Exhibit No.:
Issues: Pensions
Other Postretirement Benefits
Witness: GREG R. MEYER
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: EC-2002-1
Date Testimony Prepared: July 2, 2001

# MISSOURI PUBLIC SERVICE COMMISSION

## UTILITY SERVICES DIVISION

# DIRECT TESTIMONY

# OF

# GREG R. MEYER

# UNION ELECTRIC COMPANY, d/b/a AMERENUE

# CASE NO. EC-2002-1

Exhibit No. 65 NP
Date 7/10/02 Case No. EC-2002-1
Reporter KRM

Jefferson City, Missouri
July 2001

**NP**

**Denotes Proprietary Information**

**TABLE OF CONTENTS**

**GREG R. MEYER**

**UNION ELECTRIC COMPANY**

**d/b/a AMERENUE**

**CASE NO. EC-2002-1**

**DIRECT TESTIMONY**

**OF**

**GREG R. MEYER**

**UNION ELECTRIC COMPANY**

**d/b/a AMERENUE**

**CASE NO. EC-2002-1**

Q. Please state your name and business address.

A. Greg R. Meyer, 815 Charter Commons Drive, Suite 100B, Chesterfield, Missouri 63017.

Q. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor V with the Missouri Public Service Commission (Commission).

Q. Please describe your educational and employment background.

A. In May 1979, I graduated from the University of Missouri at Columbia, with a Bachelor of Science degree with an emphasis in Accounting.

Q. What has been the nature of your duties while in the employ of the Commission?

A. I have supervised and assisted in audits and examinations of the books and records of utility companies operating within the State of Missouri.

Q. Have you previously filed testimony before this Commission?

A. Yes. Please refer to Schedule 1, which is attached to this direct testimony, for a list of the major audits on which I have previously filed testimony. I also have been responsible for case coordination regarding Commission cases where I did not file direct testimony. Additionally, I have performed numerous audits of small water and sewer companies for rate increases and certification cases.

Q. With reference to Case No. EC-2002-1, have you made an examination of the books and records of Union Electric Company, d/b/a AmerenUE (AmerenUE, UE or Company) relating to the Staff's earnings investigation of AmerenUE's Missouri jurisdictional electric operations?

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

Q. What were the results of the Staff's investigation?

A. The Staff has determined that AmerenUE's rates should be reduced in the range of approximately $213 million to $250 million on an annual basis.

Q. What is the basis for this conclusion?

A. The Staff analyzed most of the areas that would be evaluated in the context of a rate increase case. For example, the following areas were audited by the Staff for purposes of its earnings investigation:

1) Rate of Return
2) Payroll
3) Fuel
4) Depreciation
5) General Expenses

Q. Are there areas that the Staff did not investigate?

A. Yes. The Staff did not audit the areas of affiliated transactions, allocations and the impact of Ameren's changing corporate structure.

Q. Does the Staff have any indication of the effect that an audit of these areas would have on AmerenUE's revenue requirement?

A. The Staff believes that an audit of these areas would merely increase the rate reduction that the Staff is currently seeking in this proceeding.

Q. What is the purpose of your direct testimony?

A. The purpose of my direct testimony is to address the amount of postretirement benefits other than pension expense (OPEB) and pension expense to be included in the cost of service for this case.

**OTHER POSTRETIREMENT EMPLOYMENT BENEFITS (OPEB) EXPENSE-FAS-106 AND PENSION EXPENSE-FAS 87**

Q. Please provide a brief explanation of Statement of Financial Accounting Standards No. 106 (FAS 106).

A. FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, provides the accrual accounting method used in determining the annual expense and liability for providing OPEBs. This method was developed by the Financial Accounting Standards Board (FASB) and is required under Generally Accepted Accounting Principles (GAAP) for financial reporting purposes.

Q. Is the Commission required under GAAP or Missouri law to adopt FAS 106 for determining pension expense for ratemaking purposes?

