAS 87?

A. Mr. Vogl, on page 3 of his testimony, cites four reasons why the ERISA minimum contribution is unacceptable:

1) Excessive year-to-year volatility inherent in the ERISA calculations can create test year costs significantly higher or lower than actual costs incurred during the recovery period;

2) It will create inequities between generations of ratepayers;

3) It is not consistent with Generally Accepted Accounting Principles (GAAP) and, therefore, cannot be used for shareholder financial reporting purposes;

4) It discourages funding policies that are consistent with good pension fund management.

Q. Does the Staff agree with the volatility issue, the first reason cited by Mr. Vogl, in his direct testimony?

A. No it does not. There is a volatility issue, but Staff contends that it is FAS 87 that is the more volatile method.

Q. Have you prepared an analysis comparing the historical volatility of pension costs as calculated according to FAS 87 and the ERISA minimum methodologies?

A. Yes. As shown on Schedule 1 attached to this rebuttal testimony, FAS 87 has been much more volatile than the ERISA minimum.

Q. In addition to the volatility concerns included in the first reason cited by Mr. Vogl to change EDE's accounting methodology to reflect FAS 87, he also states that ERISA calculations can create test year costs significantly higher or lower than the actual costs incurred during the recovery period. How has the Staff addressed the aspect of ERISA minimum contribution changes that would result in costs different from what was used in the determination of rates?

A. The Staff proposed in its direct filing, starting on page 10 and continuing onto page 11 of my direct testimony, that any variation in future ERISA minimum contributions from that included in rates developed from this case be set up as a regulatory asset for recovery in subsequent rate cases. This protects the ratepayer and the Company from over or under recovery of the pension expense that is actually incurred compared to the level of recovery included in rates. On the other hand, if FAS 87 is used to determine pension expense for ratemaking purposes, to the extent that FAS 87 exceeds the ERISA minimum, it creates a positive cash flow that could be used for any purpose the Company desires. There would be no assurance that this cash would be available to make contributions in the future.

Q. Discussed in his direct testimony and illustrated in Schedule 2 attached thereto, Mr. Vogl attempts to demonstrate the cost difference between FAS 87 and ERISA under different scenarios and how those cost differences show that ERISA is more volatile than FAS 87. Do you have any reservations with regards to the ERISA contributions and the FAS 87 pension costs reflected in Schedule 2 attached to Mr. Vogl's direct testimony?

A. Yes. Displayed in his Schedule 2, Mr. Vogl has calculated the costs for both FAS 87 and the ERISA minimum under the assumptions that he describes as adverse, volatile and stable returns. However, history has shown that what actually occurs can be, and often is, considerably different from the assumptions that are used in the calculation of FAS 87. As recently as 2002, the ERISA minimum was still zero and FAS 87 was a negative, rather than a positive, expense. Calculations can certainly be made to show what the result would be given certain assumptions. The problem is that there is no assurance that the assumptions will reflect anything close to what actually occurs.

Q. The second reason cited in Mr. Vogl's testimony for changing its accounting methodology to FAS 87 is that the ERISA minimum contributions will create inequities between generations of ratepayers. Will the use of ERISA minimum cause generational inequity?

A. The Company seems to imply that costs, if not incurred evenly over time, creates generational inequity. The general theory is that, since both methodologies are measuring the same pension liability, over time, the pension expense calculated under both FAS 87 and ERISA will be the same. It is a matter of timing as to the recognition of the cost. Staff's proposal to use the ERISA minimum coincides with what the Company is actually required to pay out in cash to fund pensions. The timing of the recognition of the cost according to ERISA may be different than FAS 87, but this does not necessarily result in generational inequity. Mr. Vogl states on page 15 of his direct testimony that under scenario 1, roughly $10.1 million of costs that should be borne by ratepayers for 2004 and 2005, based on the average contribution of $5.3 million, will be deferred to ratepayers after 2005. I do not know what the EDE customer turnover ratio is, but I would think that the majority of its customers after 2005 are the same customers that existed in 2004 and 2005. Yes, the timing as to the recognition of the cost is different so there may not be a perfect matching of costs from one year to the next between methodologies, but I don't think that it is appropriately described as a generational inequity.

Q. Do you agree with the third reason cited by Mr. Vogl that using the ERISA minimum contribution method is unacceptable because it is not consistent with GAAP?

