Exhibit No.:	
Issue:	**Incentive Compensation, Straight Fixed Variable Rate Design and Delayed Payment Charge**
Witness:	**Michael R. Noack**
Type of Exhibit:	**Surrebuttal Testimony**
Sponsoring Party:	**Laclede Gas Company, d/b/a MGE**
Case No.:	**GR-2014-0007**
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MISSOURI GAS ENERGY

GR-2014-0007

SURREBUTTAL TESTIMONY

OF

MICHAEL R. NOACK

APRIL 2014

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SURREBUTTAL TESTIMONY OF MICHAEL R. NOACK

Q. Please state your name and business address.

A. My name is Michael R. Noack and my business address is 3420 Broadway, Kansas City, Missouri 64111.

Q. Are you the same Michael R. Noack who filed Direct and Rebuttal Testimony on behalf of Missouri Gas Energy in this case?

A. I am.

PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. My testimony will address the rebuttal testimony of Staff Witness Keith Majors related to incentive compensation and will address the concerns of the Office of Public Counsel Witness Barbara Meisenheimer with respect to the MGE's straight fixed variable ("SFV") rate design. I will also respond to Ms. Meisenheimer's recommendation to change MGE's capacity release and off-system sales sharing mechanism and her objection to the increase in late payment fees from 0.5% to 1.5% to be applied to the outstanding balance of all bills not paid by the delinquent date on the bill.

INCENTIVE COMPENSATION

Q. On page 14 of Witness Majors rebuttal testimony, starting at line 7, the witness states Staff's position that incentive compensation based on earnings does not directly benefit ratepayers and should be paid by shareholders? Do you agree?

A. No. As I stated in my rebuttal testimony, while earnings, or net income, can benefit shareholders, it also directly benefits customers. Mr. Majors himself admits that fact.

Q. Where does Mr. Majors admit that net income benefits customers?

A. Net income is simply revenues minus expenses. On page 26, lines 21-22 of his rebuttal testimony, Mr. Majors states that "To the extent a utility can mitigate the increases in expenses with growth in revenues, utilities can avoid rate increases." Since customers pay rate increases, Mr. Majors is admitting that increasing revenues relative to expenses benefits customers. Stated another way, a Company that can increase net income by growing revenues or controlling expenses needs less of a rate increase from customers. Therefore, increasing net income directly benefits customers.

Q. So customers should support incentives that encourage an increase in earnings?

A. Absolutely. Based on Mr. Major's rebuttal testimony, he should agree.

Q. Mr. Majors indicates that since Southern Union will no longer pay an incentive to MGE employees, and since Laclede Gas has not yet paid an incentive, MGE should feel fortunate to get any incentive compensation, much less the $298,607 in incentive compensation offered by Staff? Does MGE feel fortunate?

A. Mr. Majors has set up a "heads I win, tails you lose" situation. In my rebuttal testimony, I tried to take a pragmatic approach to avoid this obvious inequity. In doing so, I looked at what both Southern Union and Laclede have done in the past to establish a reasonable level of incentive compensation to be included in MGE's cost of service. Staff's incentive compensation of $298,607 represents only 0.7% of MGE's payroll, a stingy amount to motivate employees. This amount is even less than the 1% year-end bonus approved by the Commission as part of compensation paid by United Cities Gas Company to 'spread Christmas cheer' to its employees. **(*Re:* United Cities Gas Company,** Case No. GR-95-160, 1995 WL 769947, Order issued October 10, 1995, p. 5) The incentive amount of $1.522 million advocated in my rebuttal testimony is a more reasonable sum while still being a modest 3.5% of total compensation.

Q. What is the main difference between your position and that of Staff witness Majors?

A. There are two. First, under previous ownership, MGE's incentive plan benefitted only non-union employees. Laclede's plan for both Laclede Gas and MGE covers both non-union and union. Second, Mr. Majors' incentive compensation expense covers only safety and customer service metrics, and even at that he has reduced the incentive by almost 50% while MGE's expense includes metrics for improving net income, a metric that directly benefits customers, as explained above and in my rebuttal testimony.

