Exhibit No:	
Issue:	**Revenue Deficiency; Rate Design; Incentive Compensation; Pension Amortization; Tariff and Other Changes; Off-System Sales**
Witness:	**Michael R. Noack**
Type of Exhibit:	**Rebuttal Testimony**
Sponsoring Party:	**Laclede Gas Company d/b/a Missouri Gas Energy**
Case No.:	**GR-2014-0007**
Date Prepared:	**March 4, 2014**

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

GR-2014-0007

REBUTTAL TESTIMONY

OF

MICHAEL R. NOACK

March 4, 2014

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REBUTTAL TESTIMONY OF MICHAEL R. NOACK

Q. Would you 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 Testimony in this case on behalf of MGE on September 16, 2013?

A. Yes.

PURPOSE OF TESTIMONY

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the direct testimony submitted by OPC Witness Barb Meisenheimer on a number of issues, including the appropriate criteria for determining the level of rate relief that should be granted in this case, the appropriate rate design that should be approved by the Commission, how customer charges should be sculpted on a seasonal basis, and whether and how changes should be made to MGE's off-system sales and capacity release tariff. I will also respond to an adjustment proposed by OPC witness Ted Robertson relating to his proposed exclusion of certain costs incurred by the Company to comply with environmental requirements. Further, I will respond to adjustments proposed by the Commission Staff relating to incentive compensation and the treatment of prior pension expense amortizations. Finally, I will address direct testimony relating to energy efficiency issues.

CRITERIA FOR DETERMINING LEVEL OF RATE RELIEF

Q. Beginning on page 3 of her direct testimony, OPC Witness Meisenheimer opines that the Commission should treat rate affordability as a key factor in determining the Company's revenue requirement and rates. Do you agree?

A. No. The Company, of course, recognizes its obligation to be as efficient as it reasonably can be while still providing high quality service to its customers. And the Company has always been highly supportive of measures designed to help our most vulnerable customers maintain their natural gas service. Consistent with long-standing ratemaking principles and legal requirements, however, the Company's revenue requirement should be just and reasonable based on the Company's prudently-incurred cost of service, including a reasonable opportunity to earn a fair return. Setting rates based on "affordability" is a slippery slope. Whose affordability? The income of some customers is so low that they can hardly be expected to afford service at any level. The solution is not to squeeze the utility's rates; that will only make it difficult for the utility to provide adequate service and compete for capital. The best solution is to set the utility's rates at a just and reasonable level, pursue energy affordability programs that can provide assistance to individual customers while being respectful of the interests of other customers, and encourage our state and federal governments to provide adequate energy assistance for our more vulnerable citizens.

Q. OPC Witness Meisenheimer provides a chart of unemployment rates on page 6 of her testimony. What is your view of taking unemployment rates into account in setting utility rates?

A. Again, while I believe we all have to be mindful of the needs and circumstances of our customers, I don't believe this is a factor that should affect how the

Commission determines the Company's revenue requirement and rates in this proceeding. According to the chart in Ms. Meisenheimer's testimony, unemployment rates in every county served by MGE have dropped significantly since MGE's last rate case in 2009-10. For example, Clay County's unemployment rate dropped from 8.5% in 2009-2010 to 6.4% in 2012. MGE does not believe that its rates should be increased by more than is warranted just because there is less unemployment in its service territory.

Q. On page 8 of her direct testimony, Ms. Meisenheimer displays a chart that appears to show that if the Company's rate increase request is approved, MGE revenues will have grown by twice the rate of wages and twice the CPI. Do you have a comment on this portrayal?

A. It is simply inaccurate. Timing is very important in measuring growth. While it is difficult to determine what time periods Public Counsel has chosen, they clearly do not correspond to MGE's rate cases. The basic fact is that, if MGE was granted the full increase it has requested in this case, its rates over the past 4+ years since its last rate case would show an annual increase of well under 3%. By any reasonable measure, that figure falls in line with the CPI.

Q. On page 9 of her direct testimony, OPC Witness Meisenheimer advocates setting rate of return at the lower end of a reasonable range. Do you agree?

