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Sponsoring Party: Aquila Networks
Case No: GR-2004-0072
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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-2004-0072

REBUTTAL TESTIMONY

OF

PHILIP M. BEYER

ON BEHALF OF

**AQUILA, INC.
d/b/a
AQUILA NETWORKS – MPS
and
AQUILA NETWORKS – L&P**

**Kansas City, Missouri
February, 2004**

Exhibit No. 8
Date 3/31/04 Case No. GR-2004-0072
Reporter *K

State of Missouri)

) ss

County of Jackson)

AFFIDAVIT OF Philip M. Beyer

Philip M. Beyer, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony and schedules entitled "Rebuttal Testimony of Philip M. Beyer"; that said testimony was prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

Philip M. Beyer

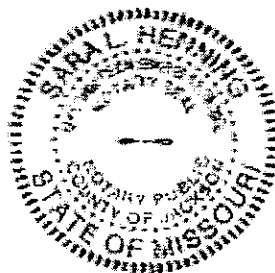
Subscribed and sworn to before me this 12th day of February, 2004.

Sara L. Henning
Notary Public

My Commission expires:

12/28/2005

SARA L. HENNING
Notary Public Notary Seal
STATE OF MISSOURI
County of Jackson
My Commission Exp. 12/28/2005



BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
REBUTTAL TESTIMONY OF PHILIP M. BEYER
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS
AND AQUILA NETWORKS-L&P
CASE NO. GR-2004-0072

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is Philip Beyer, and my business address is 20 W. 9th Street, Kansas
3 City, Missouri 64105.

4 Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

5 A. The purpose of my testimony is to respond to the Missouri Public Service
6 Commission Staff's (Staff) recommendation that expenses related to Aquila's
7 Supplementary Executive Retirement Plan (SERP) should be excluded from cost
8 of service.

9 Q. PLEASE DESCRIBE THE PURPOSE OF A SERP.

10 A. The basic purpose of a SERP is to supplement other retirement benefits in order
11 to attract and retain quality individuals at the executive level. SERP type
12 programs are standard within the industry and it is necessary for Aquila to have
13 this program in order to provide competitive compensation plans. The SERP is
14 an integral part of meeting Aquila's retirement program objectives.

15 Q. PLEASE DESCRIBE AQUILA'S RETIREMENT OBJECTIVES FOR ITS
16 EMPLOYEES.

17 A. Aquila's retirement program objective is to provide replacement of 70% of pre-
18 retirement income at age 62 for employees with 25 years of service who

1 contribute 6% to the 401(k) plan. The 70% includes Social Security retirement
2 benefits.

3 **Q. WHAT RETIREMENT PROGRAM DOES AQUILA OFFER?**

4 A. Aquila's retirement program for employees and executives consists of an IRS
5 tax-qualified pension plan and 401(k)/ profit sharing plan in addition to Social
6 Security. Each plan uses base pay to calculate benefits.

7 **Q. DO ANY OF AQUILA'S TAX-QUALIFIED PLANS INCLUDE BONUS INCOME?**

8 A. No. Bonus pay is not included in Aquila's tax- qualified pension or 401(k) /profit
9 sharing retirement plan.

10 **Q. IF AQUILA EXECUTIVES PARTICIPATE IN THE PENSION AND
11 401(K)/PROFIT SHARING PLAN, WHY DOES AQUILA PROVIDE A
12 SUPPLEMENTAL PLAN FOR EXECUTIVES?**

13 A. Without the inclusion of a supplementary executive retirement plan, the 70%
14 retirement program objective could not be achieved for executive level
15 employees.

16 **Q. PLEASE EXPLAIN.**

17 A. The Aquila SERP restores benefits to employees whose benefits are lost under
18 limitations imposed by the IRS Code [Code Sec. 415(b)(1)(a) and 401(a)(17)]
19 that apply to qualified retirement benefits. For example, the 2004 IRS 401(a)(17)
20 maximum salary limit is \$205,000. If an executive earns \$225,000 during 2004,
21 only \$205,000 of the \$225,000 can be used in the calculation of benefits in
22 Aquila's qualified pension plan. In this example, the Aquila SERP restores the
23 benefit that would have been provided without the IRS limit. Restoration plans

1 like Aquila's are not intended to provide enhanced benefits. They are limited to
2 restoring lost benefits due to the tax law.

