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**REBUTTAL TESTIMONY OF BRUCE E. GANGNON
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
ON BEHALF OF
SOUTHERN STATES UTILITIES, INC.
DOCKET NO. 920199-WS**

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FPSC-RECORDS/REPORTING

1 Q. PLEASE STATE YOUR NAME, TITLE AND EMPLOYER.
2 A. My name is Bruce E. Gangnon. I am employed as
3 Assistant Corporate Controller for Minnesota Power.
4 Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS
5 PROCEEDING?
6 A. Yes, I filed direct testimony on July 22, 1992.
7 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?
8 A. My rebuttal testimony will address certain
9 statements made and positions taken by Office of
10 Public Counsel witness Victoria A. Montanaro
11 regarding the appropriate ratemaking treatment for
12 Southern States Utilities, Inc.'s (the "Company")
13 test year expenses for other post-employment
14 benefits ("OPEBs"). It is my opinion that the
15 Commission should continue its policy of permitting
16 utilities to recover OPEBs earned and accrued
17 pursuant to Statement of Financial Accounting
18 Standard No. 106 ("SFAS 106").
19 Q. MS. MONTANARO OPPOSES RECOVERY OF SFAS 106 EXPENSES
20 CITING RULE 203 OF THE AICPA CODE OF PROFESSIONAL
21 CONDUCT WHICH PROVIDES THAT THE APPLICATION OF AN
22 ACCOUNTING STANDARD OR OTHER PRINCIPLE MAY NOT BE
23 APPROPRIATE IN "UNUSUAL CIRCUMSTANCES". DO
24 INTERPRETATIONS OF RULE 203 DISCUSS WHAT CONSTITUTE
25 "UNUSUAL CIRCUMSTANCES"?

1 **A.** **Yes.** The interpretations under Rule 203 Accounting
2 Principles found in AICPA Professional Standard
3 Volume II state:

4 "The question of what constitutes unusual
5 circumstances as referred to in Rule 203
6 is a matter of professional judgement
7 involving the ability to support the
8 position that adherence to a promulgated
9 principle would be regarded generally by
10 reasonable men as producing a misleading
11 result.

12 Examples of events which may justify
13 departure from a principle are new
14 legislation or the evolution of a new
15 form of business transaction. An unusual
16 degree of materiality or the existence of
17 conflicting industry practices are
18 examples of circumstances which would not
19 ordinarily be regarded as unusual in the
20 context of Rule 203."

21 **Q.** **WOULD APPLICATION OF SFAS 106 CONSTITUTE AN UNUSUAL**
22 **CIRCUMSTANCE UNDER RULE 203 OF THE AICPA CODE OF**
23 **PROFESSIONAL CONDUCT?**

24 **A.** **No.** The materiality of the SFAS 106 expenses
25 appears to be Ms. Montanaro's greatest area of

1 concern. However, as the interpretations I just
2 referred to confirm, materiality is not to be
3 considered an "unusual circumstance" under Rule
4 203.

5 **Q. WOULD THE COMPANY BE ALLOWED TO CONTINUE TO USE THE**
6 **CASH OR "PAY-AS-YOU-GO" METHOD OF RECORDING OPEBS**
7 **FOR FINANCIAL STATEMENT PURPOSES?**

8 **A.** No. The Company would have to record its OPEB
9 expenses for financial statement purposes, unless
10 the deferral provisions of SFAS 71 were to apply.

11 **Q. WOULD THE COMPANY BE ALLOWED TO USE DEFERRAL**
12 **ACCOUNTING UNDER SFAS 71 FOR THE DIFFERENCE BETWEEN**
13 **THE PAY-AS-YOU-GO AND THE SFAS 106 AMOUNTS?**

14 **A.** The Company would be able to use deferral
15 accounting, but only for a short period of time, as
16 noted by the staff in its recommendation in Docket
17 No. 910840-PU.

18 **Q. DOES THE COMPANY AGREE WITH MS. MONTANARO'S**
19 **PROPOSAL THAT THE COMPANY RETAIN THE CASH BASIS**
20 **METHOD OF ACCOUNTING FOR SFAS 106 COSTS?**

21 **A.** No, the Company finds Ms. Montanaro's position to
22 be unacceptable for the following reasons:

23 In the past, "pay-as-you-go" accounting was
24 considered generally accepted accounting for OPEBs
25 because they constituted a relatively minor cost

1 and the perceived difference between cash and
2 accrual accounting was not considered material.
3 Due to the high levels of medical cost inflation
4 experienced over the past decade, OPEB liabilities
5 are no longer immaterial. The Financial Accounting
6 Standards Board ("FASB") issued SFAS 106,
7 Employers' Accounting for Post-Retirement Benefits
8 Other Than Pensions, to require accrual accounting
9 for OPEBs primarily to recognize this fact. It
10 also is accepted fact that OPEBs are a form of
11 deferred compensation. As such, the costs should
12 be recognized over the active service life of the
13 employee to properly match and assess the full cost
14 of providing services with the periods such
15 services are earned.

