

Exhibit No.:  
Issues: Corporate Allocations; Six  
Sigma; Payroll Expense;  
Incentive Compensation; Payroll  
Taxes; Employee Benefits;  
Pension Expense; Prepaid  
Pension Assets; ERISA Minimum  
Tracker and Amortization  
Witness: Lesley R. Preston, CPA  
Sponsoring Party: MoPSC Staff  
Type of Exhibit: Direct Testimony  
Case No.: HR-2005-0450  
Date Testimony Prepared: October 14, 2005

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**DIRECT TESTIMONY**

**OF**

**LESLEY R. PRESTON, CPA**

**AQUILA, INC.**

**d/b/a AQUILA NETWORKS – L&P – STEAM**

**CASE NO. HR-2005-0450**

*Jefferson City, Missouri  
October 2005*

**FILED**

FEB 24 2006

Missouri Public  
Service Commission

Exhibit No. 31 1031  
Case No(s) HR-2005-0450  
Date 1-05-06 Rptr KE


**BEFORE THE PUBLIC SERVICE COMMISSION**  
**OF THE STATE OF MISSOURI**

In the Matter of the Tariff Filing of Aquila, Inc.,	)	
to Implement a General Rate Increase for	)	Case No. HR-2005-0450
Retail SteamHeat Service Provided to Customers	)	Tariff No. YH-2005-1066
in Its L&P Missouri Service Area.	)	

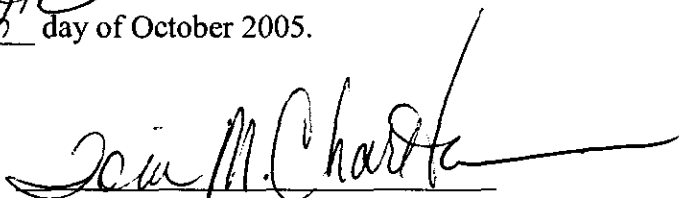
AFFIDAVIT OF LESLEY R. PRESTON

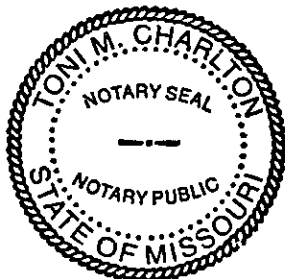
STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Lesley R. Preston, being of lawful age, on her oath states: that she has participated in the preparation of the following Direct Testimony in question and answer form, consisting of 18 pages to be presented in the above case; that the answers in the following Direct Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

  
\_\_\_\_\_  
Lesley R. Preston

Subscribed and sworn to before me this 12th day of October 2005.

  
\_\_\_\_\_  
Notary



TONI M. CHARLTON  
Notary Public - State of Missouri  
My Commission Expires December 28, 2008  
Cole County  
Commission #04474301

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**LESLEY R. PRESTON, CPA**  
**AQUILA, INC. d/b/a AQUILA NETWORKS – L&P – STEAM**  
**CASE NO. HR-2005-0450**

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1           A.     Yes. I have participated in other types of cases, such as small water cases.  
2     The information is also included on Schedule 1 attached to this direct testimony.

3     **PURPOSE OF TESTIMONY**

4           Q.     With reference to Case No. HR-2005-0450, have you made an examination of  
5     the books and records of Aquila Networks-L&P (L&P), a division of Aquila, Inc (Aquila or  
6     Company)?

7           A.     Yes, I have, with the assistance of other members of the Commission Staff  
8     (Staff).

9           Q.     What are your areas of responsibility in regard to Case No. HR-2005-0450?

10          A.     I will be sponsoring the areas of payroll expense, payroll taxes, incentive  
11     compensation, employee benefits and corporate allocations.

12          Q.     What knowledge, skill, experience, training or education do you have in  
13     regulatory matters?

14          A.     In addition to my education background and professional license, since  
15     beginning employment with the Commission, I have attended various in-house training  
16     seminars and have reviewed in-house training materials. I worked on three small water and  
17     sewer cases, which has provided a strong basis in the ratemaking process and an in-depth  
18     understanding on certain issues. I have also worked closely with senior auditors and  
19     supervisors, with extensive regulatory knowledge and experience. I have been assigned to  
20     and filed testimony as described in Schedule 1. I have also extensively reviewed other utility  
21     rate cases related to the issues I am sponsoring to ensure the consistency of the Staff's method  
22     and procedures. My prior academic education helped prepare me to successfully sponsor the  
23     ratemaking areas I've been assigned in this case. I have received a certificate of training from

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1 the National Association of Regulatory Utility Commissioners in a seminar it has sponsored  
2 concerning utility cost of service and regulation.

