

Exhibit No.
Issue: Pensions and OPEB
Witness: James A. Fallert
Type of Exhibit: Direct Testimony
Sponsoring Party: The Empire District Electric
Company
Docket No. 19-EPDE-223-RTS
Date Testimony Prepared: December 2018

Before the Kansas Corporation Commission

Direct Testimony

of

James A. Fallert

December 2018



**DIRECT TESTIMONY
OF
JAMES A. FALLERT
ON BEHALF OF
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
KANSAS CORPORATION COMMISSION
DOCKET NO. 19-EPDE-___-RTS**

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1

2 **I. POSITION AND QUALIFICATIONS**

3 **Q. PLEASE STATE YOUR NAME, BUSINESS AFFILIATION AND BUSINESS**
4 **ADDRESS.**

5 A. My name is James A. Fallert. I am doing business as James Fallert Consultant LLC and
6 my business address is 3507 Burgundy Way Dr., St. Louis, MO 63129.

7 **Q. ON WHOSE BEHALF IS YOUR TESTIMONY PRESENTED?**

8 A. The Empire District Electric Company (“Empire” or “Company”).

9 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
10 **EXPERIENCE.**

11 A. I graduated from Southeast Missouri State University in 1976 with a bachelor’s degree in
12 Business Administration, majoring in administrative management. I received a Master’s
13 in Business Administration in 1981 from Saint Louis University, with a major in Finance.
14 I was employed by Laclede Gas Company (now known as Spire Missouri Inc.) from
15 1976 until February 2012, when I retired as Controller of the Company. In this position,
16 I was responsible for the Company’s Generally Accepted Accounting Principles
17 (“GAAP”) accounting (including pension accounting), budgeting, management
18 information reporting, and financial planning functions. Subsequent to my retirement
19 from Laclede, I have provided consulting services regarding regulatory matters.

1 **II. PURPOSE OF TESTIMONY**

2 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

3 A. I support the Company's request for the amount of Pension and Other Post-Employment
4 Benefit ("OPEB") costs to be included in the revenue requirement in this case and the
5 continuation of the pension and OPEB trackers as modified in Kansas Corporation
6 Commission ("Commission") Docket No. 10-EPDE-314-RTS ("314 Docket"). I am also
7 proposing recognition of a portion of the expense savings resulting from the prepaid
8 pension asset, in partial recognition of the benefits that this asset generates for customers.

9 **Q. ARE YOU SPONSORING ANY ADJUSTMENTS IN CONNECTION WITH**
10 **YOUR TESTIMONY?**

11 A. Yes. I am sponsoring the adjustment calculated on WP ADJ 18 – Pensions and OPEB
12 and WP ADJ 18 Prepaid Pension Asset.

13 **Q. DO YOU HAVE ANY NECESSARY EXPLANATIONS OF THE**
14 **NOMENCLATURE USED IN THIS TESTIMONY?**

15 A. Yes. The accounting rules required that certain pension and OPEB deferred balances be
16 eliminated upon acquisition of Empire by Liberty Utilities. However, these balances
17 remained in place for regulatory purposes so that the pension and OPEB accounts are
18 treated as if the acquisition did not occur. References to Generally Accepted Accounting
19 Principles ("GAAP") herein refer to GAAP as adjusted for regulatory purposes.

20 **III. PENSION AND OPEB EXPENSE**

21 **Q. WHAT IS THE AMOUNT OF PENSION EXPENSE THAT EMPIRE IS**
22 **REQUESTING IN THIS CASE?**

1 A. This case includes total annual Kansas pension expense of \$816,400. This amount
2 consists of 2018 pension expense of \$355,632 determined by the Company's actuary,
3 five-year amortization of \$252,936 related to trackers authorized in the prior cases,
4 pension settlement charges of \$153,560, and actuarially determined expense of \$54,372
5 for the Supplemental Executive Retirement Plan ("SERP"). This total does not include
6 the effect of the expense savings proposed in section V. of this testimony.

7 **Q. WHAT IS THE AMOUNT OF OPEB EXPENSE THAT EMPIRE IS**
8 **REQUESTING IN THIS CASE?**

9 A. This case includes total annual Kansas OPEB expense of \$132,674, which includes 2018
10 OPEB expense of \$49,596 determined by the Company's actuary and five-year
11 amortization of \$83,078 related to the tracker authorized in the prior case.

12 **Q. ARE THESE THE FINAL EXPENSES FOR BOTH PENSION AND OPEB**
13 **COSTS?**

14 A. No. The pension, SERP, and OPEB costs are based on the actuarial valuation of
15 projected 2018 costs prepared in March 2018 and based on balances as of December 31,
16 2017. To the extent that such a valuation of projected costs related to 2019 becomes
17 available during the pendency of this case, it would be appropriate to consider this
18 valuation. The tracker amortization is based on estimated balances as of January 31,
19 2019. It would be appropriate to update these calculations to the actual balances as of the
20 final update or true-up period in this case. Settlement charges have not yet been
21 calculated for 2018. Therefore, we have conservatively based this filing on an average of
22 actual settlements in 2017 and a placeholder of zero for 2018. It would be appropriate to

1 revisit this calculation when the actual 2018 expense is determined. This is expected to
2 occur in February 2019.

