Exhibit No.:	
Issues:	*Corporate Allocations, Incentive Compensation, Pension Tracker*
Witness:	*Keith Majors*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Rebuttal Testimony*
Case No.:	*GR-2014-0007*
Date Testimony Prepared:	*March 4, 2014*

MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION
UTILITY SERVICES - AUDITING

REBUTTAL TESTIMONY

OF

KEITH MAJORS

MISSOURI GAS ENERGY
A Division of Laclede Gas Company

CASE NO. GR-2014-0007

Jefferson City, Missouri
March 2014

REBUTTAL TESTIMONY

OF

KEITH MAJORS

MISSOURI GAS ENERGY

CASE NO. GR-2014-0007

Q. Please state your name and business address.

A. Keith Majors, Fletcher Daniels Office Building, 615 East 13th Street, Room G8, Kansas City, Missouri, 64106.

Q. Are you the same Keith Majors who filed direct testimony on these issues?

A. Yes, I am. I contributed to Staff's Cost of Service Report ("Staff Report") filed in the Missouri Gas Energy (MGE) rate case designated as Case No. GR-2014-0007 on January 29, 2014.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to respond to MGE witness Michael R. Noack's Direct testimony which supports:

1. MGE's Schedule H-8, MGE's corporate allocation adjustment,
2. Schedules E-5 and H-5 which support MGE's pension adjustment and tracker balance, and
3. MGE's test year expenses, which includes incentive compensation expense.

CORPORATE ALLOCATIONS

Q. Please summarize the issue between Staff and MGE concerning corporate allocations.

A. MGE's direct rate case Adjustment H-8 reflected MGE's proposed level of corporate allocations for services that will be provided to MGE by Laclede Gas Company (Laclede Gas) and The Laclede Group. The amount recommended by MGE is the level of corporate allocations identified in the Stipulation and Agreements in Case Nos. GM-2011-0412 (the "2012 ETE Acquisition") and GM-2013-0254 (the "2013 Laclede Gas Acquisition") increased by a factor to purportedly account for inflation. Staff does not agree with the use of the inflation factor and has included the level of corporate allocations equal to the amount in the Stipulation and Agreements in Case Nos. GM-2011-0412 and GM-2013-0254, which in effect represented a ceiling or cap for corporate costs allocated to MGE's cost of service.

Q. What is the difference between Staff and MGE's adjustments?

A. The table below summarizes the test year corporate allocation, and MGE Adjustment H-8 and Staff Adjustment E-57.3 and E-57.4 in their respective direct filings:

Description	Test Year Expense	Staff	MGE
Stipulated Amount of Corporate Allocations		5,087,099	5,087,099
Adjustment for Inflation		-	467,655
Total Corporate Allocations	5,254,195	5,087,099	5,554,754
Capitalization (O&M) Ratio	81.39%	84.99%	71.60%
Net Corporate Allocation to Expense	**$ 4,276,375**	**$ 4,323,525**	**$ 3,977,390**

There are two differences in the calculation of corporate allocations: the use of an inflation factor and a different Operations & Maintenance (O&M) expense ratio. MGE recommends the use of an inflation factor applied to the $5.0 million cap; Staff does not recommend the use of this factor. In its direct filing in this case, MGE used the O&M ratio of 71.6 percent from MGE Witness Noack's Surrebuttal in Case No. GR-2009-0355. Staff utilized the O&M ratio from its payroll annualization, 84.99 percent, which is the same ratio used for payroll and payroll-related benefits and payroll taxes.

Although Staff recommends a lower amount of total corporate allocations, Staff utilized the O&M ratio from Staff's payroll annualization, resulting in a higher amount charged to expense in Staff's cost of service.

Q. Please explain the background of the stipulated corporate allocations resulting from Case Nos. GM-2011-0412 and GM-2013-0254.

A. As a condition of the acquisition of MGE's former parent company Southern Union Company (Southern Union) by Energy Transfer Equity, L.P. (ETE) in GM-2011-0412, the Parties to the *Non-Unanimous Stipulation and Agreement* in that case agreed, on page 17 of that document, that the amount of corporate allocated expenses in future MGE rate cases would not increase as a result of that transaction. The *Non-Unanimous Stipulation and Agreement* was approved by the Commission on February 29, 2012 and the transaction between ETE and Southern Union was effectuated on March 26, 2012. Subsequent to that acquisition, the MGE properties were sold to Laclede Gas effective September 1, 2013. As a condition of the acquisition by Laclede Gas, the Parties to the *Stipulation and Agreement* in Case No. GM-2013-0254 agreed to similar provisions concerning corporate allocated costs to MGE.

The *Stipulation and Agreement* in Case No. GM-2013-0254 addressed corporate allocated costs on page 27:

> b. For the next MGE rate case prior to October 1, 2015, total joint and common costs allocated to the MGE Division for purposes of setting retail distribution rates will not increase as a result of the Transaction above the levels authorized by the

> Commission in Case No. GR-2009-0355 and proposed in the Surrebuttal Testimony of Michael R. Noack, dated October 14, 2009. Schedule H·8 – Corporate Allocation, of Mr. Noack's testimony reflects pro forma joint and common costs before application of the Expense Capital Rates of $5,087,099. Net corporate plant allocated to MGE is $669,314 per Schedule C, page 1 of 2, column e, line 35. It is understood, however, that joint and common costs allocated to MGE for purposes of setting retail distribution rates may increase or decrease for reasons that are not a result of the Transaction (including, but not limited to, factors such as wages and salaries increasing over time, organizational differences which result in a function being provided at the corporate level versus at the business unit or vice versa, labor efficiencies and technological efficiencies). **Laclede Gas agrees that in any rate proceeding, it has the burden of proving the reasonableness of any allocated or assigned cost to Laclede Gas, including its MGE division, from any LG affiliate, including all corporate overhead allocations.**
>
> [Emphasis added; GM-2013-0254 *Stipulation and Agreement*, p. 27]

The terms of the *Non-Unanimous Stipulation and Agreement* in Case No. GM-2011-0412 were similar to the terms in the above case and are referenced on page 98-99 of Staff's Report filed on January 29, 2014.

Q. Please explain the background of the corporate allocations referenced in MGE Witness Noack Surrebuttal testimony in Case No. GR-2009-0355.

A. In MGE Case No. GR-2009-0355 (the "2009 Rate Case"), Staff recommended several adjustments to the corporate allocated expenses allocated to MGE from its parent company at the time, Southern Union. These adjustments were identified and described on pages 97-98 of the Staff Report.

MGE Witness Michael R. Noack's Surrebuttal testimony in the 2009 Rate Case identifies MGE's updated revenue requirement, including corporate allocations:

> **Q. WOULD YOU PLEASE BRIEFLY LIST THE MAJOR ITEMS OF CHANGE TO THE REVENUE DEFICIENCY MODEL?**
>
> **A.** …Operating Expenses – Company has accepted the staff adjustments to payroll, payroll taxes, benefits tied to payroll dollars such as insurance and the 401k match, FAS 87 expense, injuries and damages, **corporate allocation costs**, uncollectible expense, depreciation expense, property tax, franchise tax and KC earnings tax adjustments, and numerous adjustments to eliminate various miscellaneous expenses such as dues, some of the advertising costs and some costs associated with lobbying activities.
>
> [Emphasis added, irrelevant selection omitted; MGE Exhibit 33, GR-2009-0355 Noack Surrebuttal, p. 17]

Attached to Noack Surrebuttal in the 2009 Rate Case, MGE Exhibit 33 is MGE's updated revenue requirement model in that case. Schedule H-8 of that document lists the $5.0 million of "Proforma Joint and Common Costs", which is the source of the amount appearing in the ETE Acquisition *Non-Unanimous Stipulation and Agreement*, the Laclede Gas Acquisition *Stipulation and Agreement*, and consequently, the basis of Staff's adjustment in the current rate case.

Q. What inflation factor did MGE apply to the stipulated cap on corporate allocations?

A. MGE recommends using the Consumer Price Index for all Urban Consumers (CPI-U, or CPI) produced by the United States Bureau of Labor Statistics (BLS) as a factor to increase the stipulated cap on corporate allocations.

MGE used the December to December percentage change in CPI for 2009, 2010, 2011, and 2012 to inflate the stipulated cap on corporate allocations. MGE's calculations are in the table below:

Year	CPI	Stipulated Cap Inflated by CPI
2009	2.7%	$5,224,451
2010	1.5%	$5,302,817
2011	3.0%	$5,461,902
2012	1.7%	$5,554,754

Q. What is the CPI?

A. According the federal Bureau of Labor Statistics web portal[1], the CPI is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The CPI reflects the spending patterns of all urban consumers and households representing approximately 87 percent of the total U.S. population.