3 Q. Which adjustments are you sponsoring in this case?

4 A. I am sponsoring the following Income Statement Adjustments:

5 Payroll:

6 CS-5: S-8.1, S-16.1, S-17.1, S-18.1, S-20.1, S-21.1, S-22.1, S-23.1, S-24.1,  
7 S-25.1, S-26.1, S-29.1, S-30.1, S-32.1, S-35.1, S-40.1, S-42.1;

8  
9 June 30, 2005: S-8.2, S-16.2, S-17.2, S-18.2, S-20.2, S-21.2, S-22.2, S-23.2,  
10 S-24.2, S-25.2, S-26.2, S-29.2, S-30.2, S-32.2, S-35.2, S-40.2, S-42.2;

11  
12 Adjusted Massachusetts Formula: S-8.3, S-16.3, S-17.3, S-18.3, S-20.3,  
13 S-21.3, S-22.3, S-23.3, S-24.3, S-25.3, S-26.3, S-29.3, S-30.3, S-32.3, S-35.3,  
14 S-40.3, S-42.3;

15  
16 Impact of South Harper: S-8.4, S-16.4, S-17.4, S-18.4, S-20.4, S-21.4, S-22.4,  
17 S-23.4, S-24.4, S-25.4, S-26.4, S-29.4, S-30.4, S-32.4, S-35.4, S-40.4, S-42.4;

18  
19 Restructuring: S-8.5, S-16.5, S-17.5, S-18.5, S-20.5, S-21.5, S-22.5, S-23.5,  
20 S-24.5, S-25.5, S-26.5, S-29.5, S-30.5, S-32.5, S-35.5, S-40.5, S-42.5;

21  
22 Lobbying: S-8.6, S-16.6, S-17.6, S-18.6, S-20.6, S-21.6, S-22.6, S-23.6,  
23 S-24.6, S-25.6, S-26.6, S-29.6, S-30.6, S-32.6, S-35.6, S-40.6, S-42.6;

24  
25 Community Relations: S-8.7, S-16.7, S-17.7, S-18.7, S-20.7, S-21.7, S-22.7,  
26 S-23.7, S-24.7, S-25.7, S-26.7, S-29.7, S-30.7, S-32.7, S-35.7, S-40.7, S-42.7;

27  
28 Payroll Taxes: S-47.1, S-47.2, S-47.3, S-47.4;

29 Long-Term Incentive Plan: S-35.13;

30 Incentive Compensation: S-8.8, S-16.8, S-17.8, S-18.8, S-20.8, S-21.8, S-22.8, S-23.8,  
31 S-24.8, S-25.8, S-26.8, S-29.8, S-30.8, S-32.8, S-35.8, S-40.8, S-42.8;

32  
33 Corporate Allocations:

34 Aquila's Updated Factors: S-18.9, S-30.9, S-32.9, S-41.1, S-47.9;

35 Staff's Adjusted Massachusetts Formula: S-18.10, S-30.10, S-32.10, S-41.2,  
36 S-47.10;

*Impact of South Harper on Massachusetts Formula: S-18.11, S-30.11,  
S-32.11, S-41.3, S-47.11;*

*Six Sigma: S-18.17, S-30.17, S-32.17, S-32.20, S-41.9, S-47.17;*

401(k): S-35.16;

Profit Sharing Plan: S-35.12;

Medical, Dental & Vision: S-35.14, S-35.15;

Pension Expense: S-35.10; and

ERISA Tracker Amortization: S-35.11.

In addition to these income statement adjustments, I am sponsoring Prepaid Pension Asset and ERISA Minimum Tracker, found on Schedule 2, Rate Base.

## **EXECUTIVE SUMMARY**

Q. Please provide a summary of each of the issues you have identified.

A. Aquila corporate departments incur expenses that are allocated to its operating business units by various allocations. A general allocator, the Massachusetts Formula, is used to distribute costs to departments that do not have a specific cost driver. The Staff has modified the Massachusetts Formula to allocate a more accurate level of cost to the non-regulated business unit. The Massachusetts Formula has also been modified to include the impact of the South Harper generating facility on net plant. Aquila has implemented a new management process, Six Sigma, to improve efficiency and reduce costs. Six Sigma costs are also included in the corporate cost pool. The Staff is proposing to normalize outside consulting costs, related to the Six Sigma project, over a five-year period and include any identified Six Sigma savings on an annualized basis.

