2006.11.01 11:56:37
Kansas Corporation Commission
/S/ Susan K. Duffy

**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

07-AQLG-431-RTS

In the Matter of the Application of Aquila, Inc.,	)	
d/b/a Aquila Networks-KGO, For Approval of	)	
the Commission to Make Certain Changes	)	Docket No. ______________
in its Rates For Natural Gas Service	)	

Direct Testimony of Ruth H. Gustin

Manager, Employee Benefits
Aquila, Inc.

Health Care Expense

November 2006

1 **Q. Please state your name and business address.**

2 A. My name is Ruth H. Gustin, and my business address is 20 W. 9th Street,

3 Kansas City, MO 64105.

4

5 **Q. By whom are you employed and in what capacity?**

6 A. I am employed by Aquila, Inc. as Employee Benefits Manager. In that capacity,

7 I am responsible for managing the day-to-day administration of Aquila's

8 employee benefit plans.

9

10 **Q. Please state your educational background and business experience.**

11 A. Certified Employee Benefits Specialist. I have been employed by Aquila for 8

12 years. Previously, I was the Director of Human Resources at H&R Block.

13

14 **Q. Have you ever testified before any regulatory commission?**

15 A. Yes, I submitted direct testimony before the Kansas Corporation Commission.

16

17 **Q. What is the purpose of your testimony?**

18 A. The purpose of my testimony is to support the adjustment for escalating health

19 care expenses included in Pro Forma Adjustment No. 9.

20

21 **Q. Please describe your supporting documents.**

22 A. Adjustment No. 9 is the allocated cost of providing medical coverage to Kansas

23 employees. My supporting documents are for corporate-wide health care costs.

1 Exhibit No.______(RHG-1) is the projected increase in medical insurance
2 premiums for 2007. This estimate comes from Pricewaterhouse Coopers LLP.
3 and is based on actual claims paid for the twelve months ending June 30, 2006.
4 Exhibit No. ______(RHG-2) shows the history of medical cost increases and is
5 taken from Hewitt's "Health Care Expectations: Future Strategy and Direction
6 2006." Exhibit No. ______(RHG-3) is taken from a September 2005 press
7 release which summarizes the results of the 2006 Towers Perrin Health Care
8 Cost Survey. Exhibit Nos. _____(RHG- 2) and ______(RHG-3) demonstrate the
9 reasonableness of the trend factor used to calculate Aquila's 2007 medical
10 premium equivalents.
11
12 **Q. Is medical insurance the only component of this adjustment?**
13 A. No, in addition to the medical insurance premiums, there is the dental plan and
14 vision plan. These are minor compared to the medical insurance component,
15 and their annual increases have been projected for budgeting purposes. Mr.
16 Richard Petersen will address the impact of all health care increases on Kansas
17 operations.
18
19 **Q. How fast are health care costs rising?**
20 A. Aquila's overall medical plan rate increase for active employees in 2007 will be
21 14.8%, as shown on Exhibit No. ______ (RGH –1).
22
23

1 **Q. What accounts for this rapid increase in health care costs?**

2 A. The average age of active Aquila employees is 45. As employees age, their
3 physical health tends to decline requiring greater medical and Rx services.
4 Additionally, medical inflation exceeds the general inflation rate and new
5 technology and other factors have increased the cost of services.

6

7 **Q. What has Aquila done to control health care costs?**

8 A. Aquila's medical cost increases for the five years prior to 2007 averaged under
9 10% per year, while the national average for similar preferred provider plans
10 was up to 8.2% higher. Aquila has continued to control costs by negotiating
11 lower discounts with its health care provider networks, including renegotiating
12 prescription plan rates through the employer coalition that Aquila joined in 2005,
13 introducing and continuing to promote a "consumer directed" health plan option
14 designed to give employees more involvement in management of their health
15 care dollars, and continuing to emphasize the importance of health
16 management and lifestyle changes through the HealthyPath program.
17 HealthyPath is a program initiated in 2004 that offers health risk assessments,
18 personal health nurse coaches, weight control assistance, fitness and other
19 health-related programs. These offerings are complimented by online tools that
20 employees can use to make better decisions about their utilization of health care
21 services. Because health status and health care consumerism are only two
22 factors that affect medical costs, we expect medical cost increases to continue
23 to rise in spite of these efforts.