3 **IV. PENSION AND OPEB TRACKERS**

4 **Q. PLEASE DESCRIBE THE PENSION AND OPEB TRACKERS**
5 **CURRENTLY BEING EMPLOYED BY EMPIRE.**

6 A. These trackers were ordered by the Commission in the 314 Docket, and in the
7 case of pensions was a continuation of trackers ordered in Docket No. 05-EPDE-
8 980-RTS. Tracker 1 defers the difference between pension and OPEB expense
9 as calculated pursuant to GAAP and expense allowed in rates. This difference is
10 accumulated in a regulatory asset or liability account, as appropriate, and is
11 included in rates in a subsequent rate case via an amortization period determined
12 by the Commission in that subsequent rate case. Tracker 2 describes the prepaid
13 pension and OPEB assets/liabilities accumulated pursuant to ASC 715 (the
14 difference between expense as calculated pursuant to GAAP and cash
15 contributions to the pension and OPEB trusts). Tracker 2 is not amortized since
16 it delays the requirement to fund future costs until such time that the entire asset
17 is reduced to zero. At present, neither of these trackers receives rate base
18 treatment.

19 **Q. WHY WERE THESE TRACKERS ESTABLISHED?**

20 A. Pension and OPEB costs are subject to considerable volatility due to forces
21 outside of the control of the parties to a rate case. Tracker 1 ensures that the
22 costs associated with these employee benefits are neither over nor under
23 recovered in rates. Tracker 2 allows the Company to track its funding vs.

1 expense and apply any resulting asset balance to its contribution obligations. The
2 Company believes that the trackers are beneficial to all parties and should be
3 continued in this case.

4 **V. EXPENSE SAVINGS RESULTING FROM PREPAID PENSION ASSETS**

5 **Q. WHAT IS THE CURRENT BALANCE OF PREPAID PENSION ASSETS?**

6 A. The prepaid pension asset balance was \$27,737,033 as of December 31, 2017.

7 **Q. WHAT CAUSES PREPAID PENSION ASSETS TO OCCUR?**

8 A. The prepaid asset or liability tracks the difference between cash contributions
9 into the pension trust and GAAP pension expense. These balances occur because
10 the requirements for funding and rules for recording expense differ. A prepaid
11 asset occurs when the Company has provided more cash contributions than have
12 been recognized in expense at a point in time.

13 **Q. IS IT PRUDENT FOR A COMPANY TO HAVE MADE CONTRIBUTIONS**
14 **AT A LEVEL THAT RESULT IN PREPAID ASSETS?**

15 A. Yes. It is always necessary to fund to at least the minimum level required by law, which
16 may be more than the expense calculated pursuant to GAAP. Furthermore, it is
17 sometimes beneficial to fund at a higher level than the minimum in order to avoid
18 negative effects such as variable PBGC premiums or At-Risk status.

19 **Q. SINCE THE PREPAID ASSETS INDICATE THAT THE COMPANY HAS MADE**
20 **A CASH CONTRIBUTION INTO THE PLANS IN EXCESS OF RATE**
21 **RECOVERY, ARE THE PREPAID PENSION ASSETS INCLUDED IN RATE**
22 **BASE?**

1 A. No. While many jurisdictions allow rate base treatment for these prepaid balances, the
2 Stipulation and Agreement in the 314 Docket specifically excluded such treatment.

3 **Q. DO THE CUSTOMERS RECEIVE A BENEFIT FROM THE CONTRIBUTIONS**
4 **MADE IN EXCESS OF THE AMOUNT ALLOWED IN RATES?**

5 A. Yes they do. Investments made into the pension trust result in higher returns on
6 investment in the plans, which in turn serve to reduce the expense calculated pursuant to
7 GAAP. Since rates are based on GAAP expense, the benefit of the excess contributions
8 are effectively flowed back to customers through lower rates.

9 **Q. WHAT IS THE AMOUNT OF THIS SAVINGS?**

10 A. The annual expense savings can be quantified as follows:

11	Prepaid Pension Asset as of December 31, 2017	\$27,737,033
12	X Investment Return	<u>7.25%</u>
13	= Annual Savings	\$2,010,935
14	X Kansas Portion	<u>4.42%</u>
15	= Annual Kansas Savings	\$88,844

16 The Annual Savings is the reduction in pension expense resulting from the Company's
17 cumulative cash contributions in excess of GAAP expense through the years.

18 **Q. WHAT IS YOUR PROPOSAL REGARDING THESE SAVINGS?**

19 A. Expense as determined by the actuary pursuant to GAAP and used to calculate rates in
20 this proceeding has been significantly reduced due to the recognition of investment
21 returns that have resulted from the cash contributions made into the pension plans by the
22 Company. It would be appropriate for the party providing the cash (i.e., the Company) to
23 receive these savings. However, we recognize that this is a new item. Under the

1 circumstances, we believe that a sharing of these savings would be appropriate and
2 propose that $2/3$ of such savings go to the Company, with the customers receiving the
3 benefit of the remaining $1/3$. This results in an expense reduction of \$59,229 (Annual
4 Savings of $\$88,844 \times 2/3 = \$59,229$).

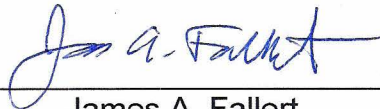
5 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY IN THIS**
6 **PROCEEDING?**

7 A. Yes.

AFFIDAVIT OF JAMES FALLERT

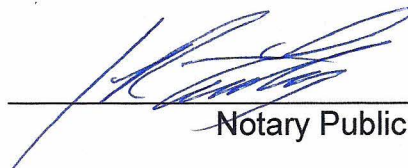
STATE OF MISSOURI)
) ss
COUNTY OF ST. LOUIS)

On the 3rd day of December, 2018, before me appeared James A Fallert, who, being by me first duly sworn, states that he is doing business as James Fallert Consultant LLC and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.



James A. Fallert

Subscribed and sworn to before me this 3rd day of December, 2018



Notary Public

My commission expires: 10-29-2022