16 **Q. WOULD THE CONTINUATION OF THE CASH OR "PAY-AS-YOU-**
17 **GO" METHOD OF RECOVERING OPEB EXPENSES HAVE ANY**
18 **IMPACT ON THE COMPANY OTHER THAN A MISMATCH OF**
19 **EXPENSE INCURRENCE AND BOOK RECOGNITION?**

20 **A. Yes.** If the Company did not recognize the full
21 SFAS 106 accrual in any given reporting period due
22 to regulatory denial of the recovery of such costs,
23 the Company would still be faced with the funding
24 question. A decision to fully fund the OPEB
25 obligation regardless of non-recovery would divert

1 the Company's credit capacity during a period when
2 water and wastewater utilities are straining
3 existing capital sources to fund mandated plant
4 additions, improvements and modifications. A
5 decision not to fund would create increased
6 uncertainty on the part of the Company's creditors
7 and investors with respect to the Company's ability
8 to service a rapidly increasing liability.
9 Prospective creditors and investors would include
10 that element of increased uncertainty in
11 establishing interest rates and equity return
12 expectations -- resulting in higher financing costs
13 for the Company.

14 Q. MS. MONTANARO STATES THAT "THERE IS SIGNIFICANT
15 REASON TO BELIEVE THAT THE COMPANY MAY RESTRUCTURE
16 ITS BENEFIT PLAN TO REDUCE COSTS IN THE FUTURE."
17 IN SUPPORT OF THIS STATEMENT, SHE REFERS TO AN
18 ACTUARIAL STUDY PREPARED BY MILLIMAN AND ROBERTSON,
19 INC. WHICH SHOWS THREE ALTERNATIVES TO THE CURRENT
20 PLAN BEING STUDIED. DO YOU AGREE WITH MS.
21 MONTANARO'S ASSESSMENT?

22 A. No, I do not. The Company has been and will
23 continue to review costs so that it will be able to
24 provide high quality service at reasonable rates.
25 As part of this process of reviewing costs we are

1 always looking at alternatives and cheaper
2 alternatives always will exist; however, as we
3 stated in response to several interrogatories,
4 there are no present plans to reduce either the
5 kinds or levels of post-retirement benefits now or
6 in the future. The current level of OPEBs have
7 been determined by the Company to be the level
8 necessary to assist the Company in attracting and
9 retaining qualified employees who can provide high
10 quality service to our customers. Also, Ms.
11 Montanaro's conclusion also seems to be based on a
12 suspicion that the Company will collect the funds
13 to cover the cost of OPEBs while trying to avoid
14 paying the OPEBs. Since the Company intends to
15 fund the OPEBs, and the Commission monitors the
16 Company's earnings, such suspicion is groundless.

17 **Q. MS. MONTANARO HAS EXPRESSED CONCERN THAT "SFAS 106**
18 **CALCULATIONS ARE INHERENTLY UNRELIABLE IN A RATE**
19 **SETTING ENVIRONMENT." DO YOU AGREE WITH THIS**
20 **STATEMENT?**

21 **A.** No, I do not. While the SFAS 106 calculations are
22 not the product of an exact process, the estimates
23 are sufficiently certain to be included in the
24 ratemaking process, as the Commission concluded in
25 the United Telephone rate case (Order No. PSC-92-

1 0708-FOF-TL). While I would not suggest that
2 actuarial estimates of future OPEBs will not
3 change, the calculations are the result of a number
4 of carefully researched and informed decisions,
5 made in consultation with independent experts, to
6 select appropriate assumptions and produce
7 reasonable results.

8 **Q. MS. MONTANARO ALSO SUGGESTS THAT ADOPTION OF SFAS**
9 **106 FOR RATEMAKING PURPOSES WILL ASSIGN COSTS TO**
10 **TODAY'S RATEPAYERS THAT RELATE TO A PRIOR PERIOD.**
11 **IS THAT ACCURATE?**

12 A. First, I must note that Ms. Montanaro's statements
13 in this regard constitute an admission that OPEBs
14 are a form of deferred compensation and, like any
15 other form of deferred compensation, should be
16 recognized over the active service life of the
17 employee. Second, the accumulated benefit
18 obligation ("APBO") which exists today was incurred
19 to provide utility service to previous and present
20 customers of the Company. Under the "pay-as-you-
21 go" method, there is no direct matching of
22 customers who pay the costs and the customers on
23 whose behalf the costs were incurred, i.e., a
24 customer who first received service in 1991 will be
25 assessed OPEBs paid to an employee who may have

1 retired in 1989. Therefore, conversion to the
2 accrual method actually would result in a more
3 appropriate matching of cost incurrence and utility
4 rates. As to previously incurred liabilities, the
5 Company believes, as did the FASB, that the
6 amortization of the APBO over twenty years is a
7 fair way to spread this liability.

8 **Q. MS. MONTANARO RECOMMENDS THAT THE COMMISSION USE**
9 **THE COMPANY'S COST OF CAPITAL AS THE DISCOUNT RATE**
10 **FOR RATEMAKING PURPOSES. DO YOU AGREE WITH THIS**
11 **RECOMMENDATION?**

12 A. No. The use of a discount rate for ratemaking
13 purposes which is different than that used for
14 financial statement purposes would only create an
15 unnecessary level of complication. Also, her
16 recommendation only has relevance to an unfunded
17 plan and it is the Company's intent to fund the
18 plan. Therefore, Ms. Montanaro's recommendation is
19 not relevant in this proceeding and should be
20 rejected.

21 **Q. DOES THAT COMPLETE YOUR REBUTTAL TESTIMONY?**

22 A. Yes, it does.

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