1

2 **Q. Are health care costs expected to decline in the foreseeable future?**

3 A. No, as the population in general ages and requires greater health care services
4 demand for medical services will continue to increase; in addition, medical
5 inflation is expected to increase due to new technologies and other factors.
6 Aquila's objective in offering HealthyPath and the consumer-directed health plan
7 model is to engage employees in helping to reduce the trend of medical cost
8 inflation for the company. Aquila will also continue to seek ways to limit future
9 cost increases by managing administrative costs of operating the plans and
10 promoting utilization of medical providers and medical care that offer the best
11 quality and cost value to participants.

12

13 **Q. Does this conclude your testimony at this time?**

14 A. Yes.

VERIFICATION

STATE OF Missouri)
)ss:
COUNTY OF Jackson)

Ruth H. Gustin, being first duly sworn, deposes and says that he is Ruth H. Gustin, referred to in the foregoing document entitled "Direct Testimony of Ruth H. Gustin" before the State Corporation Commission of the State of Kansas and the statements therein were prepared by him or under his direction and are true and correct to the best of his information, knowledge and belief.

Ruth H. Gustin

SUBSCRIBED AND SWORN to before me this 12 day of October, 2006.

Beth A. Foraker
Notary Public

My Appointment Expires:

BETH A. FORAKER
Notary Public - Notary Seal
State of Missouri - County of Jackson
My Commission Expires Jun. 25, 2010
Commission #06432785

Exhibit II
Aquila Inc.
Active Medical Underwriting
(1/1/2007 - 12/31/2007)

	MedPlus	Basic Care	Your Choice	COBRA*	Total Actives
Medical Paid Claims (Active: 7/1/05 - 6/30/06)	$13,463,575	$696,022	$954,667	$181,586	$15,295,851
High Claimant Adjustment[1]	$232,417	$20,485	$55,985	$2,402	$311,289
Estimated Humana claims (101% loss ratio/plan differential)	$308,107	$0	$0	$0	$308,107
Total Medical Paid Claims adjusted for High Claimants	$13,539,264	$675,537	$898,682	$179,185	$15,292,668
Setback Number of Employees	2,177	192	525	23	2,916
Annual Trend	10%	10%	10%	10%	10%
Months of Trend	20	20	20	20	20
Projected 2007 Incurred Medical Claims Per Capita	$7,289	$4,126	$2,008	$9,335	$6,147
Prescription Net Paid Claims (7/1/05 - 6/30/06)**					$4,262,902
Average # of employees					2,867
Annual Trend					15%
Months of Trend					18
Adjusted Projected 2007 Incurred Rx Claims Per Capita	$1,834	$1,834	$1,834	$1,834	$1,834
Projected 2007 Incurred Medical & Rx Claims Per Capita	$9,122	$5,960	$3,842	$11,169	$7,980
Current Enrollment Adjusted Projected 2007 Incurred Claims Per Capita	$9,122	$5,960	$3,842	$11,169	$8,072
Adjustment for plan design changes on 1/1/05	1.000	1.000	1.000	1.000	
Adjusted Projected 2007 Incurred Medical & Rx Claims	$9,122	$5,960	$3,842	$11,169	$8,072
Administration Charge Per Employee [2]	$647	$647	$647	$647	$647
Pooling Charge ($225,000 level with Agg) Per Employee[3]	$142	$142	$142	$142	$142
Full HRA Funding Per Employee ($500 single/$1000 family)***	$0	$0	$851	$0	$135
Required Premium Per Employee	$9,912	$6,749	$5,483	$11,958	$8,996
Current Number of Employees	2,084	197	434	20	2,735
Total Required Premium for 2007	$20,656,277	$1,329,601	$2,379,649	$239,162	$24,604,690
Annual Premium Based On 2006 Rates	$17,007,488	$1,422,184	$3,039,517	$161,448	$21,630,637
Required Increase / Decrease	21.5%	-6.5%	-21.7%	48.1%	13.7%
Suggested Rate Action	**14.8%**	**14.8%**	**7.4%**	**14.8%**	
Restated 2007 Premium Based on Suggested Rate	$19,524,596	$1,632,667	$3,264,441	$185,342	$24,607,047