The Company's payroll is comprised of both direct and allocated employee costs. The Staff is proposing to include the employee and salary levels at June 30, 2005. The allocated

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1 portion of the payroll costs are impacted by the changes in the corporate allocation factors that  
2 were updated as of July 1, 2005, the modifications to the Massachusetts Formula, and specific  
3 adjustments proposed by Staff witness Charles R. Hyneman. Payroll taxes were also  
4 annualized based upon the current tax rates and annualized level of payroll expense.

5 Incentive Compensation was updated to reflect the appropriate corporate allocations.  
6 Medical, dental and vision insurance was annualized to reflect an appropriate level of expense  
7 for the self-insured and premium based insurance. 401(k) and Profit Sharing were annualized  
8 based upon an appropriate ratio of the expense to the annualized level of payroll expense.  
9 Pension expense and related components which include the ERISA Minimum contribution,  
10 prepaid pension asset and the ERISA Minimum Tracker are reflected based upon the same  
11 methodology presented in the Stipulation and Agreement for Case No. ER-2004-0034.

#### 12 **CORPORATE ALLOCATIONS-MASSACUSETT'S FORMULA**

13 Q. Please describe the corporate structure of Aquila.

14 A. Aquila's corporate allocations consist of two groups, both organized in  
15 specialized departments. Enterprise Support Functions (ESF) provide general corporate  
16 services such as executive, legal, payroll and tax to the business units. Aquila currently has  
17 approximately 55 corporate ESF departments with 213 employees. Intra Business Units  
18 (IBU) provide services such as customer service, regulatory, and operations to the Network's  
19 business units. Aquila currently has approximately 145 corporate IBU departments with 787  
20 employees.

21 Q. How many people does Aquila employ as of June 30, 2005?

22 A. In total, Aquila has 3,233 employees. In addition to the ESF and IBU  
23 employees, 2,037 employees are assigned to the various utility business units, 178 employees



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1 are under Aquila's non-regulated Everest Communications, and 18 employees are assigned to  
2 other non-regulated business units.

3 Q. Please describe the process Aquila uses to allocate costs to its business units.

4 A. Aquila has developed a comprehensive corporate overhead allocation  
5 procedure to allocate costs to its domestic business units. Aquila's primary method of  
6 allocating ESF and IBU costs is a three-factor formula referred to as the "Massachusetts  
7 Formula." Aquila uses the factors of gross profit (margin), net plant in service, and payroll to  
8 calculate the relative allocation percentage for each business unit.

9 The Massachusetts Formula is used to allocate costs to the business units when a  
10 specific cost driver cannot be identified. Such departments that are allocated in this manner  
11 include the executive officer departments, financial reporting, tax, board of directors, and  
12 audit services.

13 In addition to the Massachusetts Formula, Aquila uses other allocation factors to  
14 allocate ESF and IBU department costs to its business units. For example, the costs charged  
15 to ESF department of 4179 (Payroll) are allocated based on the number of paychecks issued in  
16 that business unit to the total number of all business unit checks issued.

17 Q. Does Aquila allocate all corporate costs incurred to its operating companies  
18 like L&P?

19 A. No. Aquila has created departments where certain costs are accumulated but  
20 not allocated to the regulated business units. These are referred to as corporate retained  
21 departments. A significant portion of costs charged to the retained departments is associated  
22 with Aquila's continued exit from non-regulated activities and restructuring and do not get

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1 recovered in rates. Please refer to Staff witness Charles Hyneman as he further addresses  
2 these issues in his testimony.