A. In the present rate case, Ms. Meisenheimer has already accomplished, if not exceeded, her goal. Using the parent company capital structure and cost of debt, as has been the rule in Laclede Gas and MGE rate cases, results in a debt/equity ratio as of December 31, 2013 of about 44%/56% and a weighted average debt rate of 4.16%. Using a moderate ROE of 9.7%, the same ROE that the

Commission recently approved for ISRS investments in the Laclede Gas rate case in mid-2013, yields a pre-tax rate of return of 10.624%. However, pursuant to paragraph 11k of the Stipulation and Agreement approved by the Commission in Case No. GM-2013-0254, Laclede Gas agreed that it will limit the pre-tax rate of return it will sponsor in this case to 10.224% which would calculate out to a return on equity of 9.258%. MGE has effectively absorbed as much or more of the reduction sought by witness Meisenheimer.

RATE DESIGN

Q. What is a straight fixed variable rate design?

A. A straight fixed variable ("SFV") rate design is a rate design in which costs are collected in the same manner that they are incurred. So fixed costs are collected through a fixed charge and variable costs are collected through a variable charge.

Q. On page 10 of her direct testimony, witness Meisenheimer claims that MGE's SFV rate design is "unfair" because MGE's non-gas costs are collected entirely through a customer charge that does not vary with usage and can only be avoided by disconnecting from MGE's system. Do you agree that the SFV rate design is unfair?

A. Absolutely not. This issue has been raised and litigated in the last two MGE cases, and appealed to the Court of Appeals. In all of these cases, the SFV rate design was upheld as fair and reasonable. As ably explained by Staff on pages 9-10 of its Class Cost of Service Report filed in this case on February 7, 2014, the SFV rate design is an equitable and reasonable way to recover MGE's delivery costs, because it provides for fixed charges to recover fixed costs. In other words, since delivery costs don't vary with usage, it is appropriate to collect those costs through a fixed rate that also doesn't vary with usage. In addition, SFV also encourages MGE to help customers conserve energy because the Company is not penalized by lowered usage in the recovery of its distribution costs.

Q. Do customers pay usage charges in addition to the fixed customer charge?

A. Yes, they do. While MGE and the parties to this rate case are focused on delivery charges, customers tend to focus on the entire bill. Historically, approximately 2/3 of an MGE customer's annual bill is made up of gas costs, ***which are collected entirely through a usage fee.*** In other words, Public Counsel is complaining that 1/3 of the customer's bill is collected through a fixed charge, while the remaining 2/3 of the customer's bill is entirely variable. This level of variability permits customers to do precisely what Public Counsel wants – avoid costs by reducing use.

Q. You have indicated that MGE's fixed delivery costs match the fixed monthly customer charge. Are gas costs all incurred on a variable basis to match the variable charge for gas?

A. No. In fact, roughly ¼ of gas costs are actually fixed through a cost component known as demand charges or capacity reservation charges that are assessed by the Company's pipeline transporters. These costs are collected year round and do not vary with usage. So if we were to adjust our gas rates to match the way these transportation and storage costs are assessed and collected from the Company, the PGA should be set to recover ¼ of gas costs as fixed, and the rest as variable. This would create a true SFV billing structure.

Q. If ¼ of gas costs were charged in a flat rate, how much would that add to the customer charge?

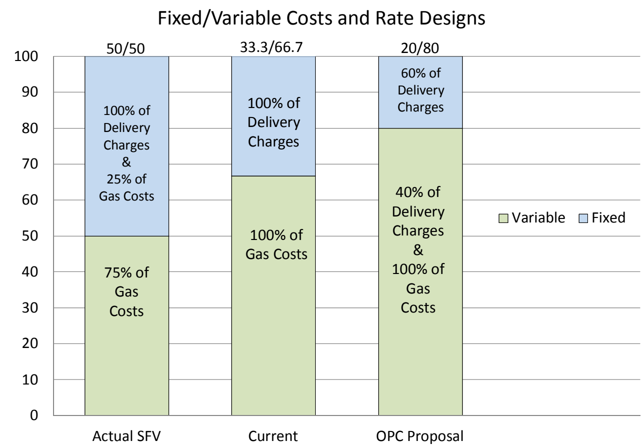
A. For the PGA filing MGE made last October, it would have added $12-$13 to the customer charge.

Q. Does the lack of matching for gas costs favor the low volume user or the high volume user?

A. The low volume user pays less for gas costs because that user avoids the fixed charge.

Q. So from the customers' perspective, the rate design is not purely SFV?

A. No, customer bills actually have a larger variable component than would be the case under a pure SFV rate design because, while fixed delivery costs are collected through a fixed charge, fixed gas costs are collected through a variable charge. Based on the assumptions discussed above, the following chart shows the actual fixed-variable proportion of gas and delivery costs, compared with the current rate design and Public Counsel's proposed rate design as set forth on page 16 of witness Meisenheimer's testimony. As you can see, MGE's current rate design already meets Public Counsel's goal of providing customers less in fixed charges than a pure SFV rate design would warrant.



