Exhibit No.:	
Issues:	*Employee Benefits including Pensions and OPEBs, Incentive Compensation & Katrina Bonus, Injuries and Damages, Insurance, Lobbying, Advertising, Dues, Donations and Miscellaneous Expenses*
Witness:	*Jeremy K. Hagemeyer*
Sponsoring Party:	*MOPSC*
Type of Exhibit:	*Direct Testimony*
Case Nos.:	*GR-2006-0387*
Date Testimony Prepared:	*September 13, 2006*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

JEREMY K. HAGEMEYER

ATMOS ENERGY CORPORATION

CASE NO. GR-2006-0387

Jefferson City, Missouri
September 2006

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company.	))))	Case No. GR-2006-0387

AFFIDAVIT OF JEREMY K. HAGEMEYER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Jeremy K. Hagemeyer, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 12 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Jeremy K. Hagemeyer

Subscribed and sworn to before me this 11 day of September 2006.

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

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

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DIRECT TESTIMONY

OF

JEREMY K. HAGEMEYER

ATMOS ENERGY CORPORATION

CASE NO. GR-2006-0387

Q. Please state your name and business address.

A. Jeremy K. Hagemeyer, 9900 Page Avenue, Suite 103, Overland, MO 63132.

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

A. I am employed by the Missouri Public Service Commission (MPSC or Commission) as a Utility Regulatory Auditor III.

Q. Please describe your educational background.

A. I graduated from Southwest Missouri State University, receiving a Bachelor of Science in Accounting in May of 2001.

Q. Please describe your duties while employed by the Commission.

A. I have assisted with audits and examinations of the books and records of public utility companies operating within the state of Missouri.

Q. Have you previously filed testimony before this Commission?

A. Yes. I have filed testimony in the Laclede Gas Company Rate Case No. GR-2002-356, and the Missouri American Water Company Rate Case No. WR-2003-0500. I also assisted, but did not file testimony in the Laclede Gas Company Rate Case No. GR-2004-0284.

Q. Did you make an examination and analysis of the books and records of Atmos Energy Corporation (Atmos or the Company) in regards to matters raised in this case?

A. Yes, in conjunction with other members of the Commission's Staff (Staff). I reviewed Staff data request responses, the general ledger, trial balance reports, a labor contract, past commission rulings, and prior case files.

EXECUTIVE SUMMARY

Q. What matters will you address in your testimony?

A. I will address employee benefits including pensions, and other post employment benefits (OPEBs), incentive compensation, lobbying, insurance, and injuries and damages expense.

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

A. I have reviewed the filed testimony, schedules, workpapers and data request responses regarding these issues in this case. I have also reviewed documents from previous rate cases involving the Missouri territories currently operated by Atmos and rate cases of other gas companies on the issues I will be addressing. In addition, I have relied on the accounting training I have received during college and the training I received through classes and seminars in utility regulation. I also have engaged in discussions with and received guidance and in-house training from my supervisors with regard to these issues in general and for this Company.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain and sponsor adjustments related employee benefits including pensions, and other post employment benefits (OPEBs), incentive compensation, advertising, miscellaneous costs, lobbying, insurance, and injuries and damages expense. I am proposing to disallowances of incentive compensation, advertising, miscellaneous expenses and lobbying costs.

EMPLOYEE BENEFITS

Q. Please explain the Staff's examination of employee benefits.

A. Staff examined employee benefits including basic life insurance, medical and dental insurance and the employee stock ownership plan. Staff examined the benefits by developing a percentage based on the relationship of benefits to the total test year payroll. Staff applied this percentage to its annualized payroll and compared it to the test year to develop its adjustment. Since the resulting adjustment was only a minimal change in employee benefits expense, the Staff believes that the test year amounts are an accurate reflection of ongoing costs.