A. Yes, the Commission is required by Missouri law (Section 386.315 RSMo), passed in 1994, to allow the recovery of OPEB expense as calculated under FAS 106. The Commission must adopt the FAS 106 method for ratemaking purposes as long as the assumptions used by the utility are considered reasonable, and the amounts collected in rates are placed in an external fund by the utility. However, for addressing the requirements of GAAP, the Commission is not bound by those requirements.

Q. Please provide a brief description of Statement of Financial Accounting Standards No. 87 (FAS 87).

A. FAS 87, *Employers' Accounting for Pensions*, provides for the accrual accounting method used in determining the annual expense and liability for pensions. This statement was issued by the FASB and is considered GAAP for financial reporting purposes.

Q. Is the Commission required under GAAP or Missouri law to adopt FAS 87 for determining pension expense for ratemaking purposes?

A. No. However, since state law beginning in 1994 has required the adoption of FAS 106, the Staff has taken the position that consistent treatment of retirement costs requires the use of FAS 87 for determining pension expense for ratemaking purposes.

Q. Are the methods used in calculating pension expense under FAS 87 and OPEB expense under FAS 106 similar?

A. Yes, in many respects. Many of the same actuarial and financial/accounting assumptions are used for both. Some of the assumptions used for both include:

Actuarial Assumptions

Employee Mortality
Employee Turnover
Retirement Age

Financial/Accounting Assumptions

Income Earned on Plan Assets
Future Salary Increases
Time Value of Money (Discount Rate)
Amortization Period for Gains and Losses
Use of Corridor Approach for Gain/Loss Recognition

Q. Why have you classified assumptions used in calculating FAS 87 and FAS 106 as either actuarial or financial/accounting?

A. The purpose of FAS 87 and FAS 106 is to provide uniform financial statement recognition of a company's total estimated liability for pensions and OPEBs and to reflect the annual cost of these benefits in the income statement ratably over the service life of the employee.

A qualified actuary must develop the actuarial assumptions required for these calculations, i.e., such as employee mortality.

Someone with a financial and/or accounting background on the other hand could develop all of the financial assumptions. For example, a decision as to the number of years to use for gain/loss amortization or use of the "corridor approach" for gain/loss amortization is a judgment made based upon the impact of cash flow on the financial statements and/or impact on utility rates. Under the corridor approach, the amount amortized is the cumulative net gain or loss that exceeds ten percent of the greater of the pension liability or the value of pension plan assets. Use of the corridor approach results in the minimum amount of amortization of gains and losses allowed by the FASB.

Q. What is the basis for the Staff's recommended level of FAS 106 expense in cost of service for this case?

A. The Staff has made three adjustments to AmerenUE's test year level of FAS 106 OPEB's cost for the year ending June 30, 2000:

1) Adjustment No. S-19.10 adjusts the June 30, 2000 test year FAS 106 OPEB's cost to reflect the results of the Towers Perrin (Company actuary) calculation of the cost for the plan year ending December 31, 2000.

2) **

**

3) Adjustment No. S-19.8 restates the gain/loss amortization in the Towers Perrin 2000 FAS 106 calculation to reflect a five-year amortization of an average balance of the unrecognized net gain balance for the five-year period from 1996 through 2000.

Q. What is the basis for the Staff's recommended FAS 87 pension expense level in this case?

A. The Staff has made three adjustments to AmerenUE's test year level of FAS 87 pension cost for the year ending June 30, 2000:

1) Adjustment No. S-19.9 adjusts the June 30, 2000 test year FAS 87 pension cost to reflect the results of the Towers Perrin calculation of the costs for the plan year ending December 31, 2000.

2) **

**



NP

3) Adjustment No. S-19.7 restates the gain/loss amortization in the Towers Perrin 2000 FAS 87 calculation to reflect a five-year amortization of an average balance of the unrecognized net gain balance for the five-year period 1996 through 2000.