Q. What types of expenses does the CPI measure?

A. The CPI uses a "market basket" of goods and services purchased by a sample of about 7,000 U.S. households. Major categories of expense include the following:

- Food and Beverages – breakfast cereal, milk, coffee, chicken, wine, full service meals, snacks
- Housing – rent of primary residence, owners' equivalent rent, fuel oil, bedroom furniture
- Apparel – men's shirts and sweaters, women's dresses, jewelry
- Transportation – new vehicles, airline fares, gasoline, motor vehicle insurance
- Medical Care – prescription drugs and medical supplies, physicians' services, eyeglasses and eye care, hospital services
- Recreation – televisions, toys, pets and pet products, sports equipment, admissions
- Education and Communication – college tuition, postage, telephone services, computer software and accessories
- Other Goods and Services – tobacco and smoking products, haircuts and other personal services, funeral expenses[2]

The BLS uses consumer surveys in combination with market pricing research to develop an index of the change in prices of actual purchased goods and service over a period of time.

[1] http://www.bls.gov/cpi/cpifaq/htm
[2] Ibid

Q. Does the *Stipulation and Agreement* in the Laclede Gas Acquisition case allow for the stipulated corporate allocation cap to be increased or decreased?

A. According to the language in that document, the cap can be increased or decreased:

> It is understood, however, that joint and common costs allocated to MGE for purposes of setting retail distribution rates may increase or decrease for reasons that are not a result of the Transaction (including, but not limited to, factors such as wages and salaries increasing over time, organizational differences which result in a function being provided at the corporate level versus at the business unit or vice versa, labor efficiencies and technological efficiencies).
>
> [*Stipulation and Agreement*, Case No. GM-2013-0254, page 27]

Q. Does Staff agree with the use of the CPI as a way to account for any of the changes to corporate allocations permitted by the *Stipulation and Agreement*?

A. No. The CPI represents the change in market prices for a broad array of goods and services used by American consumers. While the CPI is a reliable measurement of increases in the prices of the goods and services the BLS surveys, the CPI is not a proper measure of the increases and decreases of the corporate allocations from Southern Union/ETE, or from The Laclede Group and Laclede Gas. The *Stipulation and Agreement* contemplates corporate allocations may increase to decrease for the following factors:

- wages and salaries increasing over time;
- organizational differences which result in a function being provided at the corporate level versus at the business unit or vice versa; and
- labor efficiencies and technological efficiencies

The CPI has no correlation to any of the above factors, which are specific to MGE, and unrelated to broad measures of the change in prices of goods and services which the

CPI measures. Therefore, it is inappropriate to apply the CPI inflation index to MGE's corporate costs.

Q. What effect does MGE's O&M expense ratio have on the level of corporate allocations in the cost of service?

A. The O&M expense ratio reduces the annualized total expense by the amount that will be charged to capital or below-the-line accounts. For each dollar of payroll, benefits, and, in this case, corporate allocations, a portion is charged to Construction Work In Progress (CWIP) and is consequently included in plant in service at some point in the future when construction is completed. A utility will recover this amount through depreciation expense and the return on rate base. A significant portion of MGE's pro-forma corporate allocations will consist of payroll and benefits, both of which are routinely capitalized. Staff used the capitalization ratio from the current rate case, 84.99 percent, to allocate or assign corporate costs to expense. MGE's direct filing reflects the O&M ratio from the 2009 Rate Case, 71.60 percent. Staff's ratio results in a higher amount of corporate allocations charged to expense in the cost of service.

At this time, Staff does not believe MGE disagrees with using the more updated O&M ratio of 84.99 percent.

Q. Please summarize Staff's recommendation concerning MGE's corporate allocations.

A. Staff recommends the use of the stipulated cap on corporate allocations of $5,087,099, $4,323,525 net of Staff's O&M expense ratio. Staff does not recommend the use of the CPI to inflate MGE's pro-forma corporate allocations.

INCENTIVE COMPENSATION

Q. Please summarize the issue between Staff and MGE concerning incentive compensation.

A. In its direct filing, MGE included the test year unadjusted incentive compensation expense of $2,980,788. None of MGE's test year incentive compensation was capitalized, unlike payroll and payroll related benefits. In Staff's Cost of Service Report, Staff recommended a three-year average of 2010-2012 incentive compensation paid specifically for goals related to customer service and safety metrics of $351,343, or $298,607 after application of Staff's O&M ratio of 84.99 percent, discussed above.

Q. What incentive compensation plans did MGE offer its employees during the test year and in prior years?

A. Prior to the acquisition of MGE by Laclede Gas on September 1, 2013, MGE offered its non-union management employees an annual cash incentive based upon several metrics. These metrics varied from year to year, but were generally based on MGE Business Unit performance and Corporate (Southern Union/ETE) performance. MGE Business Unit performance was based on three metrics: Earnings Before Interest and Taxes (EBIT), Customer Service – Abandoned Call Rate and Average Speed of Answer, and Safety – Average Leak Response Time. Corporate performance was based on Earnings Per Share (EPS) or Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) in some years.

Staff Data Request 45.3 requested the incentive compensation payouts in plan years 2009 through 2013. The total amounts have been updated from the amounts on page 62 of the Staff Report, sourced from Data Request 45, and are listed below:

2009 Plan Year Payout	$ 1,022,803
2010 Plan Year Payout	$ 1,462,153
2011 Plan Year Payout	$ 1,317,086
2012 Plan Year Payout	$ 2,489,282
2013 Plan Year Payout - Partial Year	$ 1,547,948

The 2013 Plan Year Payout was a partial year payout based on the portion of the year MGE was owned by ETE. Upon the acquisition of MGE by Laclede Gas, the Southern Union/ETE incentive plan that awarded the payouts listed above has been terminated and will no longer have any payouts.

Q. What incentive compensation plan does MGE currently offer its employees?

A. At present, MGE employees are not under any specific incentive compensation plan. However, Staff asked MGE whether employees would be prospectively included in an incentive compensation plan after MGE's acquisition by Laclede Gas. According to the response to Data Request No. 0045.5, Laclede Gas indicated all non-union MGE employees are eligible for an incentive for the FY 2014 plan year (October 1, 2013 through September 30, 2014), two MGE employees are eligible for The Laclede Group Annual Incentive Plan, and MGE's union employees may be eligible for an annual incentive, subject to contract negotiations between the Company and its unions. But at the present time, no MGE employee has been given any performance measures or benchmarks to identify employee performance standards for 2013.

Q. What documentation did Staff request concerning the Laclede Gas Incentive Plans as they apply prospectively to MGE employees?

A. The text of Data Request 45.5 submitted January 17, 2014:

Brief Description 2013 and 2014 Incentive Compensation Plans

Description	In the period post September 1, 2013, after the acquisition of MGE by Laclede, identify if any current MGE employees will be or are currently included under 1) An MGE specific incentive compensation program, 2) Laclede Gas's incentive compensation program. If MGE employees will be or are currently included in an incentive compensation program, identify what groups of employees will be included in the program and provide all plan documents that will determine any amounts paid under the program.

Q. What documentation did Staff receive concerning the Laclede Gas Incentive Plans as they apply prospectively to MGE employees?

A. Attached to MGE's response to Data Request 45.5 are two documents: "Laclede Incentive Plan" presented to the Compensation Committee of the Board of Directors (Compensation Committee) and "The Laclede Group Annual Incentive Plan", which also appears also to have been presented to the Compensation Committee. Staff also received in one of several meetings with MGE and Laclede Gas personnel what appear to be two documents that are referred to as "scorecards", which are commonly used in incentive compensation plans. These scorecards list several metrics and actual achievement of goals for what is listed as Fiscal Year 2013, but Staff has no knowledge of any FY 2014 goals and target payouts for Laclede Gas or MGE employees. Staff at this time does not have any information specific to MGE such as goals and objectives, target payouts, or any other plan document that would identify potential plan payouts for the FY 2014 Plan Year.

Q. Did Staff request any other information concerning incentive compensation?

A. Yes. Staff requested MGE's most recent wage and salary surveys. Salary surveys are typically purchased by utility human resource departments to provide a broad database of wage and salary information. This information is used by human resources and management to evaluate current wages, salaries, employee benefits, and incentive compensation and bonuses.

When this information was requested, MGE initially replied that Southern Union retained these surveys and they were not accessible by MGE. MGE stated in the updated response to Data Request 47 that no additional surveys had been purchased since MGE's 2009 Rate Case. Staff was able to review several wage and salary surveys from 2008 that were provided to Staff in the 2009 Rate Case. However, those surveys were prepared over six years ago and they are of little value to determine if MGE's current wages, salaries, benefits, and incentive compensation compare to market wage rates.

Q. How do short-term incentive compensation plans typically work?

A. For a given plan year, management determines the goals and objectives for the incentive compensation plan and communicates them to the general body of employees at the start of the plan year. These goals are typically communicated to employees early in the plan year to provide employees time to achieve the goals and for management to determine and assess performance. In the case of MGE, five months will have passed from the beginning of the plan year which started October 1, 2013. Staff has no information from MGE or Laclede Gas concerning goals and objectives for the FY 2014 incentive compensation plan for MGE employees. Since it appears Laclede Gas has not determined goals for the FY 2014 plan and has not communicated them to the eligible employees, this is contrary to the goal of having an annual incentive plan as the fiscal year is nearly half over.