[1] High claimant adjustment assumes 75% recovery of the individual stop loss charge ($11.86 PEPM).
[2] Per current RFP, the ASO fee is $49.03 PMPM with a cap of 6% in 2008 and 8% in 2009; Future Health Disease Management cost PEPM is $4.06; $0.55 for Nurse Line.
[3] Per current RFP, the Individual Stop Loss premium is $11.86.
* COBRA premiums are assumed based on current enrollment and average rate and plan elections.
** Pharmacy claims are net of rebates ($461,000).
*** HRA claims paid from April 05 through March 06 were $149,232.
This report does not include healthcare incentives

Exhibit ____ (RHG-1)

Strategic Direction

But Expected Increases Continue to Outpace What Companies Can Pay

Although the *overall* average expected cost increase for health care benefits is down slightly from last year—10% this year versus 12% last year—cost increases still exceed what nearly one-half of participants can afford.

Among the 45% of respondents who indicated a specific percentage, the maximum added cost organizations can absorb each year over the next five years (average) is 7%.[1]

Employers have consistently stated that they can afford a rate of increase that is 3% to 7% less than the actual increase. Over time, this difference is unsustainable, but companies have not yet felt the need to make dramatic changes to their programs.

Health Care Expectations Survey Year	Anticipated Overall Cost Increase (Average Percent)	Maximum Added Costs Organizations Can Absorb (Average Percent)	Health Care Benefit Budget Gap
2003	16%	9%	7%
2004	14%	9%	5%
2005	12%	8%	4%
2006	10%	7%	3%

[1] Twenty percent indicated they can absorb "Whatever competitors are paying" and 36% indicated they can absorb "Whatever the market requires."

Source: "Health Care Expectations: Future Strategy and Direction 2006"

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TOWERS PERRIN PROJECTS AN 8% INCREASE IN EMPLOYER-SPONSORED HEALTH CARE COSTS FOR 2006 AS ANNUAL COST PER EMPLOYEE REACHES $8,424

After Five Years of Double-Digit Increases, the Crisis Turns Chronic for U.S. Businesses

Some Employers Take Action to Control Costs And Minimize Cost Shift to Employees

STAMFORD, CT, SEPTEMBER 28, 2005 — According to the *2006 Towers Perrin Health Care Cost Survey*, U.S. employers are facing an 8% increase in their 2006 health care costs. Moreover, the cumulative effect of years of double-digit increases has produced a record high for employer-sponsored health care costs in America. In flat dollar terms, next year's gross health care expenditure is expected to rise by an average of $597 per employee, to an average total cost of $8,424 — representing a 140% increase over the last 10 years.

Employers continue to shoulder the majority of the burden. Employees on average will pay $155 more in 2006, representing a 10% increase from the year before. Employers, on the other hand, will see an increase of $442 per employee, absorbing 74% of the total cost increase. Overall, employers will pay 80% of premium costs and employees will pay 20%.

Notably, while the average cost of health care coverage will increase by $597 per employee in 2006, this figure would have been close to $750 were it not for employer efforts to aggressively manage program performance through vendor selection and performance management, prescription drug expenditures, care management, employee engagement and other initiatives.

These observations are drawn from top-line results of the annual survey, now in its 17th year, conducted by Towers Perrin's HR Services Business. This year's survey includes data on the health benefit programs provided by more than 200 of the nation's largest employers, covering over five million U.S. employees, retirees and dependents.