INCENTIVE COMPENSATION & KATRINA BONUS

Q. Please explain adjustment for incentive compensation and Katrina bonus.

A. This adjustment removes the expense associated with Atmos' incentive compensation packages. The Management Incentive Plan, the Variable Pay Plan and the Long Term Incentive Plan (MIP, VPP and LTIP respectively) were based solely on Earnings Per Share (EPS) reaching a designated level. For the test year, the Company set a threshold of an EPS amount of $1.53. If the Company reached $1.53, participants in the VPP would receive an award equaling 1% of their base salary. If EPS met the target of $1.70, VPP participants would receive an award of 2% of their base salary. At the maximum level, EPS of $1.87, participants would receive 3% of their base salary. The MIP also used these EPS amounts, but the awards percentages were based on pay grades. Depending on the employee's pay grade and the EPS achieved, MIP participants could receive an award of 7.5% to 120% of base salary.

Q. What is the Staff's opinion of EPS as a basis for determining incentive compensation?

A. EPS is influenced by a whole host of factors completely outside of the control of the company's employees. For example, significantly colder than normal winter temperatures can drastically increase the level of earnings. In addition, other items like reductions in interest rates or tax changes can significantly increase earnings. These increases in earnings do not reflect improved management performance or efficiency that should be rewarded. Therefore, it is entirely inappropriate to pass the costs of such profit driven awards onto the ratepayers.

Q. Has the Commission ever provided guidelines for what would be an appropriate incentive plan?

A. Yes. In case number EC-87-114, the Commission clearly stated its conditions for acceptance of incentive plans. "At a minimum, an acceptable management performance plan should contain goals that improve existing performance, and the benefits of the plan should be ascertainable and reasonably related to the incentive plan."

Q. Does the MIP, the VPP or the LTIP meet all of these conditions?

A. No. None of the documentation associated with the plans list any goals that are required to be met as a measure of improvement in performance. The sole criteria for payout from these plans is the requisite EPS for the year. Using the example of weather, in a colder than average winter, gas usage would rise and revenues would increase. Earnings per share, assuming all other things being held constant, would increase due to no other reason than colder temperature.

Q. Has the Commission provided more recent guidance with regard to using financial performance in awarding incentive compensation packages?

A. Yes. In the 2004 Missouri Gas Energy case, GR-2004-0209, the Commission stated:

> Those financial incentives seek to reward the company's employees for making their best efforts to improve the company's bottom line. Improvements to the company's bottom line chiefly benefit the company's shareholders, not its ratepayers. Indeed, some actions that might benefit a company's bottom line, such as a large rate increase, or the elimination of customer service personnel, might have an adverse effect on ratepayers….the shareholders that benefit from that plan should pay the costs of that plan.

Given this guidance, the Staff has proposed that all expenses relating to Atmos' MIP, VPP and LTIP be borne by the shareholders of the Company, rather than its rate-payers.

Q. Does the Company have any other incentive plans?

A. Yes. The Company also offers a Customer Support Center Incentive. To be eligible to receive this bonus, customer support employees must meet attendance, quality call handling, and call handling time criteria.

Q. Does Staff support inclusion of the expense associated with this incentive plan in the cost of service calculation?

A. No. Staff has removed the expense associated with this plan. The Staff does not believe that the goals of the plan have been set at a sufficiently high enough level to justify an award. This is due to the fact that the Company's customer call handling performance has not meet both of the minimum standards to which the Company agreed in the Stipulation and Agreement for Case No. GM-2000-312. Also, in the Staff's opinion, merely showing up for work, should not be the basis for an award.

Q. Did Staff eliminate any Hurricane Katrina related Bonus costs?

A. Yes. Staff eliminated the allocated portion of the Hurricane Katrina Bonus. This bonus is related to the efforts of employees to restore service in territories other than Missouri. These costs should be borne by the ratepayers in those service territories.

INJURIES AND DAMAGES

Q. Please explain the Staff's injuries and damages adjustment.

A. This adjustment adjusts the test year level of injuries and damages expense to a normalized level of expense. This normalized expense level is based on a five-year average of actual cash outlays for claims made against the Company. The Staff averaged five years of data as a mechanism to smooth out any fluctuations.