Q. Since there is substantial uncertainty as to whether or not there will be an incentive compensation payout for MGE employees going forward, and, if so, what amount that payout would be, why did Staff include any incentive compensation in the cost of service?

A. While Staff has little evidence there will be incentive payouts and no target amounts, it is a reasonable assumption that at least some payout will be made. Historically, MGE has paid incentive compensation from at least 2008 to the present. While there is substantial speculation as to if these payments will be made, Staff conservatively based its adjustment on historical payouts.

Q. How did Staff determine its adjustment for incentive compensation?

A. Staff calculated a three year average of incentive compensation awards for customer service and safety metrics based on payments for the plan years 2010, 2011, and 2012, and did not include any financial based metrics in its average. In addition, Staff removed several management employees who are no longer employed by MGE from the amounts used for Staff's average. After determining the normalized level of incentive compensation, the total amount was reduced by the application of Staff's O&M Expense Ratio.

The following table identifies the components of the incentive plan payouts for the years 2010 through 2012:

	Total Payout	Safety	Customer Service
2010 Incentive Compensation	1,462,153	141,041	141,041
Less: Removed Employees	284,766	25,908	25,908
2010 Net	1,177,388	115,132	115,132
2011 Incentive Compensation	1,317,086	125,456	125,456
Less: Removed Employees	262,807	20,762	20,762
2011 Net	1,054,279	104,694	104,694
2012 Incentive Compensation	2,489,281	389,298	389,298
Less: Removed Employees	645,413	82,110	82,110
2012 Net	1,843,868	307,189	307,189
2010-2012 3 Year Average	$1,358,512	$175,672	$175,672

Below is the summary of Staff's recommended incentive compensation expense:

2010-2012 3 Year Average Safety	175,672
2010-2012 3 Year Average Customer Service	175,672
Staff Recommended Incentive Compensation – 3 year average of Safety and Customer Service	351,343
Staff's O&M Ratio	84.99%
Incentive Compensation to Expense	$ 298,607

Q. Why did Staff not include incentive amounts awarded for financial objectives in its average?

A. Staff's objective is to establish rates that allow the utility an opportunity to achieve a reasonable rate of return on its investment. It is Staff's position that awards solely based on earnings per share, or in this case Earnings before Interest and Taxes (EBIT)/ Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA), do not directly benefit ratepayers and should be paid by shareholders. Staff is not promoting any form of incentive program over another nor is it seeking to dictate what goals an incentive program should have, other than the program should provide benefit to ratepayers. However, if the Company determines that it will award amounts based on financial metrics primarily beneficial to shareholders, those costs should be borne by shareholders. The Commission has generally supported incentive plans that are based on direct benefits to customers, and has typically disallowed those incentive plans that are based on direct financial performance of the Company, such as earnings per share measures.

Q. Are Earnings per Share and EBIT/EBITDA substantially different measures of financial performance?

A. While the two calculations measure financial performance in different ways, they are not substantially different in terms of them both being financial performance measures. Earnings per Share (EPS) is generally calculated as Net Income, less preferred dividends, divided by the average number of outstanding shares of common stock during a period of time. EBIT/EBITDA is generally calculated as Gross Earnings before the deductions of Interest, Taxes, Depreciation, and Amortization. EPS is commonly expressed in an amount of dollars and cents resulting from typically millions of common shares outstanding. This factor can be influenced by the capital structure of utility as higher amounts of common equity will be diluted over a higher amount of shares outstanding. EBIT/EBITDA is commonly expressed as a gross amount in millions of dollars.

Like any metric or goal, management determines what percentage of incentive compensation is awarded for financial-based performance and sets specific goals to influence both the actual outcome of the performance measures and the payout for each plan year.

Q. You stated that the Commission has typically disallowed those incentive plans that are based on direct financial performance of the Company, such as earnings per share measures. Can you provide some examples from prior MGE rate cases?

A. The Commission ordered the following in the 1996 MGE Rate Case, Case No. GR-96-285:

> The Commission finds that the costs of MGE's incentive compensation program should not be included in MGE's revenue requirement because the incentive compensation program is driven at least primarily, if not solely, by the goal of shareholder wealth maximization, and it is not significantly driven by the interests of ratepayers. (p. 37) [footnote omitted]

The Commission ruled again concerning MGE's incentive compensation in the 2004 MGE Rate Case, Case No. GR-2004-0209:

> The Commission agrees with Staff and Public Counsel that the financial incentive portions of the incentive compensation plan should not be recovered in rates. 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.
>
> If the company wants to have an incentive compensation plan that rewards its employees for achieving financial goals that chiefly benefit shareholders, it is welcome to do so. However, the shareholders that benefit from that plan should pay the costs of that plan. **The portion of the incentive compensation plan relating to the company's financial goals will be excluded from the company's cost of service revenue requirement.** (p. 43)
>
> [Emphasis added]

Q. Can you provide examples of the Commission disallowing incentive compensation for utilities other than MGE?

A. In Kansas City Power & Light (KCPL) Case No. ER-2006-0314, the Commission disallowed incentive compensation based on financial measures on page 58 of its Report & Order:

> The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. As far as compensation tied to EPS, the Commission notes that KCPL management has the right to set such goals. However, because maximizing EPS could compromise service to ratepayers, such as by reducing customer service or tree-trimming costs, the ratepayers should not have to bear that expense. What is more, because KCPL is owned by Great Plains Energy, Inc., and because GPE has an unregulated asset, Strategic Energy L.L.C., it follows that KCPL could achieve a high EPS by ignoring its Missouri ratepayers in favor of devoting its resources to Strategic Energy.
>
> KCPL's attempt to state that Staff has no evidence to support its theory that maximizing EPS might not benefit KCPL shareholders misses the point; KCPL has the burden to prove that the Commission should approve the tariffs. Further, KCPL's argument that disallowing any of its incentive compensation costs would put it at a competitive disadvantage fails. KCPL

> management is free to offer whatever compensation packages it wants. Nevertheless, **if the method KCPL chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then those costs should be borne by shareholders, and not included in cost of service.**
>
> [Emphasis added]

The Commission affirmed its ruling on incentive compensation in KCPL's 2007 Rate Case No. ER-2007-0291, on pages 50-51 of its Report and Order:

> …Staff argues that EPS is not relevant to providing cash to serve ratepayers, because that cash is recovered from ratepayers via a normal level of maintenance expense. DOE [Department of Energy] largely concurs in Staff's position, and points out that such compensation is not tied directly to specific goals and therefore not related to any ratepayer benefits.
>
> …The Commission finds that the relationship between KCPL and GPE's short-term executive compensation plans and benefits to KCPL ratepayers is simply too tenuous to include in cost of service.
>
> …The Commission rejects KCPL's position, and adopts the position of Staff. **Part of the costs of KCPL's and GPE's short-term executive compensation plans should be excluded from cost of service for setting KCPL's rates.**
>
> [Emphasis added; multiple footnotes omitted]

Q. Has the Commission made any other decisions regarding incentive compensation?

A. Yes. The Commission has consistently disallowed any financial performance components for incentive compensation in rates over the course of many years. Dating back to an Ameren Missouri (then called Union Electric Company) in 1987 and Southwestern Bell Telephone Company rate cases, the Commission has excluded incentive compensation based on financial benchmarks.

Q. Please summarize your rebuttal testimony on incentive compensation.

A. Staff recommends the Commission reject MGE's recommended level of incentive compensation, which includes amounts awarded based on financial goals. Staff recommends the Commission include Staff's three-year average of incentive compensation based on safety and customer service metrics, and not include any amounts for financial performance.

INCENTIVE COMPENSATION CAPITALIZATION

Q. Did MGE capitalize any of its short-term incentive compensation in the test year in this case?

A. No. The entire amount expensed during the test year was charged to FERC Account 920 – Administrative & General Salaries by MGE.

Q. Does Staff agree with this methodology?

A. No. Staff routinely recommends capitalizing employee benefits, including a portion of incentive compensation. In the current rate case, both Staff and MGE recommended the capitalization of a portion of the following expenses:

Payroll – Salaries and Wages
Medical, Dental, and Vision Benefits
Payroll Taxes – FICA, Federal & State Unemployment Taxes
Payroll Related Insurance – Life, Long-Term Disability
Deferred Compensation – 401k Company Match
Pension Expense and Tracker Amortization

Staff's recommended incentive compensation expense is based on MGE's historical payouts from the short term incentive compensation plan. The awards were cash-based and were paid to eligible non-union employees. Staff sees no reason why a portion of incentive compensation should not be capitalized just like any other payroll related costs. Therefore, Staff included in the cost of service a level of incentive compensation net of Staff's O&M ratio, similar to payroll and benefits expenses.

<u>PENSION EXPENSE, PENSION TRACKER, AND PENSION TRACKER AMORTIZATIONS</u>

Q. Please summarize the issue between Staff and MGE concerning pension expense and MGE's pension tracker.

A. Staff and MGE have a disagreement on the treatment of MGE's over-collection of pension tracker regulatory assets. Staff recommends the tracking of these over-collections and applying (reducing) other "vintages" of pension tracker balances by the over-collections. MGE did not recognize these over-collections.