"The health care cost crisis has become a chronic problem for U.S. employers and employees alike," said David Guilmette, Managing Director of Health and Welfare for

Towers Perrin. "There is a fundamental tension between managing costs and managing people that constrains how much of the cost can be shifted to employees. Given the huge cost base built up over the years and continuing inflation at rates well above CPI, employers simply have to take a longer-term view. With this perspective as a platform, some employers are moving toward a model that increases employees' responsibility and accountability — engaging them in a long-term solution to a problem that is not going away. And these companies are beginning to see positive outcomes and a significant difference in program performance."

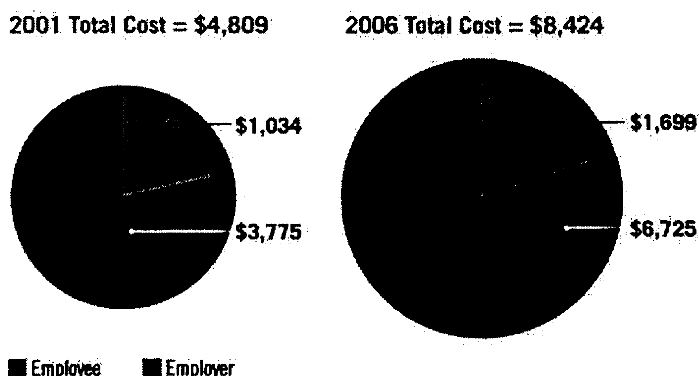
A Crisis Turns Chronic

A historical view highlights the magnitude of the health care cost problem and why cost inflation — whether at single- or double-digit rates — now produces significant additional burdens for both employers and employees (*Exhibit 1*). Employees are paying 64% more in health care costs today than they spent five years ago. Employers, meanwhile, are paying 78% more in health care costs today than five years ago.

Employers continue to bear the lion's share of the cost, and although cost-shifting in past years has increased employees' relative share, the 2006 survey suggests that employers recognize the need to look beyond stopgap "fixes" that simply shift costs and may have negative consequences for effective workforce management over the longer term.

For example, this year's survey shows that the average employee share of premium costs will increase 10% in 2006, while the employer share will increase by 7%. In the 2005 survey, the cost increases experienced by employees and employers were 12% and 8%, respectively. In the 2006 survey, the bulk of the increase in the dollar amounts contributed by employees is due to inflation on their share of the premium, with less impact coming from cost shifting (increasing the employees' percentage of the cost).

EXHIBIT 1
Total Employee/Employer Health Care Costs: 2001 – 2006



Active Employee and Retiree Medical Costs Continue to Climb

The average reported 2006 cost of medical coverage for all types of health plans combined is $355 per month ($4,260 annually) for active employee-only coverage; $715 per month ($8,580 annually) for employee-plus-one-dependent coverage and $1,033 per month ($12,396 annually) for family coverage (*Exhibit 2*).

Exhibit 2

Average 2006 Monthly Health Care Costs and Cost Increases by Covered Group

	Employee/ Retiree Only	Employee/ Retiree Plus Spouse	Family	Average Increase From 2005
Active employees	$355	$715	$1,033	8%
Retirees under age 65	$562	$1,106	$1,408	10%
Medicare-eligible retirees	$279	$576	NA	7%

The total cost for retirees under age 65 is the highest in our survey — $562 per month for retiree-only coverage ($6,744 annually) and more for coverage that includes dependents. Notably, the rate of cost increase for this group is higher than for active employees — 10% versus 8% for active employees — a trend that has persisted in employer-sponsored plans since 1999. This is of particular concern for employers who have large postretirement medical obligations.