Q. On page 17 of his rebuttal testimony, beginning at line 9, Staff witness Majors states that "The Commission has consistently disallowed any financial performance components for incentive compensation…[d]ating back to an Ameren Missouri (then called Union Electric Company) case in 1987 and Southwestern Bell Telephone Company rate cases…" Is he correct?

A. No. First, his representation of the 1987 Union Electric (UE) case is inaccurate. In that case, UE had 7 metrics, including "Limit O&M expenses to the budgeted level" and "Limit construction expenditures to a specified level." While the Commission found the UE plan to be flawed, it did not disallow the incentive plan on grounds that the incentive had financial benchmarks. In fact, the Commission stated its belief that "programs designed to improve management performance should be encouraged and [the Commission] is not opposed, in principle, to cost of service recovery of the costs associated with such programs." **(*Re: Union Electric***, 29 Mo. P.S.C. (N.S.) 313, 325 (1987))

Q. Is witness Majors correct that the Commission excluded incentive compensation based on financial benchmarks in Southwestern Bell Telephone Company ("SWBT") rate cases?

A. Not in the one I read. In Case No. TC-89-14 **(*Re: SWBT,*** 104 P.U. R. 4th 381, 406 (1989)), the Staff criticized SWBT's incentive plan for, among other things, having a net income goal that only benefited shareholders. The Commission swept aside that argument, finding that the incentives were reasonably calculated to encourage company-wide performance and that, even with the incentive, SWBT's compensation level was not excessive. Likewise, MGE believes that, with incentive compensation comprising only 3.5% of payroll, its total compensation is not excessive. I would note that the 3.5% figure is less than the 11.6% previously earned by MGE management employees under MGE's incentive plan, and less than the 5.8% earned by Laclede low and mid-level management. It is also less than the 4.2% earned by Laclede union personnel, all as set forth in my rebuttal testimony.

Q. Are there other cases where the Commission approved in rates incentive programs that included financial benchmarks?

A. Certainly. In a GTE North case, the Staff proposed to eliminate incentive plans because they emphasized "net income as a high priority." (***Re: GTE North Inc.***, Case Nos. TR-89-182, 89-238 and TC-90-75, 30 Mo. P.S.C. (N.S.) 88 (1990)) The Commission again found that the plan did not cause compensation to be excessive and stated that an insufficient number of valid criticisms were raised to discourage the use of the Company's incentive plans. Implied in these approvals is the concept that increasing revenues relative to expenses benefits customers by reducing rate increases. Similarly, in the 1995 ***United Cities*** case mentioned above, the Commission rejected Staff's proposed disallowance even though the Company's incentive plan included a financial benchmark called an 'expense efficiency ratio.'

Q. Please summarize your testimony on incentive compensation.

A. An incentive compensation level of 3.5% is both modest and reasonable and does not cause overall compensation levels to be excessive. Financial benchmarks can and do benefit customers and should be supported by customers in rates. Although financial benchmarks have been rejected in recent cases in favor of safety and customer service benchmarks, it is no more rational to have customer service and safety metrics without financial metrics than it is to have financial metrics without customer service and safety metrics. The optimal incentive plan balances financial criteria with customer service and safety metrics.

STRAIGHT FIXED VARIABLE (SFV) RATE DESIGN

Q. Does the Company agree with Staff that the SFV rate design is still the most appropriate rate design for MGE and its residential and small general service (SGS) customers?

A. Yes, while the Company is always open to considering other alternatives, contrary to the rebuttal testimony of OPC Witness Meisenheimer, the SFV rate design continues to be the most appropriate rate design for MGE and its customers at this time and certainly preferable to the rate design proposed by OPC. Without even addressing the merits of one rate design approach over another, the fact remains that is a singularly poor time to implement a different rate design, for the reasons discussed by MGE witness Crickette West in her surrebuttal testimony. I also believe that debating the impact of alternative rate designs on low-income customers and other customers with different usage or demographics would be more informative if all parties made a constructive effort to gather data following this rate case. That would put the Commission is a much better position to consider alternatives on a more informed basis.