**FIVE-YEAR AVERAGE BALANCE OF UNRECOGNIZED NET GAINS/LOSSES**

Q. Please explain the term "Unrecognized Net Gain/Loss" as it applies to calculating (1) pension expense under FAS 87 and (2) other postretirement benefits expense under FAS 106.

A. As explained earlier in my testimony, FAS 87 and FAS 106 are calculated using numerous actuarial and financial/accounting assumptions. When the actuary changes an assumption to reflect more current information based on updated actual experience data, a change in the total projected liability and/or assets under FAS 87 and FAS 106 will result. This change is accounted for as an unrecognized gain or loss depending upon the impact on the projected liability. The impact of these changes are reflected in expense under FAS 87 and FAS 106 by amortizing the Unrecognized Net Gain/Loss Balance over a period not to exceed the remaining service period of active plan participants.

Q. Please explain why the Staff is recommending that the Unrecognized Net Gain Balance, subject to amortization, be calculated based upon a five-year average balance instead of the current year balance.

A. Gains and losses under FAS 87 and FAS 106 result from changes in assumptions (changing the discount rate, for example) and from differences between estimated assumptions and actual results. In dealing with this issue in cases involving major utility companies in Missouri, differences between the expected return on funded assets and the actual return earned on those assets accounts for the majority of the balance in the Unrecognized Net Gain/Loss Balance. Annual differences between the expected rate of return assumption and the actual return earned are often so significant that the Unrecognized Net Gain/Loss Balance experiences considerable annual fluctuation (volatility).

Since the Unrecognized Net Gain/Loss Balance is amortized in calculating pension and OPEB cost under FAS 87 and FAS 106, significant volatility in the balance subject to amortization has an undesirable impact on the calculation of annual pension and OPEB expense for ratemaking purposes.

Using a five-year average balance to determine the Unrecognized Net Gain/Loss Balance subject to amortization mitigates the effect on rates of any significant volatility experienced.

Q. Has the five-year average balance method been used for any other Missouri utility companies to determine the Unrecognized Net Gain/Loss Balance to be amortized in calculating FAS 87 and FAS 106?

A. Yes. This method was stipulated to in settled rate cases respecting Missouri Gas Energy (MGE), Case Nos. GR-98-140 and GR-2001-292; Laclede Gas Company, Case No. GR-98-374; and St. Joseph Light & Power Company, Case No. ER-99-247.

Q. Have any Missouri utilities filed rate cases using the Staff's method of amortizing a five-year average balance of the Unrecognized Net Gain/Loss over five years?

A. Yes. MGE's Case No. GR-2001-292 and Laclede Gas Company's Case No. GR-99-315 were filed using a five-year average of the Unrecognized Net Gain/Loss balance to determine the total amount of unrecognized gains and losses to be amortized in calculating FAS 87 and FAS 106 pension and OPEBs expense.

**FIVE-YEAR AMORTIZATION PERIOD FOR GAIN/LOSS RECOGNITION**

Q. What is the basis for the Staff's recommendation to amortize all of AmerenUE's unrecognized gains and losses over five years?

A. **

**

Pension and OPEB expense included in the cost of service should be calculated based upon the most accurate information available. Timely recognition of the actual income earned on fund assets is required to meet this objective. Deferred recognition of actual earned returns on fund assets for a period exceeding five years does not result in accurate pension and OPEB expense under FAS 87 and FAS 106 for ratemaking purposes.

Q. What flexibility does the Company have in determining the number of years to be used in amortizing the net gain/loss balance under FAS 87 and FAS 106?

A. Paragraph 33 of FAS 87 explains the wide flexibility allowed in choosing the amortization period for gains and losses:



NP

> Any systematic method of amortization of unrecognized gains and losses may be used in lieu of the minimum specified in the previous paragraph provided that (a) the minimum is used in any period in which the minimum amortization is greater (reduces the net balance by more), (b) the method is applied consistently, (c) the method is applied similarly to both gains and losses, and (d) the method used is disclosed.

