

Exhibit No.:

Issues: SERP

Witness: Philip M. Beyer

Sponsoring Party: Aquila Networks-MPS  
& L&P

Case No.: ER-2004-0034 &  
HR-2004-0024  
(Consolidated)

Before the Public Service Commission  
of the State of Missouri

Rebuttal Testimony

of

Philip M. Beyer

**FILED<sup>3</sup>**

APR 28 2004

Missouri Public  
Service Commission

Exhibit No. 75  
Case No(s) ER-2004-0034  
Date 2/23/04 Rptr KF

**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 NOS. ER-2004-0034 AND HR-2004-0024 (CONSOLIDATED)**

1 Q. Please state your name and business address.

2 A. My name is Philip Beyer, and my business address is 20 W. 9<sup>th</sup> Street,  
3 Kansas 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  
7 Aquila's Supplementary Executive Retirement Plan (SERP) should be  
8 excluded from cost 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 to attract  
11 and retain quality individuals at the executive level. SERP type programs are standard  
12 within the industry and it is necessary for Aquila to have this program in order to provide  
13 competitive compensation plans. The SERP is an integral part of meeting Aquila's  
14 retirement program objectives.

15 Q. Please describe Aquila's retirement objectives for its employees.

16 A. Aquila's retirement program objective is to provide replacement of 70% of pre-retirement  
17 income at age 62 for employees with 25 years of service who contribute 6% to the 401(k)  
18 plan. The 70% includes Social Security retirement benefits.

1 Q. What retirement program does Aquila offer?

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

5 Q. Do any of Aquila's tax-qualified plans include bonus income?

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

8 Q. If Aquila executives participate in the pension and 401(k)/profit sharing plan, why does  
9 Aquila provide a supplemental plan for executives?

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

12 Q. Please explain.

13 A. The Aquila SERP restores benefits to employees whose benefits are lost under limitations  
14 imposed by the IRS Code [Code Sec. 415(b)(1)(a) and 401(a)(17)] that apply to qualified  
15 retirement benefits. For example, the 2004 IRS 401(a)(17) maximum salary limit is  
16 \$205,000. If an executive earns \$225,000 during 2004, only \$205,000 of the \$225,000  
17 can be used in the calculation of benefits in Aquila's qualified pension plan. In this  
18 example, the Aquila SERP restores the benefit that would have been provided without the  
19 IRS limit. Restoration plans like Aquila's are not intended to provide enhanced benefits.  
20 They are limited to restoring lost benefits due to the tax law.

21 Q. Staff states in testimony beginning on page 26, Line 19 that "In Staff's view, that since  
22 Aquila's SERP eligible employees have been or are members of the Aquila 401(k) and

1 pension plan, these plans provide sufficient retirement benefits for all of its employees  
2 and the addition of another retirement plan is excessive. Do you agree with Staff's view

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

17 Q. Do other utility companies provide restoration benefits to their executives?

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

1 Q. Do any regulated utilities in Missouri offer restoration and supplemental benefits to their  
2 executives?

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

8 Q. Has Staff ever eliminated these supplemental benefit programs from other utility  
9 companies revenue requirement determination?

10 A. Not to my knowledge.

11 Q. Has Staff approved SERP expenses in cost of service determination in prior Aquila rates  
12 cases?

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

19 Q. Staff cites on page 26, Lines 8-18 that "Aquila's SERP was significantly modified on  
20 January 1, 2001 to add additional SERP benefits." Why were these modifications  
21 needed?

22 A. Aquila's Pension and Benefits Committee of the Board increased SERP benefits as a  
23 result of a third party studies conducted by Hewitt Associates and Mercer that revealed

1 that Aquila's executive retirement program provided 17% less retirement benefits than  
2 peer utility companies. Aquila's 1998 plan design objective was to restore lost benefits  
3 due to the IRS maximum salary limits described above. Per the Mercer study, most peer  
4 companies included bonus income in the calculation of supplemental benefits while  
5 Aquila only included base pay. Consequently, in 2001 Mercer recommended that  
6 Aquila's plan be amended to include bonus pay in order to make up the deficiencies in  
7 executive retirement benefits.

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

15 Q. Staff states that "Given Aquila's current financial difficulties, the Staff does not believe it  
16 is an appropriate time to reward Aquila's top executives by providing them with  
17 additional retirement benefits." Do you agree with Staff's conclusion?