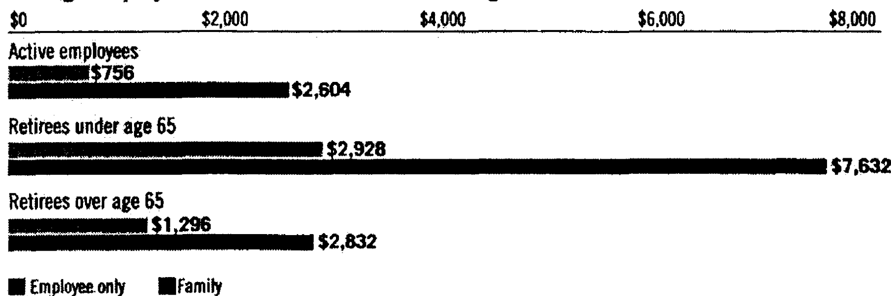
Meanwhile, the Medicare Modernization Act is changing the landscape for employer-sponsored retiree medical programs. With a 2006 effective date for Medicare Part D on the horizon, the vast majority (83%) of the survey respondents who offer retiree medical say they will provide prescription drug coverage at least as rich as Medicare's new program and take the federal subsidy offered to employers who provide this benefit.

For many companies, however, the 2006 approach could be an interim step toward a new strategy for the longer term as the impact of rising costs, changing demographics and the new Medicare law combine. Notably, over half (53%) of responding companies offering retiree medical say the Medicare changes will prompt them to rethink their commitments to *all* retirement programs, including both medical and retirement income benefits.

Employees Have More at Stake

Despite what appears to be a slowdown in costshifting, the data suggest that the trend toward greater sharing of costs between employers and employees is still under way. And in flat dollar terms, the employee share represents a significant cost by any standard (*Exhibit 3*). Employees will contribute 18% of the premium cost for employee-only coverage and 21% for dependent coverage (20% overall) — an average of $63 a month ($756 annually) for employee-only coverage and $217 a month ($2,604 annually) for family coverage in 2006.

Retirees, meanwhile, will contribute approximately 43% of the total cost of their coverage. Retirees under 65 will pay an average of $244 a month ($2,928 annually) for retiree-only coverage, while retirees age 65 and older will pay an average of $108 a month ($1,296 annually) for retiree-only coverage.



"As health care costs continue to rise faster than the rate of general inflation, it's more important than ever for employees to actively participate in controlling the overall spend and realize that increasing costs will affect them in both direct and indirect ways," said Guilmette. "Clearly, as the company's health care costs increase, the employee's cost goes up as well. Continuing high inflation rates mean that employees' out-of-pocket health care expenses will also rise. And, at the end of the day, employees need to recognize that a larger piece of the total compensation pie is being taken up by health care costs."

"The money has to come from somewhere, and increasingly we're seeing it come from resources set aside to reward employee performance," adds Ron Fontanetta, Principal in the Towers Perrin Health and Welfare practice. "Health care has become a tremendous financial burden on employers, and unless health care cost increases moderate, the funds available for compensation and rewards will be reduced. Moreover, as employees plan for retirement, they need to factor in health care premium costs because future retirees will often have to pay the entire amount."

Beyond the Averages: Creative Actions Can Drive Positive Results
The survey data overall tell a sobering story, but the averages don't give the complete picture — i.e., the data also show significant variations in both the flat dollar and percentage cost increases experienced by U.S. companies and their employees. And the survey results suggest that companies with lower-than-average costs are doing some creative things — notably, taking a comprehensive, longer-term approach to cost management and actively engaging employees in the process.

To better understand the factors that contribute to lower costs, the Towers Perrin analysis divides the survey group into three categories — low-cost companies (companies in the lower third, with the lowest premium level per employee), average cost (the middle third) and high cost (the upper third, experiencing the highest cost per employee).

The cost variation across these groups is significant, with companies in the upper third facing a total cost of $10,022 per employee in 2006, against a $6,866 per employee cost for companies in the lower third. The rate of cost increases for the two groups — 9% versus 6%, respectively — is also notable (*Exhibit 4*). "While some variations in health care costs can be explained by differences in geography or employee demographics, many companies are experiencing better cost containment as a direct result of proactive steps they have taken," said Guilmette.