MGE amortized a portion of the pension costs over seven years and a portion of the costs over a five-year period. Two of the three pension amortization vintages ended during the period between the most recent rate case and this case. MGE ended the amortizations in 2012 and 2013, resulting in those monthly amortization amounts increasing the Company's earnings, all other things considered equal.

Q. What document currently governs the treatment of pension expense for MGE?

A. The *Partial Stipulation and Agreement*, approved by the Commission on page 5 of its *Report and Order* in Case No. GR-2009-0355, defined certain unique accounting treatment for MGE's pension expense. The language applicable to pension expense from this document appears below. The complete *Partial Stipulation and Agreement* is attached to this testimony as Schedule KM 1.

Pensions (FAS87) and Other Post-Employment Benefits (FAS106)

20. The Parties agree that the rates established in this case for Missouri Gas Energy, a division of Southern Union Company ("Company") for pension expense include an allowance of $10,000,000. Additionally, the rates established in this case include recovery of the amortization of prepaid pension assets established in prior cases and the amortization of the prepaid pension asset established in this case as follows:

a. $1,139,310 - GR-2004-0209;
b. $803,300 - GR-2006-0422;
c. $2,828,673 - GR-2009-0355

(All amounts above, including the $10,000,000, are stated prior to application of transfer rate.)

21. **Recovery in rates of the prepaid pension asset amortizations listed above shall continue in subsequent rate cases as necessary until the asset balances are eliminated. The Company shall continue to be authorized to record as a regulatory asset/liability, as appropriate, the difference between the cash contributions made to the pension trusts, which are used in setting rates** and the pension expense as recorded for financial reporting purposes as determined in accordance with generally accepted accounting principles (GAAP) pursuant to Financial Accounting Standard (FAS) 87 and FAS 88 (or such standard as the Financial Accounting Standards Board (FASB) may issue to supersede, amend, or interpret the existing standards), and that such difference shall be subject to recovery from or return to customers in future rates.

22. The difference between the amount of pension expense included in Company's rates and the amount funded by Company shall be included in the Company's rate base in future rate proceedings.

[*Partial Stipulation and Agreement*, Case No. GR-2009-0355, attached as Schedule KM 1, Emphasis added]

Q. What is a “tracker”, as that term applies to ratemaking methodology?

A. For ratemaking purposes, a tracker mechanism is an ongoing comparison of the amount of an expense actually incurred by a utility to the amount of the same expense reflected in the utility's rates. While tracker mechanisms are generally not appropriate for use in setting rates, trackers for pension expenses are a unique exception because of the possibly significant cash flow implications to utilities if their pension funding requirements are materially different from their pension expense recovery levels in rates. Trackers have been used for several years for all major utilities in Missouri rate cases because of the volatility of pension costs. Tracker mechanisms provide rate recovery of the exact amount of an expense and are specifically designed to consider both increases and decreases to pension costs. Ongoing tracker mechanisms capture both under and over recovery of an expense for recovery from or return to ratepayers. The overall goal of a tracker mechanism, when properly exercised, is to provide the utility with dollar-for-dollar recovery of reasonable and prudently incurred expenses, no more and no less.

Q. What are "vintages", as that term applies to tracker methodology?

A. A tracker captures the relationship between cash expenditures paid by a utility and specific recovery of those expenditures in rates during a specific time period. From rate case to subsequent rate case, under-recovery or over-recovery of the item is captured into a regulatory asset or regulatory liability, respectively, depending on what was specifically in rates for the expenditure and what the utility paid for that expenditure. The specific time periods are determined by cutoff periods in rate cases, and effective dates of new rates in rate cases. These assets or liabilities are amortized to allow sufficient recovery in rates to recover the pension costs and are referred to as "layers" or "vintages". Each vintage is specially identified to ensure that each of the pension layers is fully recovered.

Q. What is the difference between MGE's pension tracker deferrals and Accounting Authority Order (AAO) deferrals?

A. In most cases, an AAO represents a unique, infrequent, and extraordinary expense incurred by a utility for which that utility requests deferral treatment of those costs into a regulatory asset for possible future rate recovery. These costs cannot be anticipated and included in the normal ratemaking process. Utilities typically request the Commission to approve AAOs outside the context of a rate case. Examples of expenses the Commission has approved for AAO treatment include severe ice storms, catastrophic weather events, changes in Commission rules that require utilities to incur additional costs such as for environmental costs, and one-time costs for conversion of generating assets.

Trackers, on the other hand, typically apply to certain ongoing costs incurred by the utility. Trackers are usually authorized in the context of a rate case, and have been rarely used.

While pension expenses are most definitely unique, they are not necessarily infrequent or extraordinary. Historically, cash expenditures to the pension trusts and pension expense can and have varied significantly from year to year. Market conditions, actual returns, and cash expenditures are some of the variables that created the need for a pension tracker mechanism established in the 2004 MGE Rate Case No. GR-2004-0209.

Q. Are tracker mechanisms appropriate for broad categories of expenses?

A. No. Pension expenses have unique attributes that reduce the amount of direct control utility management has over these expenses. While management has some control of the expenses, such as the asset mix of the pension trusts and negotiation of future benefits, the investments in the pension trusts are subject to market forces, of which management has little to no control.

Q. Please identify the separate vintages of MGE's pension tracker.

A. The following table lists the various vintages applicable to MGE's pension tracker:

Vintage Number	Tracker Vintage	Accumulation Period	Amortization Period	Total Amount
1	FAS 87 Prepaid Pension Asset	Pre October 2004	7 Years	$7,975,181
2	2006 Minimum ERISA	Oct 2004 - March 2007	5 Years	$4,016,500
3	2009 Minimum ERISA	April 2007 - April 2009	5 Years	$14,143,364
4	Current Pension Tracker	May 2009 - Dec 13	5 Years	$(5,483,060)

Each vintage represents the difference between cash collected in rates and the cash expense for pensions during the applicable accumulation periods. The "total amount" column represents the amount of pension cost that needed to be collected from customers (positive number) or returned to customers (negative number) to make the utility or its customers "whole."

Beginning with the effective date of rates in the 2004 MGE Rate Case, MGE was allowed dollar for dollar recovery of its pension tracker, "Vintage 1", through the cost of service. Vintage 1 of MGE's pension tracker was established in the 2004 MGE Rate Case and represented the cumulative prepaid pension asset created by reflecting negative pension cost in rates under the "FAS 87" method of calculating pension cost. This asset was amortized over a period of seven years, the approximate time period the FAS 87 method of calculating pension expense was used for ratemaking for MGE. The recovery of this amortization in rates continued in the 2006 and 2009 MGE Rate Cases. This asset was fully recovered through its amortization that ended as of September 2011.

"Vintage 2" began its amortization with the effective date of rates in the 2006 Rate Case and continued through the 2009 Rate Case. This asset was fully recovered through the amortization as of March 2012.

"Vintage 3" began its amortization with the effective date of rates in the 2009 Rate Case which started March 2010 and runs through February 2015.

"Vintage 4" has not begun its amortization until the effective dates of rates determined in this case.

Q. Why did MGE over-collect for Vintages 1 and 2 of its pension trackers?

A. Pension tracker Vintages 1 and 2 were fully recovered between the 2009 and current (2014) rate cases. Like any amortization, if rates do not change reflecting the decrease in expense at the time the amortization ceases, all other things being equal the Company will over-collect the amortization. In the case of these two vintages, MGE's cost of service established in the 2009 Rate Case included amortizations for these two vintages. When these vintage assets were fully recovered, the amortizations continued to be collected in rates by MGE, creating the over-collection resulting in increased MGE earnings.

The table below lists each over-collection through December 31, 2013:

Vintage	Tracker	Amortization Period	Begin Amortization	Date Fully Recovered	Over-Collection At December 31
1	FAS 87 Prepaid Pension Asset	7 Years	October 2004	September 2011	$ (2,563,451)
2	2006 Minimum ERISA	5 Years	April 2007	March 2012	$ (1,405,775)
3	2009	5 Years	February 2010	January 2015	---

The over-collection of Vintages 1 and 2 through December 31, 2013 is $3,969,226. Because new rates from the current rate case are not anticipated to be effective until mid-August 2014, MGE will continue to over-collect on the amortizations of Vintage 1 and 2 until the date new rates are effective. Through July 2014, the last full month prior to the anticipated effective date of new rates, MGE will over-collect a total of $5,102,416 on the amortization of these two vintages.

Q. How does Staff recommend treatment of the over-collections?

A. The over-collections represent money that ratepayers have paid in excess of the original asset balances. Because MGE's pension expense has received extraordinary treatment through the use of a tracker, it is completely appropriate to capture these over-collections to offset other asset balances that would otherwise be amortized. This treatment maintains the fundamental premise of tracker accounting; that is, dollar for dollar recovery of expense, no more and no less with the tracker designed to capture increases and decreases in pension costs.