18 A. No. The primary modification to our plan accomplished a program design that brought  
19 executive retirement benefit levels more in line with the market, while at the same time  
20 implementing incentives for improved performance. Aquila disagrees with Staff's belief  
21 that Aquila rewards executives when the company is going through financial difficulties.  
22 It appears that Staff is criticizing a provision that accomplishes exactly what they

1 endorse. The modification to include incentive compensation in the determination of  
2 SERP benefits will not increase those benefits unless executive performance is superior.  
3 Staff incorrectly assumes that this modification would have had a positive impact on  
4 SERP compensation during the test year. It did not. Because supplemental executive  
5 retirement benefits include bonus income, during years in which bonus income is reduced  
6 or not paid, executive retirement benefits are reduced. Aquila's senior management did  
7 not receive bonus awards for fiscal year 2002 and will not receive bonus awards for fiscal  
8 year 2003. SERP compensation is defined as consecutive years of salary plus bonus. In  
9 periods where no bonus is earned, the covered compensation and SERP benefit is  
10 reduced. Additionally, Aquila's senior management did not receive any base pay  
11 increases in 2003 and will not receive increases in 2004. This will also affect their SERP  
12 retirement income. Consequently, Aquila's SERP plan design is "self-adjusting" by  
13 reducing retirement income opportunities in years that executives do not receive bonus or  
14 base pay increases.

15 Q. Staff cites on Page 25, Line 22 to Page 26, Line 7 that the "Change in Control"(CIC)  
16 provisions of the SERP are not a cost that could reasonably be considered necessary to  
17 operate a utility company. Are you in agreement?

18 A. No. SERP CIC provisions were present in Plan document during the last test year. The  
19 SERP plan document was amended and restated on January 1, 1998 to  
20 include CIC provisions (Section 1.2 of the Plan document). The Plan was again  
21 amended in November 2000 to fund the Plan's trust in event of a CIC.  
22 CIC provisions do not create an expense. For example, when the CIC provision  
23 was added in 1998 and amended in 2000, there were no increased expenses. The

1 CIC funding provision does not increase the cost of the SERP to the acquiring  
2 company. The provisions of the SERP define the benefit level that may be  
3 earned by the participant. The CIC funding provision simply sets aside ("funds")  
4 the cash necessary for the anticipated cost of the SERP benefits in the event of a CIC  
5 event. This provision is designed to ensure funds are dedicated to the exclusive purpose  
6 of satisfying the obligations of the SERP.

7 Q. On Page 27 lines 1-6 Staff states "The accounting for the SERP on a cash basis, which  
8 Aquila did on a cash basis, which Aquila did for many years was appropriate. Aquila  
9 was not required by any accounting regulatory body to change the method of accounting  
10 for the SERP, but it decided to do so on its own." Do you agree with Staff's view?

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



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

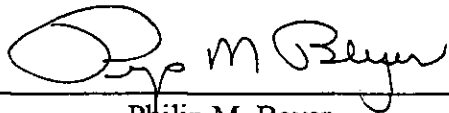
In the matter of Aquila, Inc. d/b/a Aquila Networks-MPS and Aquila Networks-L&P, for authority to file tariffs increasing electric rates for the service provided to customers in the Aquila Networks-MPS and Aquila Networks-L&P area	)	)	)	)	)	Case No. ER-2004-0034
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In the matter of Aquila, Inc. d/b/a Aquila Networks-L&P, for authority to file tariffs Increasing steam rates for the service provided To customers in the Aquila Networks-L&P area	)	)	)	)	)	Case No. HR-2004-0024
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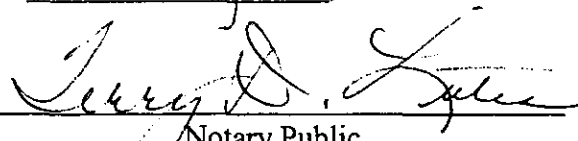
County of Jackson )  
 ) ss  
 State of Missouri )

**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 entitled "Rebuttal Testimony of Philip M. Beyer;" that said testimony was prepared by him and 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 23 day of January, 2004.

  
 \_\_\_\_\_  
 Notary Public  
 Terry D. Lutes

My Commission expires:  
8-20-2004