Q. Ms. Meisenheimer on page 2 of her rebuttal testimony states that since April 2007, when SFV was first implemented, customers with very low usage experienced a more than doubling of their monthly distribution charges while customers with very high usage paid only a fraction of the monthly distribution charges when compared to the charges they had paid previously. How do you respond to those comments?

A. First, when Ms. Meisenheimer makes these comparisons, she is ignoring completely the most significant portion of the customer's bill – the gas costs. Those gas costs at the time SFV rates were first implemented made up almost 75% of the customer's bill. Today, because gas prices are lower, the gas costs make up approximately 60% of the bill before taxes.

Second, when looking at the makeup of MGE's residential customer usage, 74% of all residential customers use between 500 and 1300 Ccf per year. When you consider that the break even usage point for SFV and OPC's requested rate design is approximately 785 Ccf per year it is clear that most of MGE's customers should be generally indifferent to the SFV rate design.

Q. In Case No. GR-2009-0355 when the Commission reaffirmed its approval of MGE's SFV rate design and in fact found that it should also be the rate

design administered to the SGS rate class, what were the reasons cited for continuing the SFV rate design?

A. The Commission cited 6 principal reasons for using a SFV rate design.

First, the SFV rate design best reflects the actual costs customers impose upon MGE's system. The only cost that is variable is the cost of gas delivered to that customer. Whether a customer uses 1 Ccf per month or 132 Ccf per day, there is no difference in the cost of delivery service on average within the residential and SGS rate classes.

Second, the SFV reduces the spikes in winter bills and moderates bill fluctuations throughout the year. In January and February 2014 alone when the weather was so cold, the SFV rate design saved residential customers over $2 million from what the bills would have been using OPC's rate design.

Third, SFV rates represent economically efficient pricing.

Fourth, SFV simplifies customers' bills. It tells the customers exactly what they are paying for their gas and for the cost to deliver it

Fifth, the SFV stabilizes MGE's revenue. As pointed out earlier when describing how the rate design reduces spikes in customers' bills, it also provides the company with a more predictable revenue stream and protects both the customer and the company from the effects of weather. In January and February alone, this rate design saved residential customers over $2 million. In 2012 when the weather was historically warm, the company with OPC's rate design would have realized a revenue shortfall just for the residential class of $17 million.

Finally, state energy policy strongly favors revenue decoupling rate designs.

Q. In your opinion have any of those six reasons for having a SFV rate design changed between MGE's last case and this case?

A. No they have not.

Q. On pages 3 and 4 of her rebuttal testimony, Ms. Meisenheimer describes Diagram 2 which purports to be a comparison of SFV and traditional rate design on annual distribution charges by customer use. Is there important information missing from her diagram?

A. Yes. While Diagram 2 shows graphically the distribution charges being collected from customers under the two different rate designs at different usage levels, the diagram does not show the reader the amount of annual distribution costs incurred by the company at each level of usage. That cost level is exactly the amount which is being charged to each customer at the annual usage levels under SFV. Under OPC's rate structure, high users pay significantly more than their share of the annual costs of the company while low users pay less than their share of the costs.

Q. On pages 5 and 6 of her rebuttal testimony (lines 8-12, 1-3) Ms. Meisenheimer states that the SFV rate design impacts households which use less than average amounts of natural gas, which includes low-income households. How do you respond to that testimony?

A. With around 450,000 residential customers there will always be customers that appear to pay more or less than their fair share. With SFV, customers pay their share of distribution costs regardless of the amount of gas used. At the same time, customers also pay a volumetric rate for gas regardless of the fact that some gas costs are fixed. On balance, the SFV rate design provides a fair result to customers.