Staff recommends that the over-collections through December 31, 2013 offset the positive balance now existing for Vintage 3. At December 31, 2013, Vintage 3 had a positive balance of $3,300,118. Using the over-collection of Vintages 1 and 2 to offset this balance results in a negative overall pension tracker balance of $(669,108). This negative regulatory asset, which is in effect a regulatory liability, represents the cumulative difference between cash provided in rates versus cash paid to the pension trusts. The over-collections occurring after the December 31, 2013 cutoff should be addressed in MGE's next rate case, along with any other over-collections and future pension tracker balances.

Q. What is the benefit to the utility and its customers of using tracker accounting?

A. When properly exercised, tracker accounting ensures dollar-for-dollar recovery of an expense. For both the utility and its customers, regulatory lag is effectively eliminated for certain unique expenses, one of which is currently pensions.

Q. How does regulatory lag affect the utility and its customers?

A. Regulatory lag is the time period between when an increase or decrease in a revenue or expense occurs and when that change is reflected in the cost of service through rates. The effect of regulatory lag can have either a positive impact or a negative impact on a utility's earnings. For example, if established rates were premised upon an employee level of 700, and the utility were to implement a program to improve efficiency and reduce its workforce by 10 percent, the utility would retain the effect of 70 employees' wages, salaries, and benefits to earnings, notwithstanding any increases in other expenses. On the other hand, if maintenance or insurance expense increased from the amount in established rates, the utility would have to absorb the increased expense, notwithstanding any decreases in other expenses.

Regulatory lag (both positive and negative) is a natural effect of actual historical cost-based ratemaking in Missouri. Unless specific mitigating accounting treatment is used, such as fuel clauses for electric utilities and the Infrastructure System Replacement Surcharge (ISRS) for gas utilities, a utility's expenses will naturally differ from the levels of expenses that rates are premised upon. Individual increasing and decreasing expenses must be viewed in the context of the entire aggregate cost of service as these differences can and do mitigate one another.

Q. Does MGE routinely over- and under-collect its operating expenses and revenues when compared to the amounts rates are premised upon?

A. Yes. The entire mix of operating expenses and revenues fluctuates from rate case to rate case. To the extent a utility can mitigate the increases in expenses with growth in revenues, utilities can avoid rate increases. Without specific accounting treatment, a utility retains reductions in expense and absorbs increases in expenses with no way to pass those specific changes to its ratepayers.

However, the use of a tracker mechanism such as the one used for MGE's pension costs is a divergence from the normal regulatory treatment of expense. While over and under-collections of an expense would normally not be subject to return to or recovery from its customers, tracker mechanisms provide dollar-for-dollar recovery of expenses through rates. This unique treatment mitigates regulatory lag for both the utility and its customers.

Q. Does the use of an expense tracker completely mitigate regulatory lag for that expense?

A. Yes. In the case of MGE, the pension tracker completely mitigates regulatory lag for pension expense.

One of the issues considered by the Commission in the 2009 Rate Case was the date pension tracker Vintages 1-3 began. Staff's position was that the amortizations of the trackers be assumed to begin the month after the balances were established. MGE recommended the amortizations be assumed to begin on the effective dates of the respective Commission Orders in those cases. Ultimately, the Commission decided in favor of MGE. Therefore, for Vintages 1-3, the amortizations began on the effective date of rates in the respective cases. Vintage 4, the current tracker balance, will begin amortization on the effective date of new rates resulting from this case, assuming the continuance of tracker accounting for pension expense.

If the amortizations of the tracker vintages were to have been started without a change in rates, MGE would have absorbed the increase in expense, all other things being equal. If this had been the case, MGE might have an argument that, since there was no immediate change in rates when the amortizations began, it is likewise entitled to the over-collection of the expense in rates until its rates can be changed to reflect the reduction in expense. This, however, is not the case. MGE was allowed to defer these cash expenditures and receive specific rate recovery concurrent with the effective date of new rates, eliminating the regulatory lag associated with these expenses.

Q. How does MGE treat the over-collections of these amortizations?

A. Because there is no recognition on MGE's books and records of these over-collections, MGE otherwise will retain these over-collections as increased earnings. This is contrary to typical tracker accounting and is a one-sided approach to an expense that has received unique treatment by the Commission.

Q. Does MGE's accounting for the pension tracker conform to typical tracker accounting?

A. No. Since MGE's tracker vintages were determined to be amortized on the effective date of rates in each case, if would be an inconsistent use of tracker accounting to not reflect over-collections of these vintages. If applied to every vintage amortization of the pension tracker, MGE will <u>always</u> over-collect when amortizing these regulatory assets through the cost of service. Thus, using the pension trackers the way MGE would use them, the Company will have the opportunity to enhance (increase) its earnings when the amortizations of the pension costs are completed. Unless rate cases are perfectly timed with the expiration of the pension amortizations, it is a virtual certainty that MGE will benefit from those ended amortizations to the detriment of its customers.

Staff's approach, on the other hand, preserves congruent treatment of regulatory assets and regulatory liabilities. In fact, Vintage 4 is a regulatory liability which will be amortized as a *negative* expense in the cost of service, reflecting excess of pension expense collected through the cost of service over actual pension expense. If this regulatory liability is reduced to $0 at any point in time other than the effective date of new rates, MGE will have reduced rates in excess of the regulatory liability. Under Staff's approach, the amount of money returned to customers in excess of the amount of the regulatory liability would be subject to recovery by the Company. In the long term, under a tracking mechanism the amount of pension expense incurred by MGE should be the amount collected in cost of service—no more, no less.

Q. Did MGE use the over-collections as additional contributions to the pension trusts?

A. No. The actual pension contributions, which are determined by MGE's actuary, are being tracked in Vintage 4. Again, MGE retained the over-collections as an addition to earnings.

Q. How does an over-collection occur?

A. At the conclusion of the amortization period, if rates are not adjusted, the Company continues to collect the same amount in rates after the completion of the amortization as it did during the amortization period. When the Company started charging amortization costs to expenses, those monthly entries to expense increased expenses, decreasing income. When the amortizations stopped, the reverse occurred—monthly expenses reduced, increasing income. For the two vintages fully recovered in rates by MGE, the Company's treatment of those pension amortizations resulted in over $4 million increase in earnings using its approach of "keeping" the amortizations. But Staff's approach, consistent with the language of the *Partial Stipulation and Agreement*, treats the amortizations collected in rates to reduce outstanding amortizations for pension.

Q. Were the trackers specially designed to capture any over collections?

A. Yes. Staff would not have agreed to the tracker approach for pension costs if it believed the Company was inherently going to "profit" from any over-collection of these costs. Staff worked with the utility industry to develop a mechanism to ensure the proper funding of pensions and other post-employment benefits (OPEBs). Staff developed the tracker approach to allow the utility companies the ability to fully recover reasonable and proper pension costs. The pension and OPEBs trackers were not designed to allow for either under-recovery or over-recovery of those costs.

Q. Does the Staff believe the *Partial Stipulation and Agreement* in the 2009 Rate Case addresses the treatment of the over-collections?

A. Yes. Paragraph 21, stated earlier in this testimony clearly states:

> "Recovery in rates of the prepaid pension asset amortizations listed above shall continue in subsequent rate cases as necessary **until the asset balances are eliminated**." [Emphasis added]

At the time Vintages 1 and 2 were fully recovered, Vintage 3 still had a positive balance, meaning that MGE had not collected from customers the full amount of Vintage 3 pension expenses in rates. Proper tracker accounting dictates the amortizations being recovered through rates should be applied to the vintages that have positive balances; in this case, Vintage 3. If MGE's treatment of these over-collections is adopted, MGE will always over-recover regulatory asset amortizations. This type of accounting is contrary to tracker methodology and results in consistent windfalls retained by the Company— an MGE wins, customers lose approach.

Q. Please summarize Staff's position on the treatment of over-collections of pension expense.

A. Proper tracker accounting dictates that expenses deferred for recovery by a utility are recovered dollar-for-dollar with over-collections returned to customers and under-collections recovered by the utility. Retaining over-collections results in a windfall to the utility and is an abuse of the unique treatment pension expenses has received from the Commission. Tracker accounting is a unique tool that eliminates regulatory lag for both the utility and its customers for the particular regulatory item. MGE should not be permitted to retain over-collections while asking its customers to pay for expenses it has already recovered.

Q. Does that conclude your rebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy, Inc.'s Filing of Revised Tariffs to Increase its Annual Revenues for Natural Gas	)))	Case No. GR-2014-0007

AFFIDAVIT OF KEITH MAJORS

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF JACKSON	)	

Keith Majors, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 31 pages to be presented in the above case; that the answers in the foregoing Rebuttal 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.

Keith Majors

Keith Majors

Subscribed and sworn to before me this 4th day of March, 2014.