3 Q. Is the Staff proposing adjustments to the L&P test year corporate allocated  
4 costs in this case?

5 A. Yes. The Staff's adjustments can be classified into several categories of  
6 adjustments to L&P per book corporate allocated costs. These adjustments are included in  
7 Accounting Schedule 10, Adjustments to Income Statement:

- 8 1. Adjust test year costs to reflect Aquila's July 1, 2005 corporate allocations;
- 9 2. Adjust corporate expenses to reflect the Staff's adjustment to the  
10 Massachusetts Formula;
- 11 3. Adjust the Massachusetts Formula to reflect the Staff's level of net plant  
12 associated with the South Harper generating facility;
- 13 4. Adjust certain corporate expenses related to restructuring;
- 14 5. Adjust lobbying expenses;
- 15 6. Adjust Community Relations Department expenses;
- 16 7. Adjust corporate expenses to reflect 20 W. 9<sup>th</sup> lease revenue;
- 17 8. Adjust corporate expenses to reflect Staff's SERP adjustment;
- 18 9. Reflect the Staff's adjustment associated with Six Sigma.

19 Q. Please explain adjustments S-18.9, S-30.9, S-32.9, S-41.1, and S-47.9.

20 A. These adjustments update L&P corporate allocated costs in 2004 using the  
21 updated July 1, 2005 allocation factors provided by Aquila. These adjustments are simply the  
22 difference between the level of L&P per books net residual allocated corporate costs and the  
23 annualized level of net residual allocated corporate costs proposed by Aquila.

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1 Q. Please explain what you mean by "net residual" corporate costs.

2 A. Net residual corporate costs simply mean total corporate costs less the  
3 corporate costs that are being annualized and adjusted by other witnesses. For example, both  
4 Aquila and the Staff have witnesses that are sponsoring corporate payroll and benefits,  
5 pensions, insurance, dues and donations, advertising, depreciation and injuries and damages.  
6 These witnesses are sponsoring adjustments to L&P direct costs as well as the related  
7 corporate costs. Thus, the corporate costs have been removed from the total corporate pool of  
8 expense dollars subject to allocation to the business units. The remaining costs left in the  
9 corporate pool after removal of these costs are referred to as net-residual corporate costs.

10 Q. Please explain adjustments S-18.10, S-30.10, S-32.10, S-41.2, and S-47.10.

11 A. These adjustments reflect the impact of the Staff's adjustment to the  
12 Massachusetts Formula. As discussed above, the Massachusetts Formula is comprised of  
13 three factors including margin, net plant and payroll. I have attached Schedule 2 to show the  
14 calculation of the Massachusetts Formula that would be applied to a department such as 4030,  
15 Chief Operating Officer. The first calculation demonstrates the result as included in the  
16 Company's direct filing. The margin (gross profit), in the first line for MEP, is a negative  
17 \$57,760,000. A negative number in the calculation will cause less cost to be allocated to the  
18 business unit with the negative number and more to the other business units included in the  
19 calculation.

20 Q. What is department 1150 MEP General?

21 A. Department 1150 is the department that corporate costs are allocated to for the  
22 non-regulated Aquila Merchant Services.

23 Q. Has the Company's allocation factors changed since their direct filing?

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1           A.     Yes. The Company, in response to Data Request No. 121, indicated that the  
2     “use of the negative figure for the Merchant gross margin was an oversight... our intent [is] to  
3     treat any negative gross margin amount as null (zero).” The Company provided the Staff with  
4     updated workpapers that reflected this change and the July 1, 2005 allocation factors. This  
5     calculation is shown by the second calculation on Schedule 2.

6           Q.     How is the Staff proposing to treat the margin associated with MEP?

7           A.     The Staff proposes to use the actual margin for MEP, but included it as a  
8     positive number. The actual margin for MEP had decreased further to negative \$72,962,000.  
9     The calculation that Staff performed is shown by the third example on Schedule 2.

10          Q.     Will you please provide an example to illustrate the application of the  
11     Massachusetts Formula?

12          A.     Yes. Assume that there is Company X with Divisions A and B, which has  
13     \$100,000 in corporate shared costs to be allocated in 2003. Below is the allocation for 2003.

<u>Company X</u>	<u>Margin</u>	<u>Payroll</u>	<u>Net Plant</u>	<u>Average=</u> <u>Mass. Formula</u>
Division A	\$100 63%	\$75 60%	\$200 57%	60%
Division B	\$60 37%	\$50 40%	\$150 43%	40%
Total	\$160	\$125	\$350	

19          Division A is allocated \$60,000 ( $\$100,000 \times 60\%$ ) of the corporate costs, and  
20     Division B is allocated \$40,000 ( $\$100,000 \times 40\%$ ) of the corporate costs based on the  
21     respective weighting of each of the three allocation factors.