Q. Do you agree that a low-income household equates to a low use customer?

A, No. In both GR-2006-0422 and GR-2009-0355, MGE witness Philip Thompson testified that low income customers did not necessarily equate to low use customers. His testimony concluded that the income-consumption relationship for MGE's customers is "U"-shaped; that is, usage may be high at low income levels and fall as income rises, but then reaches a minimum and begins to climb again at higher income levels.

Q If you look at the frequency distribution of usage for customers who received energy assistance funds in 2013 how would that compare to the overall customer usage?

A. The percentage of customers receiving energy assistance using over the average use per residential customer of 800 Ccf per year is 43% while for all MGE customers the percentage is 47%, This tells me that the usage pattern for low-income customers is not really any different from the general customer base.

Q The Commission in its order in GR-2009-0355 at page 65 ordered OPC to propose specific EE programs or other programs to assist low use heating customers. Has OPC to your knowledge proposed any such programs to the collaborative?

A. No. In fact, the minutes of the July 7, 2010 MGE Energy Collaborative Meeting reported Ryan Kind of OPC expressing OPC's discomfort with having their name associated with further work on the low use residential discussion and pointed out in the May meeting, that OPC had indicated to the Commission in the February 10, 2010 Motion for Rehearing in Case No. GR-2009-0355 that OPC is not aware of any additional programs that can mitigate the harm of SFV on low usage customers. Mr. Kind than stated that OPC would no longer be responding to that part of the Order.

Q. Has Ms. Meisenheimer addressed how her rate design might affect MGE's energy efficiency programs?

A. No. Her testimony does not address that. Along with the rate design approved in GR-2009-0355, the Commission on page 52 of its Order found that with SFV, ratepayers' interests will be aligned with the interests of the shareholders because of the removal of the disincentive for the utility to encourage natural gas conservation. The Commission then ordered that MGE should work toward developing an energy efficiency program with a goal of .5% of gross operating revenues as a target. The only assumption one can make from OPC's testimony is that they want to discontinue the energy efficiency programs and go back to the rate design of seven years ago.

Q. In conclusion, do you continue to believe that the SFV rate design is the best rate design for both customers and the Company?

A. Yes I do. While, as I said previously, the Company is open to exploring alternative rate designs under appropriate circumstances, those circumstances do not exist in this case, because of the customer billing and information system concerns, lack of information regarding the impact on customers of making a radical change to the rate design, and the unacceptability of the alternative proposed by OPC. For these reasons, the Commission should make no changes to the Company's rate design at this time.

<u>INCREASE IN DELAYED PAYMENT CHARGE</u>

Q. **Do you agree with Ms. Meisenheimer's criticisms of the Company's proposal to increase its delayed payment charge from .5% to 1.5%?**

A. No, I do not. Late payment charges are a customary way to encourage customers to pay their bills within a reasonable period of time and compensate other customers for the added costs incurred when such payments are not forthcoming on a timely basis. In fact, late payment fees are routinely assessed by businesses in virtually every industry and business segment, including landlords, mortgage companies, banks, credit card companies, retail service providers, and public utilities. The main problem with MGE's delayed payment charge is that it is well below the fees charged by virtually every other utility and that have been found necessary by other business, both because of smallness of the percentage and the fact that it is only applied to the customer's most recent bill. The Company's proposal to increase the percentage will help to address this disparity.

Q **Does this conclude your surrebuttal testimony?**

A Yes it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT

STATE OF MISSOURI COUNTY OF JACKSON	)))	SS.

Michael R. Noack, of lawful age, being first duly sworn, deposes and states:

1. My name is Michael R. Noack. My business address is 3420 Broadway, Kansas City, MO 64111 and I am the Director of Pricing and Regulatory Affairs.

2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony on behalf of Missouri Gas Energy.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Michael R. Noack

Subscribed and sworn to before me this 2nd day of April, 2014.

Kim W. Henzi
Notary Public

KIM W. HENZI
Notary Public - Notary Seal
State of Missouri
Commissioned for Jackson County
My Commission Expires: February 22, 2015
Commission Number: 11424654