Beverly M. Webb

Notary Public

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

BEVERLY M. WEBB
My Commission Expires
April 14, 2016
Clay County
Commission #12464070

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy and	**)**	
Its Tariff Filing to Implement a General Rate	**)**	**Case No. GR-2009-0355**
Increase for Natural Gas Service	**)**	

PARTIAL STIPULATION AND AGREEMENT

COME NOW Missouri Gas Energy, a division of Southern Union Company ("MGE"); the Staff of the Missouri Public Service Commission ("Staff"); the Office of the Public Counsel ("OPC"); Midwest Gas Users' Association ("MGUA"); University of Missouri at Kansas City ("UMKC"), University of Central Missouri ("UCM"), and Superior Bowen Asphalt Co., LLC ("Superior Bowen"); Constellation NewEnergy-Gas Division, LLC ("Constellation"); and, ONEOK Energy Marketing Company ("ONEOK") ; (collectively the "Parties" or individually a "Party"), and respectfully submit the following Partial Stipulation and Agreement ("Stipulation") to the Missouri Public Service Commission ("Commission").

1. **Issues Not Settled.**

If this Stipulation is approved by the Commission, the following issues remain to be tried by the parties and decided by the Commission:

a. Rate Design:
   i. SGS Class (including re-defined class)
   ii. Residential.
b. Rate of Return/Capital Structure/Cost of Capital.
   i. Capital Structure
   ii. ROE
   iii. Cost of Debt [all debt costs]
   iv. Rate Design Risk Issue
c. Energy Efficiency

2. **Issues Settled**. This Stipulation is intended to settle all issues among the Parties for purposes of Case No. GR-2009-0355, except the issues specifically enumerated in paragraph 1

above ("Issues Not Settled"). The Stipulation is not "unanimous" because, as noted below, certain parties have not joined as signatories to the document or in the resolution of individual issues. However, those parties have further affirmatively stated their non-opposition and waived their right to a hearing.

3. **Class Cost of Service**.

a. It is agreed that LVS class normalized present non-gas revenues shall be reduced by $400,000 and residential class normalized present non-gas revenues shall be increased by $400,000 to establish the Adjusted and Normalized Present Non-Gas Class Revenues. Any increase in revenue, net of miscellaneous revenue increases, shall be spread among all customer classes as an equal percentage of the Adjusted and Normalized Present Non-Gas Revenues. The increase so spread shall be added to the Adjusted and Normalized Present Non-Gas Class Revenues to establish the approved class non-gas rate revenues for each customer class.

b. Staff does not join as to this issue, but does not oppose this provision and does not request a hearing as to the Class Cost of Service issue.

4. **Positions of MGUA, UMKC, UCM, Superior Bowen, Constellation and ONEOK**. MGUA, UMKC, UCM and Superior Bowen join in this Stipulation as to the issues found in paragraphs 3 (Class Cost of Service), 16 (Transportation Tariffs) and 18 (Rate Design). ONEOK and Constellation join in this Stipulation as to the issues found in paragraphs 16 (Transportation Tariffs) and 17 (Transportation Threshold). MGUA, UMKC, UCM, Superior Bowen, Constellation and ONEOK do not oppose any other settled issue and do not request a hearing as to any other settled issue.

5. **Position of MDNR and Kansas City**. Counsel for the Missouri Department of Resources ("MDNR") and the City of Kansas City, Missouri ("City") indicate that while MDNR

and the City do not join this Stipulation, they also do not oppose the Stipulation and do not request a hearing as to the settled issues.

Rate Base, Revenue, and Expense

6. **Rate Base**.

a. Total rate base before true-up items are included is $619,181,554.

b. The following items will be a part of the true-up in this case in regard to rate base:

i. Plant in service;
ii. Depreciation reserve;
iii. Deferred taxes;
iv. Materials and supplies;
v. Natural gas in storage;
vi. Prepaid pensions; and,.
vii. Cash Working Capital impact of other true-up items.

7. **Operating Revenues**.

a. Total as adjusted operating revenues before true up are $186,802,700.

b. Residential customer growth will be the only component of operating revenues to be trued-up.

8. **Total Operating Expenses**.

a. Total operating expenses before income taxes and true-up items are $137,850,000, in settlement of all Operating Expense Issues. The agreed-upon total operating expenses amount does not include expenses for the Energy Efficiency/Conservation Programs[1] or any impact that may result from the adjudication of the Rate Design Risk issue. As part of this settlement, the Safety Line Replacement Plan (SLRP) deferral balances from Case Nos. GR-98-140 and GR-2001-292 as of March 1, 2010 shall be combined and amortized over a 48 month period for financial

[1] Energy Efficiency is an issue to be decided by the Commission. If the Commission decides that energy efficiency funding should be included in rates, then total operating expenses would need to be increased by the amount of energy efficiency funding to be included in rates. Also, as clarification, funding for MGE's low-income weatherization program, which is not an issue in this proceeding, is included in the settled total operating expense figure.

statement purposes. MGE shall not seek rate recovery of any remaining unamortized costs related to those SLRP deferrals in any general rate proceeding initiated subsequent to the conclusion of Case No. GR-2009-0355.

b. The following items will be a part of the true-up in this case in regard to total operating expenses:

i. Depreciation expense;
ii. Payroll costs (including the effects of employee levels, wage levels and benefit levels and associated payroll taxes);
iii. Rate case expense (to be updated through September 30, 2009 and to include an estimate for remainder of the case); and,
iv. Income tax effects of other true-up items.

c. For purposes of the settlement the base amount for each true-up item from which to measure the true-up adjustment will be as follows:

Depreciation	$26,224,367
Payroll, associated payroll taxes and payroll benefit costs	$36,421,592
Rate Case expense	$72,382

9. **Kansas Storage Gas Property Tax Accounting Authority Order**. MGE shall be granted the following accounting authority order (AAO): That Missouri Gas Energy, a division of Southern Union Company, ("MGE") is granted an Accounting Authority Order whereby the company is authorized to record on its books a regulatory asset, which represents the expenses associated with the property tax to be paid to the state of Kansas in relation to natural gas in storage pursuant to House Substitute for Senate Bill No. 98 for 2009 and subsequent years based on assessments from Kansas taxing authorities. Missouri Gas Energy may maintain this regulatory asset on its books until the beginning of the month after the final judicial resolution of the legality of that tax. Thereafter, Missouri Gas Energy shall commence amortization of the deferred

amounts, with the amortization to be completed over a five-year period. If MGE files a general rate case prior to that final resolution, ratemaking treatment of the deferral may be considered within that case. If MGE is allowed ratemaking treatment providing a return of any AAO funds for Kansas Property Tax, there shall be no return on the Kansas Property Tax AAO funds included in rates. The Commission shall include language in its Order stating that the grant of this AAO does not in any way control how the Commission will treat this deferral for ratemaking purposes in subsequent rate cases, except there shall be no rate base treatment of deferred amounts as provided above.

10. **Tariff Liability language**. No change shall be made in this case to MGE's liability tariff language. Issues related to the liability language shall be resolved in Commission Case No. GC-2009-0036.

11. **Service fees**. MGE's tariffs shall be modified to provide for the following service fees: Service Initiation (transfers and connects): $32; Revert-to-owner (landlord to tenant or tenant to landlord): $15; collection and disconnection: $24; and, Reconnect fee: $65. The total increase in revenue resulting from the service fee increases is $2,521,998.

12. **Credit Card Payments**. MGE shall be responsible for the per-transaction expense associated with customer credit card payments for credit card transactions processed via _MGE's web site, MGE's interactive voice response system, or manually either by MGE contact center personnel (a telephone transaction) or MGE field collections personnel (a transaction in person) and this expense shall be considered in the calculation of MGE's cost of service in this case.

13. **PGA Proposals**. MGE shall, and hereby, withdraws its PGA-related proposals, including property taxes on gas held in storage, FERC-related regulatory costs, and uncollectible gas costs.

14. **Other tariff changes**.

a. MGE shall be authorized to eliminate the word "Experimental" from the title of its existing School Transportation Program tariff sheets.

b. MGE shall be authorized to eliminate the Experimental Low Income Rate tariff language from its tariff sheets.

c. MGE shall be authorized to modify Tariff Sheets Nos. 24 and 24.1 as described in **Appendix A** to restate the PGA computation volumes to reflect the current mix of pipeline transportation, storage and commodity assets under contract to MGE for purposes of calculating PGA factors after November 1, 2009.

d. Eliminate stand-alone natural gas vehicle rate, but include language in the "Applicable" sections of the SGS, LGS and LVS tariff sheets that permits gas service under those rate schedules, consistent with applicable volumetric provisions, to retail distributors for the purpose of compressing natural gas for use as a fuel in vehicular internal combustion engines.