22          Assume again for 2004, \$100,000 was incurred for corporate costs. The only change  
23     from the above example is that Division B lost \$35 instead of earning \$60. Due to this single  
24     change, Division A is allocated \$90,000 ( $\$100,000 \times 90\%$ ) and Division B is allocated  
25     \$10,000 ( $\$100,000 \times 10\%$ ). The calculation of the allocation is illustrated below.

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<u>Company X</u>					<u>Average=</u>
	<u>Margin</u>	<u>Payroll</u>	<u>Net Plant</u>		<u>Mass. Formula</u>
Division A	\$100 154%	\$75 60%	\$200 57%		90%
Division B	<u>\$(35)</u> -54%	<u>\$50</u> 40%	<u>\$150</u> 43%		10%
Total	\$65	\$125	\$350		

6 This example illustrates the counterintuitive effect of including a negative number in a  
7 component of the Massachusetts Formula. This would lead to a smaller allocation of  
8 management time to a division that is losing money. This is counterintuitive as it is expected  
9 that management will focus more of its energy on a division that is losing money over a  
10 division with stable earnings.

11 Q. Please explain adjustments S-18.11, S-30.11, S-32.11, S-41.3, and S-47.11.

12 A. These adjustments represent an additional change to the Massachusetts  
13 Formula, and are included as the fourth calculation listed on Schedule 2. This simply adjusts  
14 the net plant for Aquila's MPS Division to reflect the Staff's level of plant for the South  
15 Harper generating facility. This is consistent with the amount recommended by Staff  
16 Auditing witness Phillip K. Williams in Case No. ER-2005-0436. The Company's direct  
17 filing reflected estimated costs for the South Harper generating facility at \$140,000,000, and  
18 the updated workpapers reflecting the July 1, 2005 allocation factors included \$155,000,000  
19 as the total estimated cost.

20 Q. Will you be addressing the remaining proposed adjustments?

21 A. I will address issue 9, Six Sigma in the next section of my testimony. Staff  
22 witness Hyneman will address the remaining corporate issues listed above.

23 **SIX SIGMA**

24 Q. Please explain what is meant by Six Sigma?

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1           A.     Six Sigma is a methodology Aquila has implemented to improve its processes  
2 and efficiency. Aquila began training and implementation of Six Sigma in 2004.

3           Q.     Are there costs associated with the introduction of Six Sigma?

4           A.     Yes. Aquila has established corporate IBU department 6134, to capture costs  
5 associated with Six Sigma. This department is then allocated to the business units through the  
6 allocation process.

7           Q.     How have the costs for this function been treated in this case?

8           A.     The Staff has not adjusted any departmental costs except for the outside  
9 consulting fees. The Staff proposes to normalize those costs over a five-year period. This  
10 period is typically used by the Staff on costs that are non-investment related.

11          Q.     Has Six Sigma resulted in improved efficiency?

12          A.     Yes. In implementing Six Sigma, the Company identified specific projects  
13 where improvements can be made. Data Request No. 209 response identified several  
14 successfully completed projects since 2004, which resulted in improved efficiency and cost  
15 savings.

16          Q.     What other adjustments has the Staff made in regards to Six Sigma?

17          A.     Also in the response to Data Request No. 209, Aquila identified potential cost  
18 savings that can be recognized for each project that is proposed. These savings may affect the  
19 income statement or balance sheet and may be a recurring savings (cost reduction), or a one-  
20 time benefit. In 2004, Aquila identified savings that were recurring and impacted the income  
21 statement. These cost reductions are embedded in the per book amounts in the income  
22 statement. The Staff has made an additional adjustment to realize additional savings Aquila  
23 identified that have occurred through June 30, 2005.

1 Q. Which adjustments are you sponsoring associated with Six Sigma?

2 A. I am sponsoring adjustments S-18.17, S-30.17, S-32.17, S-32.20, S-41.9, and  
3 S-47.17.

4 **PAYROLL EXPENSE**

5 Q. Please explain the process taken to annualize payroll.

6 A. As Staff witness Williams explains in his direct testimony, the Staff is filing a  
7 calendar year 2004 test year updated for known and measurable events through June 30, 2005.  
8 Therefore, I have developed the payroll expense by annualizing payroll costs at June 30,  
9 2005, for L&P and the corporate ESF and IBU departments. The annualized payroll expense  
10 is based upon actual employees and the authorized wage levels paid as of June 30, 2005.