3 **Q. STAFF WITNESS CHARLES HYNEMAN STATES IN HIS DIRECT**
4 **TESTIMONY BEGINNING ON PAGE 24, LINE 20 THAT "THE INDIVIDUALS IN**
5 **AQUILA'S SERP ARE OR HAVE BEEN PARTICIPANTS IN AQUILA'S**
6 **REGULAR PENSION PLAN AND 401(K) PLAN. IN THE STAFF'S VIEW,**
7 **THESE PLANS PROVIDE SUFFICIENT RETIREMENT BENEFITS FOR ALL**
8 **OF AQUILA'S EMPLOYEES AND THE ADDITION OF ANOTHER**
9 **RETIREMENT PLAN IS EXCESSIVE." DO YOU AGREE WITH STAFF'S**
10 **VIEW?**

11 **A.** No. As I stated previously, Aquila's retirement program objective is to provide
12 replacement of 70% of pre-retirement income at age 62 for employees with 25
13 years of service. As mentioned above, IRS Code limits the maximum salary that
14 can be considered in qualified retirement plans. Additionally, Social Security
15 retirement benefits have maximum benefit limits that disadvantage higher paid
16 employees. Aquila compensation programs are designed using designated
17 bands for various employee levels. Executive level bands are defined as Bands
18 A through D. Without restoration and supplemental retirement benefits, Aquila
19 executives in Band A will have only 13.57% of pay replaced by Aquila's qualified
20 plans. Aquila executives in Bands B, C, and D will have only 33.65%, 24.93%,
21 and 28.90% respectively of their pre-retirement income replaced by Aquila's
22 qualified retirement plans. In order to restore benefits lost due to IRS Code and
23 meet the income replacement objective, Aquila needs to provide supplemental

1 retirement benefits. Since comparable employers have supplemental retirement
2 plans, Aquila needs such plans to attract and retain executives.

3 **Q. DO OTHER UTILITY COMPANIES PROVIDE RESTORATION BENEFITS TO**
4 **THEIR EXECUTIVES?**

5 A. Yes. According to Hewitt Associates Inc., an international human resources
6 consulting firm, ninety percent (90%) of utility companies sponsor restoration
7 plans and 81% utilize some form of supplemental plan for their executives.
8 Within Aquila's peer utility group (attached), 82% sponsor a defined benefit
9 restoration plan and 64% provide supplemental benefits to their executives. Of
10 the five companies that do not use a SERP, four already include bonuses in their
11 qualified pension plan.

12 **Q. DO ANY REGULATED UTILITIES IN MISSOURI OFFER RESTORATION AND**
13 **SUPPLEMENTAL BENEFITS TO THEIR EXECUTIVES?**

14 A. Yes. Two Missouri regulated companies, Ameren Corporation and Empire
15 District Company include base and bonus in the qualified pension plan plus have
16 non-qualified restoration plans. A third Missouri regulated utility, Great Plains
17 Energy Incorporated, recognizes base pay in its qualified pension plan but has a
18 non-qualified restoration plan and supplemental benefits.

19 **Q. HAS STAFF EVER ELIMINATED THESE SUPPLEMENTAL BENEFIT**
20 **PROGRAMS FROM OTHER UTILITY COMPANIES REVENUE**
21 **REQUIREMENT DETERMINATION?**

22 A. Not to my knowledge.

1 Q. HAS STAFF APPROVED SERP EXPENSES IN COST OF SERVICE
2 DETERMINATION IN PRIOR AQUILA RATE CASES?

3 A. Yes. Aquila's SERP has been in place since 1986. Those costs have never
4 previously been eliminated from cost of service determination. In Aquila's last
5 electric rate case in 2001, for example, Staff witness Graham Vesely listed at
6 page 12 of his direct testimony, "Benefits Supplemental Retirement," Source
7 Code 1725, as a benefit he specifically recommended to be included in the cost
8 of service. This source code is for supplemental employee retirement program
9 expenses.

10 Q. STAFF WITNESS HYNEMAN CITES ON PAGE 23, LINES 9-19 THAT
11 "AQUILA'S SERP WAS SIGNIFICANTLY MODIFIED ON JANUARY 1, 2001
12 TO ADD ADDITIONAL SERP BENEFITS." WHY WERE THESE
13 MODIFICATIONS NEEDED?

14 A. Aquila's Pension and Benefits Committee of the Board increased SERP benefits
15 as a result of a third party studies conducted by Hewitt Associates and Mercer
16 that revealed that Aquila's executive retirement program provided 17% less
17 retirement benefits than peer utility companies. Aquila's 1998 plan design
18 objective was to restore lost benefits due to the IRS maximum salary limits
19 described above. Per the Mercer study, most peer companies included bonus
20 income in the calculation of supplemental benefits while Aquila only included
21 base pay. Consequently, in 2001 Mercer recommended that Aquila's plan be
22 amended to include bonus pay in order to make up the deficiencies in executive
23 retirement benefits.