15. **Capacity Release/Off System Sales Revenue Sharing Grid**. MGE shall replace the current sharing grid on MGE tariff Sheet No. 24.2, with the following:

Annual Capacity Release Credits and Off-System Sales Margins	MGE Retention Percentage	Firm Sales Customer Percentage
First $1,200,000	15%	85%
Next $1,200,000	20%	80%
Next $1,200,000	25%	75%
Amounts Over $3,600,000	30%	70%

16. **Transportation Tariffs.** MGE shall be authorized to modify its transportation tariff provisions as follows. No other changes to MGE's transportation tariff shall be authorized in this case.

a. (i) On under-nominations, charge the Southern Star Central Pipeline: 1) max tariff transportation rate (approx. $0.3275/dth); and 2) incremental/variable storage withdrawal cost rate (No Notice Fee of $0.0007/dth plus withdrawal rate of $0.0114/dth); for a total of approximately $0.3396/dth; and

(ii) On over-nominations, payment for transportation at the Southern Star Central Pipeline: 1) max tariff transportation rate (approx. $0.3275/dth); less 2) incremental/variable storage injection rate (No Notice Fee of $0.0007/dth plus injection rate of $0.0114/dth); for a net credit total of approximately $0.3154/dth;

b. Reduce monthly imbalance tolerance by 5% at each level of penalty;

c. MGE shall file tariff sheets containing the language concerning Operational Flow Orders (OFO) found in **Appendix B**; and,

d. Receive changes to pools no later than four (4) business days prior to the end of each month.

17. **Transportation Threshold.**

a. MGE agrees that it has no objection in principle to lowering the threshold for eligibility for transportation service.

b. No later than March 15, 2010, MGE will file a revised transportation tariff lowering the threshold for eligibility to include larger customers within the LGS rate class of MGE with a proposed effective date of September 1, 2010.

c. The parties request that the Commission establish a docket, when the above tariff is filed, the purpose of which is to examine and resolve issues attendant to lowering the transportation volume threshold on MGE's system, with the goal of implementing that service no later than November 1, 2010. All parties to Case No. GR-2009-0355 will be permitted to participate in that proceeding without filing applications for intervention. Other parties may intervene and participate in accordance with applicable Commission rules.

d. The revised transportation tariff to be filed by MGE will, among other things, reflect the cost of telemetry equipment to transportation customers, which shall be no more than the actual, new cost of installed telemetry equipment.

e. MGE, along with the other parties in the case, will endeavor to have the revised transportation threshold tariff (including the telemetry costs tariff) become effective no later than September 1, 2010 and in time to enable new transportation customers to be able to opt-in to transportation service for the 2010-2011 heating season.

18. **Rate Design.**

a. LGS- Equal percentage increases to fixed charge and volumetric rate elements. LGS for customers whose usage exceeds 10,000 Ccf on an annual basis, but whose usage does not exceed 30,000 Ccf in any one month. The seasonal differential shall be retained; and,

b. LVS - Equal percentage increases to fixed charge and volumetric rate elements after applying the adjustment referenced in Paragraph 3(a) above. The seasonal differential shall be retained.

Depreciation.

19. The conditions ordered by the Commission in Case No. GE-2010-0030 shall also remain in effect, as well, for purposes of this Stipulation and Agreement. Those agreed-upon conditions are:

a. MGE shall retain the current depreciation rates, as listed in **Appendix C** to this Stipulation and Agreement.

b. MGE may add a new depreciation rate for a transportation subaccount, which was not part of the last rate case, as shown in **Appendix C**.

c. MGE shall submit a depreciation study no later than June 30, 2010, which conforms to, among other things, Commission Rule 4 CSR 240-3.275 and include actuarial analysis for all accounts inclusive, identifying those specific accounts that lack sufficient data to perform an actuarial analysis.

d. MGE shall use the currently authorized Missouri depreciation rates for General Plant Accounts for the respective functional accounts of its Corporate Plant accounts.

e. MGE shall maintain mortality records in compliance with Commission Rule 4 CSR 240-40.040 Uniform System of Accounts – Gas Corporations and 4 CSR 240-3.275 Submission Requirements for Gas Utility Depreciation Studies.

f. MGE shall account for all payments from other parties when it is required to remove, relocate, rearrange, reroute, or otherwise make changes in utility property, other than for purposes of rendering utility service, as credits to the depreciation reserve in compliance with Commission Rule 4 CSR 240-040 Uniform System of Accounts – Gas Corporations and appropriately identify amounts in their Annual Reports.

g. MGE shall establish and adopt accounting policies or procedures of separation and allocation removal costs of plant that is being retired from costs to install new plant.

h. MGE shall continue to keep a separate accounting of its amounts accrued for recovery of its initial investment in plant from the amounts accrued for the cost of removal, consistent with the Commission's Third Report and Order in Laclede Case No. GR-99-315.

<u>Pensions (FAS87) and Other Post-Employment Benefits (FAS106)</u>

20. The Parties agree that the rates established in this case for Missouri Gas Energy, a division of Southern Union Company ("Company") for pension expense include an allowance of $10,000,000. Additionally, the rates established in this case include recovery of the amortization of

prepaid pension assets established in prior cases and the amortization of the prepaid pension asset established in this case as follows:

a. $1,139,310 - GR-2004-0209;

b. $803,300 - GR-2006-0422;

c. $2,828,673 - GR-2009-0355

(All amounts above, including the $10,000,000, are stated prior to application of transfer rate.)

21. Recovery in rates of the prepaid pension asset amortizations listed above shall continue in subsequent rate cases as necessary until the asset balances are eliminated. The Company shall continue to be authorized to record as a regulatory asset/liability, as appropriate, the difference between the cash contributions made to the pension trusts, which are used in setting rates and the pension expense as recorded for financial reporting purposes as determined in accordance with generally accepted accounting principles (GAAP) pursuant to Financial Accounting Standard (FAS) 87 and FAS 88 (or such standard as the Financial Accounting Standards Board (FASB) may issue to supersede, amend, or interpret the existing standards), and that such difference shall be subject to recovery from or return to customers in future rates.

22. The difference between the amount of pension expense included in Company's rates and the amount funded by Company shall be included in the Company's rate base in future rate proceedings.

23. The Company shall be allowed rate recovery for contributions it makes to its pension trust that exceed the ERISA minimum for the purpose of reducing Pension Benefit Guarantee Corporation (PBGC) variable premiums.

24. Additional contributions made pursuant to this Paragraph shall increase Company's

rate base by increasing the prepaid pension asset and/or reducing the accrued liability, and shall receive regulatory treatment as described in paragraph 20 of this agreement. Company shall inform the Staff and Public Counsel of contributions of additional amounts to its pension trust funds pursuant to this Paragraph in a timely manner.

25. The provisions of FAS 158 require certain adjustments to the prepaid pension or OPEBs asset and/or accrued pension or OPEBs liability with a corresponding adjustment to equity (i.e., decreases/increases to Other Comprehensive Income). The Company shall be allowed to set up a regulatory asset/liability to offset any adjustments that would otherwise be recorded to equity caused by applying the provisions of FAS 158 or any other FASB statement or procedure that requires accounting adjustments to equity due to the funded status or other attributes of the pension or OPEB plans. The parties acknowledge that the adjustments described in this paragraph shall not increase or decrease rate base.

26. The Parties further agree that Company shall be authorized to record expense under FAS 87, for financial reporting purposes only, in a manner that does not require adjustment for amortization procedures that vary from FAS minimum amortization requirements, including without limitation, a five year amortization of the average of unrecognized gains or losses over the past five fiscal periods, subject to a minimum amortization to the extent that the current unrecognized gains or losses fall outside of a 10% corridor as described in FAS 87 and FAS 106. The minimum amortization of unrecognized gains or losses falling outside of the 10% corridor shall be made over the average remaining service life of participants for financial reporting purposes.

27. The Parties further agree that gains and losses for all pension lump-sum settlements shall be calculated only to the minimum extent permitted by FAS 88.

28. Due to the Pension Protection Act of 2006 (PPA), MGE may be required to make contributions in excess of the Minimum ERISA amount in order to avoid benefit restrictions under the PPA. Such contributions will be examined in the context of future rate cases and a determination will be made at that time as to the appropriate and proper level recognized for ratemaking as a Net Prepaid Pension Asset.

29. The Parties agree that the rates resulting from this case also make provision for the recovery of Other Post-Employment Benefits ("OPEBs") costs on a FAS 106 basis. The Parties further agree that the Company shall continue to be authorized to apply its accounting policy relative to the OPEBs consistent with that specified for FAS 87 above, for financial reporting purposes only. For ratemaking purposes, the OPEBs expense in this case was determined using a fair value method and a five-year amortization of the most recent five-year average of the balance of unrecognized gains and losses as calculated by the Company's actuary, subject to applying the minimum amortization requirements for unrecognized gains and losses as required under SFAS 106.

30. The Company shall continue to use this ratemaking methodology to determine amounts funded into the plans. The parties agree that the rates established in this case for FAS 106 expenses include an allowance of $2,664,792 (amount stated prior to application of transfer rate), based on the adjusted fiscal 2008 calculation of FAS 106 expense of $0 and the amortization of the Transition Obligation of $2,664,792. The Parties further agree that the Company shall be authorized to record as a regulatory asset/liability, as appropriate, the difference between such expense used in setting rates and the FAS 106 financial reporting expense as actually incurred (or such standard as the FASB may issue to supersede, amend or interpret the existing standards), and that such difference shall be subject to recovery from or return to customers in future rates. The

difference between the amount of OPEB expense included in Company's rates and the amount funded by Company shall be included in the Company's rate base in future rate proceedings.