11 Q. How did Staff develop payroll costs in this case?

12 A. The Staff requested payroll information for each department and individual  
13 employed by Aquila and its operating divisions. This information was analyzed to track  
14 changes in the work force and to identify any areas that needed to be reviewed in further  
15 detail. Salary and wage rates were reviewed to determine the pay levels of the Aquila  
16 employees.

17 I determined the salary and wage rates as of June 30, 2005, and applied those rates to  
18 employees that were included in the payroll costs as of that date. The annualized amount was  
19 compared to the test-year per-book amount at December 31, 2004, to identify the related  
20 adjustment to the annualized level as of June 30, 2005. The annualized amount was  
21 distributed to the Federal Energy Regulatory Commission (FERC) Uniform System of  
22 Accounts by a payroll distribution percentage based on the payroll distribution percentage  
23 used for the test year. I also developed the payroll annualization by applying a capitalization

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1 ratio to assign part of the payroll to construction activities. This essentially assigns a portion  
2 of payroll costs for employees who work on construction projects.

3 I have also included an allowance for overtime and "other than standard" labor costs  
4 by including them at the test year level. These costs were reviewed over a three-year  
5 historical time frame to determine the reasonableness of the test year levels.

6 Finally, I was provided changes to the costs, subject to allocation, for specific  
7 corporate departments by Staff witness Hyneman to incorporate into the payroll and payroll  
8 related costs. For a discussion on the specific corporate adjustments, please refer to  
9 Mr. Hyneman's direct testimony.

10 Q. How did Staff account for the payroll costs of Aquila's corporate departments  
11 and other business units that provide service to L&P?

12 A. These costs have been allocated to L&P using an appropriate allocation factor  
13 using the updated factors as of July 1, 2005, the modified Massachusetts Formula and the  
14 impact of South Harper.

15 Q. Has Aquila paid any executive bonuses in 2004?

16 A. No. However, Aquila announced the sale of four of its utility properties on  
17 September 21, 2005. The Compensation and Benefits Committee of the Board of Directors  
18 determined that the chief executive officer and eight other top executives will receive a cash  
19 bonus of 25% of their current salary. Upon the consummation of the sales transactions, the  
20 executives are eligible for an additional 75% cash bonus of their current salary.

21 Q. Has the Staff reflected the announced executive bonuses in its direct filing?

22 A. No.

23 Q. Will the executive bonuses be reflected in the true-up?



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1 A. No.

2 Q. Why will these bonuses not be reflected?

3 A. These bonuses are associated with the corporate restructuring activities and  
4 should not be recovered in rates. Staff witness Hyneman discusses this further in his direct  
5 testimony.

6 **INCENTIVE COMPENSATION**

7 Q. Please explain what is meant by incentive compensation.

8 A. Incentive compensation is additional compensation, above base wages/salary,  
9 that employees receive if certain pre-set goals are met.

10 Q. What is the nature of Staff's review in auditing this area?

11 A. Among other things, the Staff's audit scope includes a review of the goals of  
12 the plan and a determination as to who benefits by achieving the goals and, therefore, who  
13 should pay for achieving the goals. Historically, the Staff has recommended that ratepayers  
14 pay for progress made towards accomplishing goals of improving safety, reliability and  
15 customer service, and that goals intended to improve the Company's earnings/rate of return be  
16 assigned to shareholders.

17 Q. What types of incentive compensation plans does the Company have?

18 A. The Company has a Variable Compensation Plan (VCP), and a Long-Term  
19 Incentive Plan (LTIP).

20 ***Variable Compensation Plan***

21 Q. What is the purpose of the Variable Compensation Plan?

22 A. Aquila's response to Data Request No. 53 identifies the purpose to "reward  
23 the accomplishment of operation business objectives and to motivate participants to

1 accomplish significant business group and individual goals. Achievement of these goals will  
2 further enhance Aquila's mission to enhance business stability and service reliability."

3 Q. How are incentive payments determined under the VCP?

4 A. Incentive payments for the 2004 VCP are made based upon the achievement of  
5 established goals for each of the components of reliability, safety, customer service and  
6 effective use of capital.

7 Q. Is the Staff recommending any disallowance of payments made under the  
8 VCP?

9 A. No. No disallowance to the VCP program is being proposed in this case  
10 because the goals are not directly related to the Company achieving a specific rate of return or  
11 financial earnings benchmark. Future recommendations made to support inclusion in rates for  
12 the VCP in future rate cases will be made on a case-by-case basis based on the information at  
13 the time.