Exhibit 4
Cost Variation Across Companies: Top Third vs. Bottom Third

	High-Cost Companies	Low-Cost Companies
Cost per employee per year	$10,022	$6,866
Increase in employer cost	9%	6%
Increase in employee cost	14%	7%

Looking more closely at what distinguishes these groups, a number of key findings come to light. First, the low-cost companies seem to be looking at all aspects of their vendor relationships for quality of care, efficiency and cost-saving opportunities. For example, these companies are more likely than their high-cost counterparts to have consolidated vendors or implemented enhanced vendor performance standards/service levels. They are also much more likely to have implemented processes to monitor the results of their care management initiatives.

Aggressive vendor management does appear to yield results that go beyond the impact of geographic and demographic differences. And, while the average increase for HMOs in this year's survey is 9% (compared with 7% for other plans overall), for the "low cost" companies, the average HMO increase is only 7%. "Smart employers are managing their HMOs using tactics that have been successful with PPOs, such as terminating poor-performing vendors and using self-insured arrangements," noted Fontanetta.

"The gains achieved through aggressive program management allow these employers to minimize any cost shift to employees, as shown in the contrast between the rate of cost increases for employees at high-cost versus low-cost companies," added Fontanetta.

Relief from cost shifting does not mean, however, reduced responsibility for employees at the low-cost companies. In fact, companies with the lowest health care costs are more likely to be sharing more of the costs as a percentage of the total with employees — i.e., employees at low-cost companies pay on average 22% of the total, while employees at high-cost companies pay 17% (*Exhibit 4*).

The companies with lower costs are also more likely to have put other cost-sharing elements into place that encourage employees to take responsibility for their decisions at the point of care. For example, the differential between the copay amount for brand-name drugs compared with that for generic drugs is greater for employees at low-cost companies than for those at high-cost companies, creating a stronger incentive to use the less expensive alternative. Other incentives aimed at increasing employee accountability include meaningful differentials between primary care and specialist copays, along with a move away from copays altogether to coinsurance — a trend much more prevalent among the low-cost companies.

Perhaps most important, companies with the lowest costs are not only requiring employees to take more responsibility for their health care decisions, but are also equipping them to do just that by communicating more effectively about health care costs, providing decision support tools and encouraging them to understand and manage their health risks.

"Most of the companies in the survey say they see their role and responsibility as employers continuing as it is or even growing over the next five years," said Guilmette. "In other words,

they see themselves *in the game* for the foreseeable future. But it's interesting to note that companies with lower costs also seem to have more of a long-term philosophy and are taking actions that minimize the need to shift costs to employees.

"For employees who work at these more proactive companies, there is a quid pro quo. They must actively share responsibility, understand and accept the financial consequences of their decisions, and protect and invest in their own health," added Guilmette. "Overall, we call this a culture of health — employers and employees *together* managing the money, managing the vendors and providers, and sharing a commitment to the value of employee health."

About the Survey

The *Towers Perrin 2006 Health Care Cost Survey* was conducted during August and September 2005. Participants were asked to report their 2006 per capita premium costs for insured health and dental plans, and premium equivalents (i.e., estimated benefit and administrative costs) for self-insured plans. Survey respondents represent primarily *Fortune* 1000 companies with operations in numerous locations nationwide. Health benefits for the 204 participating companies cost more than $24 billion annually.

About Towers Perrin

Towers Perrin is a global professional services firm that helps organizations improve their performance through effective people, risk and financial management. Through its HR Services business, Towers Perrin provides global human resource consulting that helps organizations effectively manage their investment in people. Areas of focus include employee benefits, compensation, communication, change management, employee research and the delivery of HR services. The firm's other businesses are Reinsurance, which provides reinsurance intermediary services, and Tillinghast, which provides management and actuarial consulting to the financial services industry. Together, these businesses have offices and business partner locations in 25 countries. More information about HR Services is available at www.towersperrin.com/hrservices.

EDITOR'S NOTE: *David Guilmette, Ron Fontanetta, Mark Olson and other Towers Perrin consultants are available for interviews on this topic. Please contact Joe Conway (914-745-4175) or Jerry Tolk (212-367-6831) to arrange for an interview.*

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