1 In order for executives to receive supplemental SERP benefit, they must attain
2 age 55 or have 10 years of service. Consequently, if they leave Aquila before
3 *meeting those requirements, executives forfeit their restoration and supplemental*
4 SERP benefits, thereby reducing the cost of the plan to the company.
5 *Additionally, highly compensated employees have a greater portion of their total*
6 *pay in variable compensation. While annual incentives may contribute 5-10% of*
7 *a typical employee's cash compensation, annual incentives may contribute more*
8 *than 30% of an executive's cash compensation.*

9 **Q. STAFF STATES THAT "GIVEN AQUILA'S CURRENT FINANCIAL**
10 **DIFFICULTIES, THE STAFF DOES NOT BELIEVE IT IS AN APPROPRIATE**
11 **TIME TO REWARD AQUILA'S TOP EXECUTIVES BY PROVIDING THEM**
12 **WITH ADDITIONAL RETIREMENT BENEFITS." DO YOU AGREE WITH**
13 **STAFF'S CONCLUSION?**

14 A. No. The primary modification to our plan accomplished a program design that
15 brought executive retirement benefit levels more in line with the market, while at
16 the same time implementing incentives for improved performance. Aquila
17 disagrees with Staff's belief that Aquila rewards executives when the company is
18 going through financial difficulties. It appears that Staff is criticizing a provision
19 that accomplishes exactly what they endorse. The modification to include
20 incentive compensation in the determination of SERP benefits will not increase
21 those benefits unless executive performance is superior.
22 Staff incorrectly assumes that this modification would have had a positive impact
23 on SERP compensation during the test year. It did not. Because supplemental

1 executive retirement benefits include bonus income, during years in which bonus
2 income is reduced or not paid, executive retirement benefits are reduced.

3 Aquila's senior management did not receive bonus awards for fiscal year 2002
4 and will not receive bonus awards for fiscal year 2003. SERP compensation is
5 defined as consecutive years of salary plus bonus. In periods where no bonus is
6 earned, the covered compensation and SERP benefit is reduced. Additionally,
7 Aquila's senior management did not receive any base pay increases in 2003 and
8 will not receive increases in 2004. This will also affect their SERP retirement
9 income. Consequently, Aquila's SERP plan design is "self-adjusting" by reducing
10 retirement income opportunities in years that executives do not receive bonus or
11 base pay increases.

12 **Q. STAFF CITES ON PAGE 24, LINES 7 - 8 THAT THE CHANGE IN CONTROL**
13 **(CIC) PROVISION OF THE SERP "IS NOT A COST THAT COULD**
14 **REASONABLY BE CONSIDERED NECESSARY TO OPERATE A UTILITY**
15 **COMPANY." ARE YOU IN AGREEMENT?**

16 **A.** No. SERP CIC provisions were present in the Plan document during the last test
17 year. The SERP plan document was amended and restated on January 1, 1998
18 to

- 19 • include CIC provisions (Section 1.2 of the Plan document). The Plan was
20 again amended in November 2000 to fund the Plan's trust in event of a
21 CIC.

- 1 • CIC provisions do not create an expense. For example, when the CIC
2 provision was added in 1998 and amended in 2000, there were no
3 increased expenses.
- 4 • The CIC funding provision does not increase the cost of the SERP to the
5 acquiring company. The provisions of the SERP define the benefit level
6 that may be earned by the participant. The CIC funding provision simply
7 sets aside ("funds") the cash necessary for the anticipated cost of the
8 SERP benefits in the event of a CIC event. This provision is designed to
9 ensure funds are dedicated to the exclusive purpose of satisfying the
10 obligations of the SERP.

11 **Q. ON PAGE 25 LINES 3 - 6 STAFF STATES "THE ACCOUNTING FOR THE**
12 **SERP ON A CASH BASIS, WHICH AQUILA DID FOR MANY YEARS, WAS**
13 **APPROPRIATE. AQUILA WAS NOT REQUIRED BY ANY ACCOUNTING**
14 **REGULATORY BODY TO CHANGE THE METHOD OF ACCOUNTING FOR**
15 **THE SERP, BUT IT DECIDED TO DO SO ON ITS OWN." DO YOU AGREE**
16 **WITH STAFF'S VIEW?**

17 **A.** Aquila disagrees with Staff's view. Aquila believes that it is prudent for purposes
18 of total disclosure to all stakeholders and compliance with FAS 87 to change
19 accounting methods. Per Aquila's actuary, Hewitt Associates, the proper SERP
20 accounting should be under FAS 87 rules, similar to our qualified pension plan.
21 Because of the accounting change to FAS 87 rules from pay as you go
22 accounting, Aquila was required to expense a Prior Service Cost of \$11.6 million
23 that will be recognized over 11 years beginning with fiscal year 2002.

1 Q. DOES THIS COMPLETE YOUR REBUTTAL?

2 A. Yes.