14 Q. Please explain adjustments S-8.8, S-16.8, S-17.8, S-18.8, S-20.8, S-21.8,  
15 S-22.8, S-23.8, S-24.8, S-25.8, S-26.8, S-29.8, S-30.8, S-32.8, S-35.8, S-40.8, and S-42.8.

16 A. These adjustments reflect the test-year levels of incentive compensation  
17 adjusted to reflect the July 2005 corporate allocation factors.

18 ***Long-Term Incentive Plan***

19 Q. Please explain the adjustment S-35.13 for the long-term incentive plan (LTIP).

20 A. This adjustment removes LTIP expenses from the cost of service. The  
21 Company is not seeking recovery of this plan in rates at this time.

**PAYROLL TAXES**

Q. Please explain adjustments S-47.1, S-47.2, S-47.3, and S-47.4 related to payroll taxes.

A. These adjustments serve to ensure the appropriate level of Social Security (FICA), Medicare, state unemployment (SUTA) and federal unemployment (FUTA) taxes associated with the level of Staff's annualized payroll are included in rates.

Q. Please briefly explain how you computed the correct level of payroll taxes.

A. The current 2005 tax rates for the individual tax components were used for this calculation. Applying these rates to the current annualized level of payroll expense produces an appropriate level of payroll taxes on a going forward basis.

**EMPLOYEE BENEFITS**

***Medical, Dental & Vision Expense***

Q. Please describe adjustments S-35.14 and S-35.15 associated with the health, vision and dental benefits.

A. The Staff's adjustment regarding health, vision and dental benefits is two-fold. An adjustment was made to eliminate the historical over-accrual on the Company's books for the self-insured portion of health, dental and vision benefits. The second adjustment reflects the change in premium-based insurance based on Aquila's Election Report dated for June 2005.

***401(k) Expense***

Q. Please describe adjustment S-35.16 associated with 401(k) expense.

A. The 401(k) benefits matching expense incurred by L&P in the test year represent a certain percentage of payroll. I have maintained this same relationship, but

1 multiplied it by the Staff's annualized level of payroll to produce the Staff's 401(k) benefit  
2 level. The difference between this and the test-year level generates the adjustment.

3 ***Profit Sharing Plan***

4 Q. Please describe adjustment S-35.12 associated with the profit sharing plan.

5 A. The profit sharing plan was formerly known as the employee stock  
6 contribution plan. The change occurred in 2004 and is a cash contribution to the employees  
7 investment account.

8 Q. Please explain how your adjustment was determined.

9 A. The profit sharing contribution expense incurred by Aquila in the test year  
10 represents a certain percentage of payroll. I have maintained the same relationship, but  
11 multiplied it by the Staff's annualized level of payroll to produce the Staff's profit sharing  
12 contribution expense level. The difference between this and the test year level gives rise to  
13 my adjustment.

14 **PENSION EXPENSE**

15 Q. How has the Staff reflected pension expense in the instant case, adjustment  
16 S-35.10?

17 A. The Staff has taken the same approach in calculating pension expense as  
18 outlined in the Stipulation and Agreement (Stipulation) for Aquila's last case, Case  
19 No. ER-2004-0034. The annual pension cost is based upon a five-year average of the  
20 Company's ERISA contributions to the pension fund and is intended to reflect the Company's  
21 funding requirement under ERISA minimum.

22 **PREPAID PENSION ASSET**

23 Q. Please explain the prepaid pension asset.

Direct Testimony of  
Lesley R. Preston

1           A.    The prepaid pension asset represents the level of negative Financial  
2   Accounting Standard (FAS) 87 expense flowed back in rates in prior years. The amount was  
3   determined as part of the settlement of the pension issue in Case No. ER-2004-0034. The  
4   unamortized balance has been included as an addition to Rate Base, Schedule 2.

5           Q.    Please explain the adjustments to amortize the prepaid pension asset.

6           A.    The adjustments to amortize the prepaid pension assets are based upon a  
7   9.25 year amortization period. The amortization periods correspond with the time frame since  
8   the adoption of FAS 87 for ratemaking purposes for L&P and are in accordance with the  
9   Stipulation in Case No. ER-2004-0034.