Q. Please explain why the Staff is not recommending an amortization period less than or greater than five years.

A. The Staff's recommendation of five years for amortizing gains and losses under FAS 87 and FAS 106 is based upon three factors:

1) Timely recognition of actual results and assumption changes is necessary for accurate pension and OPEB expense for ratemaking purposes. The Staff considers five years to be a reasonable time period to meet this primary objective.

2) The federal government enacted legislation in 1987 that reduced the amortization period for asset gains and losses from 15 years to five years for pension funding requirements. This legislation was the Omnibus Budget Reconciliation Act of 1987. Section 412(b)(2)(B) of the Internal Revenue Code requires that gains and/or losses from pension plan assets be amortized over a five-year period. A five-year amortization would treat asset gains and losses consistently for period expense under FAS 87 and funding requirements under ERISA/Internal Revenue Service (IRS) Regulations.

3) Using a five-year amortization period is consistent with this Commission's long-standing precedent for amortizing abnormal, significant, expenses/losses over five years for ratemaking purposes. Attached as Schedule 2 to my

direct testimony is a list of cases in which the Commission allowed a five-year amortization period.

Q. Are any other Missouri utility companies using a five-year amortization for unrecognized gains/loss under FAS 87 and FAS 106?

A. Yes. Gains and losses under FAS 87 and FAS 106 are being amortized over five years by St. Louis County Water Company; UtiliCorp United, Inc.-Missouri Divisions, Missouri Public Service and St. Joseph Light & Power; Empire District Electric Company; Missouri Gas Energy; and Laclede Gas Company. All major utility companies in Missouri which have had rate cases since legislation was passed in 1994 requiring the adoption of FAS 106 for ratemaking purposes, are amortizing gains and losses under FAS 87 and FAS 106 over a five-year period.

**ELIMINATION OF MARKET RELATED VALUE METHOD**

Q. Please define the term "market related value" and how it is used in calculating pension cost under FAS 87.

A. The components of AmerenUE's FAS 87 pension cost for the year 2000 are reflected below:

**THE REMAINDER OF THIS PAGE INTENTIONALLY LEFT BLANK**

**PENSION COST**
**FAS 87**
**2000**

| COMPONENTS | AMOUNT | EXPLANATION |
|---|---|---|
| (1) Service Cost | ** ** | Present value of pension benefits earned during the year |
| (2) Interest Cost | ** ** | Increase in the projected pension liability due to the passage of time. |
| (3) Expected Return on Assets | ** ** | Expected annual return earned on pension fund assets |
| (4) Amortization of Unrecognized Transition Asset and Amortization of Prior Service Cost | ** ** | Amortization of transition asset as of the adoption date of FAS 87 and impact of plan amendments related to prior service |
| (5) Amortization of Unrecognized Net (Gain) Loss | ** ** | ** ** of net balance resulting from assumption changes and excess of actual returns over expected returns. |
| (6) Net Periodic Pension Cost | ** ** | |

Line (3) reflects the expected return on the pension fund assets. Under FAS 87, this amount can be calculated by applying an estimated rate of return of ** ** to either the actual market value of pension fund assets or to the market related value of the assets. Market related value is a calculation, which reduces or increases the market value of the assets by gains and losses which have occurred in the most current five-year period. Its only purpose is to smooth out annual fluctuations (reduce volatility) in annual gain/loss activity. **



NP

**



NP

The Staff position on gain and loss recognition in calculating FAS 87 and FAS 106 is that gains and losses need to be reflected on a timely basis in order to accurately reflect a utility's pension and OPEBs cost.

AmerenUE's **        ** million in net gains used in calculating market related value should be amortized over five years consistent with the five-year amortization period being recommended for AmerenUE's other gains and losses occurring in prior years.