31. The Company agrees that it shall fully fund its ongoing level of FAS 106 expense, as calculated above for ratemaking purposes, on a prospective basis.

32. In the event that FAS 106 expense becomes negative, the Company shall set up a regulatory liability to offset the negative expense. In future years, when FAS 106 expense becomes positive again, the amount in rates will remain zero until the prepaid asset, if any, that was created by the negative expense is reduced to zero. The regulatory liability will be reduced by the same rate as the prepaid asset. This regulatory liability is a non-cash item and should be excluded from rate base in future years.

33. **"Catch-Up" OPEB Funding**. The Company will pay $14,368,000 (stated before application of interest) into its OPEBs trust funds, spread ratably over no more than three (3) years. The initial payment will be made no later than May 1, 2010, with the remaining payments due no later than the first two annual anniversary dates of the initial payment. The Company will apply an interest rate that is equivalent to the Weighted Average Cost of Capital as determined by the Commission in this case and apply it to the unfunded balance over the three-year payment period. Interest on the unfunded balance shall accrue beginning May 1, 2009.

34. **Billing Lag Study.** MGE agrees to perform an analysis of its current customer billing and mailing practices to determine whether its cash working capital billing lag can be reduced to the benefit of its customers while still maintaining reasonable standards of customer service. Such a study shall be completed and presented to the Staff and the Office of the Public Counsel within two years of the effective date of rates resulting from this proceeding, or at the time of MGE's next general rate filing in Missouri, whichever comes first.

35. **Testimony Received Into Evidence**. Unless called by the Commission to respond to questions, in the event the Commission approves this Stipulation without modification or condition, the prefiled testimony (including all exhibits, appendices, schedules, etc. attached thereto) and reports of all remaining witnesses in this proceeding relating to the settled issues shall be received into evidence without the necessity of those witnesses taking the witness stand.

General Provisions

36. This Stipulation is being entered into solely for the purpose of settling the issues specified in Case No. GR-2009-0355. Unless otherwise explicitly provided herein, none of the Parties to this Stipulation shall be deemed to have approved, accepted, agreed, consented or acquiesced to any ratemaking or procedural principle, including, without limitation, any method of cost determination or cost allocation or revenue-related methodology, cost of capital methodology or capital structure, rate design principle or methodology, or depreciation principle or methodology, and except as explicitly provided herein, none of the Parties shall be prejudiced or bound in any manner by the terms of this Stipulation (whether this Stipulation is approved or not) in this or any other proceeding, other than a proceeding limited to enforce the terms of this Stipulation.

37. This Stipulation has resulted from extensive negotiations among the Parties and the terms hereof are interdependent. If the Commission does not approve this Stipulation unconditionally and without modification, then this Stipulation shall be void and no Party shall be bound by any of the agreements or provisions hereof, except as explicitly provided herein.

38. If the Commission does not approve this Stipulation without condition or modification, and notwithstanding the provision herein that it shall become void; neither this Stipulation nor any matters associated with its consideration by the Commission shall be considered or argued to be a waiver of the rights that any Party has for a decision in accordance

with §536.080 RSMo 2000 or Article V, Section 18 of the Missouri Constitution, and the Parties shall retain all procedural and due process rights as fully as though this Stipulation had not been presented for approval, and any suggestions, memoranda, testimony, or exhibits that have been offered or received in support of this Stipulation shall become privileged as reflecting the substantive content of settlement discussions and shall be stricken from and not be considered as part of the administrative or evidentiary record before the Commission for any purpose whatsoever.

39. In the event the Commission approves the specific terms of this Stipulation without condition or modification, and as to the specified issues, the Parties waive their respective rights to call, examine, and cross-examine witnesses pursuant to § 536.070(2) RSMo 2000; present oral argument and written briefs pursuant to §536.080.1 RSMo 2000; their respective rights to the reading of the transcript by the Commission pursuant to RSMo §536.080.2 RSMo 2000; their respective rights to seek rehearing, pursuant to §386.500 RSMo 2000; and their respective rights to judicial review pursuant to §386.510 RSMo 2000. These waivers apply only to a Commission order approving this Stipulation without condition or modification issued in this above-captioned proceeding and only to the issues that are resolved hereby. These waivers do not apply to any matters raised in any prior or subsequent Commission proceeding nor any matters not explicitly addressed by this Stipulation.

40. If requested by the Commission, the Staff may file suggestions or a memorandum in support of this Stipulation. Each of the Parties shall be served with a copy of any such suggestions or memorandum and shall be entitled to submit to the Commission, within five (5) days of receipt of Staff's suggestions or memorandum, responsive suggestions or a responsive memorandum, which shall also be served on all Parties. The contents of any suggestions or memorandum provided

by any Party are its own and are not acquiesced in or otherwise adopted by the other Parties to this Stipulation, whether or not the Commission approves and adopts this Stipulation.

WHEREFORE, for the foregoing reasons, the undersigned Parties respectfully request that the Commission issue its Order approving all of the specific terms and conditions of this Partial Stipulation and Agreement.

Respectfully submitted,

James C. Swearengen # 21510
Paul A. Boudreau # 33155
Dean L. Cooper #36592
BRYDON, SWEARENGEN & ENGLAND P.C.
312 East Capitol Avenue
P.O. Box 456
Jefferson City, MO 65102-0456
(573) 635-7166
(573) 634-7431 (fax)
dcooper@brydonlaw.com
ATTORNEYS FOR MISSOURI GAS ENERGY, A DIVISION OF SOUTHERN UNION COMPANY

Lera L. Shemwell #43792
Deputy General Counsel

Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102
(573) 751-2690
(573) 751-9285 (fax)
lera.shemwell@psc.mo.gov
ATTORNEYS FOR THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION

Marc D. Poston #45722
by dlc
Deputy Public Counsel
P O Box 2230
Jefferson City, MO 65102
(573) 751-5565
(573) 751-5562 FAX
marc.poston@ded.mo.gov
ATTORNEY FOR THE OFFICE OF THE PUBLIC COUNSEL

Jeremiah D. Finnegan #18416
by dlc
Finnegan, Conrad & Peterson, LC
3100 Broadway, Suite 1209
Kansas City, MO 64111
(816) 753-1122
Facsimile (816)756-0373
jfinnegan@fcplaw.com
ATTORNEY FOR UMKC, UCM AND SUPERIOR BOWEN ASPHALT CO., LLC

Stuart Conrad by WDS

Stuart W. Conrad, Mo. Bar #23966
FINNEGAN, CONRAD &
PETERSON L.C.
3100 Broadway, Suite 1209
Kansas City, Missouri 64111
(816) 753-1122
Facsimile (816)756-0373
Internet: stucon@fcplaw.com
ATTORNEY FOR MIDWEST GAS USERS' ASSOCIATION

William D. Steinmeier

William D. Steinmeier #25689
William D. Steinmeier, P.C.
2031 Tower Drive
P.O. Box 104595
Jefferson City, MO 65110-4595
573-659-8672
573-636-2305 Fax
wds@wdspc.com
ATTORNEY FOR CONSTELLATION NEWENERGY-GAS DIVISION, LLC

Charles W. Hatfield

Charles W. Hatfield #40363
Stinson Morrison Hecker LLP
230 West McCarty Street
Jefferson City, MO 65101
(573) 636-6263
(573) 636-6231 Fax
chatfield@stinson.com
ATTORNEYS FOR ONEOK ENERGY MARKETING COMPANY

CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been sent by electronic mail this 5th day of November, 2009, to:

Lera Shemwell
Missouri Public Service Commission
Governor's Office Building
200 Madison Street
P.O. Box 360
Jefferson City, Missouri 65102
Lera.shemwell@psc.mo.gov

Marc Poston
Governor's Office Building
200 Madison Street
P.O. Box 7800
Jefferson City, Missouri 65102
marc.poston@ded.mo.gov

Stuart Conrad
Finnegan, Conrad & Peterson, LC
3100 Broadway, Suite 1209
Kansas City, MO 64111
stucon@fcplaw.com

Jeremiah Finnegan
Finnegan, Conrad & Peterson, LC
3100 Broadway, Suite 1209
Kansas City, MO 64111
jfinnegan@fcplaw.com

William D. Steinmeier
William D. Steinmeier, P.C.
2031 Tower Drive
P.O. Box 104595
Jefferson City, MO 65110-4595
wds@wdspc.com

Sarah Mangelsdorf
Shelley A. Woods
Assistant Attorney General
P.O. Box 899
Jefferson City, Missouri 65102
sarah.mangelsdorf@ago.mo.gov
shelley.woods@ago.mo.gov

Charles W. Hatfield
Stinson Morrison Hecker LLP
230 West McCarty Street
Jefferson City, MO 65101
chatfield@stinson.com

Mark Comley
Newman, Comley & Ruth P.C.
P.O. Box 537
Jefferson City, MO 65102
comleym@ncrpc.com

APPENDICES

APPENDIX A – Tariff Sheets 24 and 24.1

APPENDIX B – OFO Tariff Language

APPENDIX C – Depreciation Rates