10   **ERISA MINIMUM TRACKER AND AMORTIZATION**

11          Q.    What is the ERISA minimum tracker and associated amortization expense?

12          A.    The Stipulation in Case. No. ER-2004-0034 provided that the difference  
13   between annual ERISA minimum and the ERISA minimum included in rates in Case  
14   No. ER-2004-0034 be recorded as a regulatory asset or liability. The Company has not made  
15   any ERISA minimum contributions since the effective date of rates for Case  
16   No. ER-2004-0034. Thus, as of June 30, 2005, the Company had recovered funds for  
17   14.3 months, which results in a regulatory liability that is being included as an offset to rate  
18   base.

19          The terms of the Stipulation provided for a five year amortization of the regulatory  
20   asset or liability. This has been reflected as adjustment S-35.11.

21          Q.    Does this conclude your direct testimony?

22          A.    Yes, it does.

**CASE PARTICIPATION  
LESLEY PRESTON**

<b>Participation</b>			<b>Testimony</b>
<b>Company</b>	<b>Case No.</b>	<b>Exhibit</b>	<b>Issues</b>
Missouri Gas Energy	GR-2004-0209	Direct	Advertising, Dues & Donations, Plant in Service, Depreciation Reserve, Depreciation Expense, Rate Case Expense, PSC Assessment, Injuries & Damages
Aquila, Inc. d/b/a Aquila Networks-L&P and Aquila Networks-MPS	GR-2004-0072	Direct	Cash Working Capital, Account Receivable Sales, Materials & Supplies, Prepayments, Customer Deposits and Interest, Customer Advances, Postage, Maintenance Expense
Aquila, Inc. d/b/a Aquila Networks-L&P and Aquila Networks-MPS	GR-2004-0072	Rebuttal	Cash Working Capital
Aquila, Inc. d/b/a Aquila Networks-L&P and Aquila Networks-MPS	ER-2004-0034 & HR-2004-0024 (Consolidated)	Direct	Cash Working Capital, Account Receivable Sales, Materials & Supplies, Prepayments, Customer Deposits and Interest, Customer Advances, Maintenance Expense, Postage
Aquila, Inc. d/b/a Aquila Networks-L&P and Aquila Networks-MPS	ER-2004-0034 & HR-2004-0024 (Consolidated)	Surrebuttal	Cash Working Capital

**SMALL COMPANY CASE PARTICIPATION**

<b>Company</b>	<b>Case No.</b>	<b>Tracking No.</b>
Middlefork Water Company		QW-2005-0005
Central Rivers Wastewater	SA-2005-0302	
Hickory Hills Water & Sewer Company, Inc.	WR-2005-0126	QW-2004-0008
Hickory Hills Water & Sewer Company, Inc.	SR-2005-0125	QS-2004-0009
Raytown Water Company	WR-2005-0052	QW-2003-0023
Taney County Utilities	WR-2004-0450	QW-2003-0016
Taney County Utilities	SR-2004-0451	QS-2003-0015

Company Direct Filing				
	Margin	Payroll	Net Plant	
MEP	-57,760	14,336	183,038	3.65%
MPS	206,954	22,062	927,360	29.68%
L&P	84,906	10,043	190,459	9.76%
Other Units	426,859	73,921	1,053,604	56.92%
	660,959	120,362	2,354,461	

Company Updated Filing				
	Margin	Payroll	Net Plant	
MEP	-	2,560	164,018	3.21%
MPS	196,418	16,836	1,065,126	30.68%
L&P	66,172	7,167	191,577	8.57%
Other Units	409,538	63,834	989,631	57.53%
	672,128	90,397	2,410,352	

Staff's Proposed Massachusetts Formula				
	Margin	Payroll	Net Plant	
MEP	72,962	2,560	164,018	6.48%
MPS	196,418	16,836	1,065,126	29.72%
L&P	66,172	7,167	191,577	8.25%
Other Units	409,768	63,834	989,631	55.55%
	745,320	90,397	2,410,352	

Staff's Proposed Massachusetts Formula-South Harper Net Plant				
	Margin	Payroll	Net Plant	
MEP	72,962	2,560	164,018	6.50%
MPS	196,418	16,836	1,035,120	29.49%
L&P	66,172	7,167	191,577	8.28%
Other Units	409,768	63,834	989,631	55.72%
	745,320	90,397	2,380,346	