INSURANCE

Q. Please explain your adjustment to Insurance.

A. The insurance adjustment was made to annualize the Company's cost of non-property insurance. The Staff based its annualization of the cost of insurance on the most current insurance premiums in effect on June 30, 2006.

LOBBYING

Q. Please explain the Staff's lobbying adjustment.

A. This adjustment was made to eliminate the salary associated with the Director of Governmental Affairs and to eliminate a partial amount of salary for the Vice President of Governmental & Public Affairs from the cost of service. Job descriptions provided in response to Staff data request No. 181 indicate that the role of the Director of Governmental Affairs is to supervise the Company's lobbying efforts. The Vice President of Governmental & Public Affairs performs lobbying roles, but also performs roles related to public relations. Therefore, Staff proposes to eliminate only a portion of the salary expense associated with the Vice President and eliminate completely the Director's salary from the cost of service.

Q. How was the portion of the Vice President's salary the Staff wishes to disallow calculated?

A. Staff asked the Company to determine the amount of time the Vice president spent on each activity listed in the job description. The percentage of time that corresponded to lobbying activities was used to calculate the disallowances.

Q. What has been the Commission's policy regarding lobbying expense?

A. In several past cases the Commission has disallowed the costs associated with lobbying. Specifically in Case No. 18,180 <u>In the matter of Missouri Public Service</u>

Company, Kansas City, Missouri, 20 Mo.P.S.C. (N.S.) 68, 105 (1975) and Case No. ER-83-49, In the matter of Kansas City Power & Light Company, 26 Mo.P.S.C. (N.S.) 104, 116 (1983), the Commission stated that the beneficiaries of lobbying activities are usually the stockholders of the company involved in lobbying. The Commission has also stated that the stockholders of a company involved in lobbying should be the ones to assume responsibility for these expenses unless the company offers substantial evidence for their inclusion in rates. Also, the Commission noted that it is very difficult, if not impossible, to say for certain how effective a lobbyist's actions may be, and thus the expenses related to lobbying cannot absolutely be shown to provide any benefit.

ADVERTISING

Q. Please explain the Staff's adjustments to advertising expense.

A. These adjustments restate the test year to reflect allowable levels of advertising expense.

Q. Please explain the history of such adjustments before the Commission.

A. The Commission, in its Report And Order for Case Nos. EO–85–185 and EO-85-224 involving Kansas City Power and Light Company (KCPL), adopted the following treatment which separates advertisements into five categories and provides separate rate treatment for each category. The five categories of advertisements recognized by the Commission for purposes of this approach are:

(1) General – advertising that is useful in the provision of adequate service;

(2) Safety – advertising which conveys the ways to use the Company's service safely and to avoid accidents;

(3) Promotional – advertising used to encourage or promote the use of the particular commodity the utility is selling;

(4) Institutional – advertising used to improve or retain the Company's public image; and

(5) Political – advertising associated with political issues.

The Commission adopted these categories for advertisements because it believed that a utility's revenue requirement should: (1) always include general and safety ads, provided such costs are reasonable; (2) never include the cost of institutional or political ads and; (3) include the cost of promotional ads only to the extent that the utility can provide cost–justification for the ads. (KCPL, pp. 50–51).

Q. What examination has the Staff performed in relation to the Company's advertising expenditures?

A. The Staff performed an advertisement-by-advertisement review of the advertisements provided by the Company in response to Data Request No. 35.

Q. How did the Staff determine each advertisement's classification under the KCPL standard?

A. To date, the Company has only provided the advertisements that it did not eliminate from the cost of service. All of the advertisements that were not eliminated provide for the dissemination of information necessary to obtain safe and adequate service. These advertisements are classified as general or safety and represent allowable advertising. The Company has not provided any of the advertisements that it eliminated from the cost of service in its case. As a result, these advertisements cannot be reviewed by the Staff and are assumed to be unallowable for inclusion in the cost of service.