A. No. As indicated on page 11 of my direct testimony, EDE can make such entries on its books as appropriate under FAS 71 to reflect that rates do not include FAS 87 in cost of service.

Q. Isn't FAS 71 a GAAP?

A. Yes. It is a "Statement of Financial Accounting Standards" to account for the effects of certain types of regulation. In appendix C of FAS 71, Bases For Conclusions, paragraph 54 states:

> The Board concluded that regulatory-prescribed accounting should not be considered generally accepted per se, but rather that Board should specify how generally accepted accounting principles apply in the regulatory environment.

However, paragraph 59 of Appendix C to FAS 71 also states:

> ...The Board concluded that comparability would not be enhanced by accounting as though regulation had no effect. Regulation creates different circumstances that require different accounting.

The FASB clearly recognizes that accounting for regulation may be different from standard GAAP. I would point out that on page 4 of Mr. Vogl's direct testimony, he provides a table indicating how the Company has accounted for pension expense. Note that prior to 1994, pension expense and financial accounting was based on actual contributions and this was subsequent to the issue of FAS 87 in December 1985. As I previously stated, history has shown that what actually occurs can be, and often is, considerably different from the assumptions that are used in the calculation of FAS 87. Basing rates on the actual known cash outlays required to fund pensions provides a better basis for establishing rates than an accrual method based on assumptions which have proved to be inaccurate in the past.

Q. The final reason Mr. Vogl provides for why the ERISA minimum is unacceptable is it discourages funding policies that are consistent with good pension fund management. Does the Staff agree with this statement?

A. No. I think it is ironic that on one hand EDE claims that the ERISA minimum is unacceptable because it creates generational inequities and then claims that ERISA minimum is unacceptable because it won't allow the Company to make contribution in excess of ERISA minimum funding requirements. As stated on page 5 of Mr. Vogl's direct testimony, lines 23 and 24, he states; "In fact, voluntary contributions in excess of the minimum required for a given year will reduce, dollar for dollar, the ERISA minimum contribution in subsequent years." Mr. Vogl appears to be advocating a policy of generational inequity where ratepayers are asked to make higher pension fund contributions in excess of the ERISA minimum today, in an effort to lower the required contributions in the future. This argument is inconsistent with Mr. Vogl's earlier discussion on generational inequity that was cited as making the ERISA minimum contribution method unacceptable. Including in rates the contributions that are prescribed according to laws specifically enacted to provide security to employee pensions funds, in the Staff's opinion, promotes sound pension fund management.

Q. Would the Staff consider including contributions in excess of the ERISA minimum in the determination of the cost of service?

A. Yes, the Staff would and has made such a recommendation. In Case No. ER-2004-0034 involving Aquila, Inc., the Staff did include pension contributions in excess of the ERISA minimum, because by doing so avoided the write-off to income of an existing prepaid pension asset and a significant increase in the annual premiums to the Pension Benefit Guarantee Corporation (PBGC). A contribution in excess of ERISA minimum would be recommended if proven that it would provide a future cost avoidance. It would not be allowed if it were simply a cost deferral.

Q. Please summarize the Staff's position on pensions.

A. It is the Staff's opinion that pension expense based on the ERISA minimum method is superior to the FAS 87 accrual method for ratemaking because it matches the cost the ratepayer is required to pay through rates with the actual cost the Company incurs to fund pensions. History has demonstrated that FAS 87 is more volatile than the ERISA minimum. Cost recognition is a matter of timing and does not create generational inequity. The FASB has acknowledged that regulation creates circumstances that require different accounting and, finally, funding pensions in accordance with laws specifically enacted to provide security to employee pensions funds is sound pension fund management.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

Empire District Electric Company
Case No. ER-2004-0570

Analysis of Annual Change in Pension (Accrual vs Contribution)

	FAS 87			Minimum ERISA	
Year	Cost	$ Change	% Change	Cost	$ Change
1999	(4,390,811)			0	
2000	(7,780,497)	(3,389,686)	-77.2%	0	0
2001	(4,366,247)	3,414,250	43.9%	0	0
2002	(3,581,781)	784,466	18.0%	0	0
2003	3,753,522	7,335,303	204.8%	342,348	342,348
2004	2,900,653	(852,869)	-22.7%	0	(342,348)
Average		1,458,293	33.3%		