Q. Have you prepared schedules that describe the Staff's adjustments to UE's OPEB and pension expense?

A. Yes. Please refer to Schedule 3 for the Staff's calculation of OPEB and pension expense.

Q. Does this conclude your direct testimony?

A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| The Staff of the Missouri Public Service Commission, | ) | |
| | ) | Case No. EC-2002-1 |
| Complainant, | ) | |
| vs. | ) | |
| | ) | |
| Union Electric Company, d/b/a AmerenUE, | ) | |
| | ) | |
| Respondent. | ) | |

AFFIDAVIT OF GREG R. MEYER

| | | |
|---|---|---|
| STATE OF MISSOURI | ) | |
| | ) | ss. |
| COUNTY OF COLE | ) | |

Greg R. Meyer, is, of lawful age, and on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 14 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.

Greg R. Meyer

Greg R. Meyer

Subscribed and sworn to before me this 2nd day of July, 2001

Toni M. Charlton

Notary Public

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

SUMMARY OF RATE CASE INVOLVEMENT

***Greg R. Meyer***

| COMPANY | CASE NO. |
|---|---|
| Missouri Utilities Company | GR-79-270 |
| Missouri Public Service Company | GR-80-117 |
| Missouri Public Service Company | ER-80-118 |
| Missouri Utilities Company | ER-80-215 |
| General Telephone Company of the Midwest | TR-81-47 |
| Capital City Water Company | WR-81-193 |
| Missouri Utilities Company | GR-81-244 |
| Missouri Utilities Company | WR-81-248 |
| Missouri Utilities Company | ER-81-346 |
| Associated Natural Gas Company | GR-82-108 |
| Southwestern Bell Telephone Company | TR-82-199 |
| Kansas City Power and Light Company | ER-83-49 |
| Southwestern Bell Telephone Company | TR-83-253 |
| Kansas City Power and Light Company | ER-85-128/ EO-85-185 |
| Arkansas Power and Light Company | ER-85-265 |
| Southwestern Bell Telephone Company | TR-86-84 |
| General Telephone Company of the Midwest | TC-87-57 |
| Union Electric Company | EC-87-114 |
| Southwestern Bell Telephone Company | TC-89-14 |
| GTE North Incorporated | TR-89-182 |
| Arkansas Power and Light Company | EM-90-12 |
| Southwestern Bell Telephone Company | TC-93-224 |
| Laclede Gas Company | GR-94-220 |
| Union Electric Company | EM-96-149 |
| Laclede Gas Company | GR-96-193 |
| Imperial Utility Corporation | SC-96-427 |

| | |
|---|---|
| Union Electric Company | GR-97-393 |
| Laclede Gas Company | GR-98-374 |
| Union Electric | GR-2000-512 |

**UNION ELECTRIC COMPANY,**
**d/b/a AMERENUE**
**CASE NO. EC-2002-1**
**PAST COMMISSION ORDERS ALLOWING**
**A FIVE-YEAR AMORTIZATION OF ABNORMAL EXPENSES**

| Case No. | Company | Description |
|---|---|---|
| ER-78-29 | Missouri Public Service Company | 3-year average ordered maintenance expense. |
| ER-83-49 | Kansas City Power & Light Company | 5-year average ordered for station outages. |
| WR-83-14 | Missouri Cities Water Company | 5-year average ordered maintenance expense. |
| EO-85-185<br>EO-85-224 | Kansas City Power & Light Company | 5-year average ordered ice storm. |
| EC-93-252 | St. Joseph Light & Power Company | 5-year average ordered for maintenance. |
| WO-94-195 | St. Louis County Water Company | 5-year amortization of flood cost. |
| EO-94-149 | Empire District Electric Company | 5-year amortization of flood cost. |
| EO-94-35 | St. Joseph Light & Power Company | 5-year amortization of flood cost. |

Schedule 3 is

Proprietary

In Its Entirety