DUES, DONATIONS AND MISCELLANEOUS EXPENSES

Q. Please explain the adjustments related to dues, donations and miscellaneous expenses.

A. These adjustments eliminate any dues, donations and miscellaneous expenses that, based on the Staff's examination, do not provide direct benefit to ratepayers and/or are duplicative of other expenses allowed in the cost of service. Staff currently has outstanding questions that must be answered in order to more fully review this area. Responses to these questions may require changes be made to Staff's calculations of the adjustment.

PENSION AND OPEB EXPENSES

Q. Please explain the Staff's adjustments for Pensions and Other Postretirement Employee Benefits (OPEBs) Expense.

A. These adjustments reflect Staff's calculations of Pension and OPEBs Expenses associated with the Company's three different pension plans and one OPEB plan. The Company currently has a qualified pension plan, a supplemental executive benefit pension plan (SEBP), a non-qualified retiree pension plan, and a retiree medical plan.

For purposes of calculating the pension expense associated with the qualified pension account plan and the retiree medical plan, Staff relied on the Financial

Accounting Standard (FAS) 87 and FAS 106, respectively, computations performed by the Company's actuary, Towers Perrin. Staff proposes a modification to these calculations to eliminate the "corridor" approach and amortizing unrecognized gains and losses over a ten-year period.

Q. Please explain what the "corridor" approach is and why Staff has chosen to eliminate it.

A. The "corridor" approach defines the minimum amortization of unrecognized gains and losses required under FAS 87 and FAS 106. The amount of the unrecognized net gain (loss) balance that must be amortized under FAS 87 and FAS 106 is the amount that exceeds 10% of the greater of the benefit obligation (PBO for pensions and APBO for OPEBs) or the market related value of the assets in the fund. Accordingly, the "corridor" is the amount equal to 10% of the PBO or market related value of assets, whichever is greater, as defined under FAS 87 and FAS 106. Since the PBO exceeds $300 million and the APBO exceeds $170 million, a significant amount of gains and losses are not considered for amortization under the corridor approach. Under the Company's calculation, gains and losses considered for amortization are amortized over a period exceeding 10 years. The effect of this calculation is to significantly lengthen the time it takes to fully amortize any unrecognized gains or losses. Staff believes that this lengthened amortization is unacceptable and therefore proposes that the corridor approach be eliminated and unrecognized gains or losses be amortized over a period of 10 years.

Q. Please explain why Staff has chosen to amortize unrecognized gains and losses over 10 years.

A. The Staff believes that it is important to recognize costs and benefits in rates in a timely manner. The delayed recognition resulting from the corridor approach does not accomplish this goal. The Staff believes that a ten-year amortization period is long enough to address any questions of volatility that may arise by using a shorter time period, yet short enough to achieve the goal of recognizing the cost or benefit of gain/loss amortization in a timely fashion.

Q. How did Staff determine the cost for the non-qualified and SEBP pension plans?

A. Staff has included the cost of these plans based on the actual payments that are made to retirees. Staff has made this recommendation because the FAS 87 calculation does not recognize any funding for these plans. A significant component of the FAS 87 calculation of pension expense is an offset to the cost due to the return on the plan's assets. Since the FAS 87 calculation for these plans does not recognize any funding, it is not reflective of the cost that should be included in rates.

Q. Does the Staff have any additional items to discuss regarding pensions and OPEBs?

A. Yes. In Case Nos. GR-95-160 and GR-97-272 the Commission authorized the inclusion in rates of OPEBs cost, based on a FAS 106 calculation, for United Cities Gas Company and Arkansas Natural Gas Company, respectively. This recognition was in response to Missouri Statute 386.315, which required inclusion in rates of FAS 106 cost, as long as the utility funded this amount in an external account.

During its audit, the Staff discovered that since Atmos acquired the Missouri territories of United Cities Gas in 1997 and Arkansas natural Gas in 2000, the Missouri portion of FAS 106 has not been funded. However, the Company has agreed to actuarially calculate and then fund a “catch-up” contribution to address this situation. The Staff received this calculation from the Company on September 11, 2006. As a result the Staff may need to file supplemental direct testimony to address any problems that it identifies after it has had adequate time to examine the Company’s calculation.

Q. Does this conclude your direct testimony?

A. Yes. It does.