Q. On page 11 of her direct testimony, witness Meisenheimer states that, because the SFV rate design requires customers to pay the same rate regardless of usage, MGE's weather related risk is shifted to customers. Is there a flaw in this logic?

A. Yes. If MGE's fixed delivery costs were charged on a variable usage basis, both the customers and the Company would assume weather related risk. Under the SFV rate design, both the Company and the customers avoid the risk of weather.

Q. Please explain.

A. Assume MGE's fixed delivery costs are charged on a variable basis. In winters that were warmer than normal, customers would use less gas and save money by underpaying the Company's fixed delivery costs, while the Company would conversely under-collect those costs. In winters that were colder than normal, customers would use more gas and would overpay fixed delivery costs, while the

Company would enjoy the benefit of over-collecting its fixed costs. In a winter like 2013-14, where the weather is unusually cold, not only would customers pay more through excess use, but because increased demand drives up the price of gas, customers would suffer the double whammy of buying more therms of gas at more expensive prices. MGE's SFV rate design allows customers to fix their delivery charges and avoid an adverse result in a winter such as the one we are currently experiencing. In fact, the SFV rate design saved customers $1.5 million in delivery charges in January alone. Given these circumstances, I don't understand why Public Counsel is so willing to subject customers to weather risk just to force MGE to also face that risk.

Q. Does the SFV rate design mean that MGE has no risk?

A. Not even close. All the SFV rate design does is remove the risk and reward from lesser or greater usage than expected. It does not remove the risk that MGE will lose customers, or that it will not be able to collect revenues. Most important, it does not remove the risk that MGE will not be successful in controlling its costs.

Q. Is Ms. Meisenheimer's rate design proposal consistent with her stated concerns about energy affordability?

A. I don't think so. Based on prior analysis that has been performed for MGE, we believe the number of low-income customers who have greater than average usage, and who therefore benefit from an SFV rate design, is substantial. Moreover, in a very cold winter like this, those customers – as well as many who have lower than average usage – are benefitting significantly from the SFV rate design. In fact, the SFV rate design is working exactly as intended by shielding customers from excess usage charges at the very time that escalating gas prices are also increasing or will be increasing their bills. From an energy affordability standpoint, the last thing you would want to do for these customers is adopt OPC's proposal.

SCULPTED RATES/RECONNECTION CHARGES

Q. **What is MGE's sculpted rate proposal?**

A. The sculpted rate proposal would, on a revenue neutral basis, decrease the customer charge for the Company's residential customers in the seven summer months of April through October and increase it by an offsetting amount in the five winter months of November through March.

Q. **Has any party expressed opposition to the proposal?**

A. Not directly, although none of the parties that filed direct testimony included such a concept in their recommendations. It is also fair to note that there were concerns expressed by a number of consumers at our recent public hearings about the potential impact of having higher customer charges apply during the winter period, even if they are offset by lower customers charges during the summer period.

Q. Does MGE nevertheless believe that such a concept continues to have merit?

A. Yes. But out of respect to the concerns that were expressed by some of our customers at the local public hearing, we have decided to modify our proposal so that the increase in the winter customer charge and decrease in the summer customer charge would be significantly more modest. Specifically, we would propose that the Commission limit any increase in the customer charge during the winter months to $32.84, regardless of the revenue requirement approved by the Commission in this case.

Q. How would this proposal compare to the winter customer charge increases that were reflected in the customer notices sent in connection with the local public hearings?

A. This would represent a $8.11 per month reduction from the charges reflected in the customer notice. In creating a sculpted rate, MGE raised the winter rate by $10.78 over the amount expected with an SFV rate design. By this adjustment, MGE is offering to reverse 75% of that increase.

Q. With that modification, does the Company believe the Commission should still approve a modest movement in the direction of sculpted rates?

A. Yes. As we have previously said, the sculpted rate proposal is part of an overall effort to help customers stay on the system and continue receiving gas service during the summer period by reducing the cost of staying on during the summer period. Today, approximately 20,000 customers fall off the system during the summer, a result that not only imposes a hardship on the customer who discontinues service but also harms other customers by increasing customer service expenses and reducing the contribution made by such customers to the distributions costs that must be borne by all customers. This will also lower customers' bills at a time when the electric bills are the highest.

Q. Will this result in a significant shift of cost responsibility to the winter period when it might be harder for customers to pay their bills?

A. No. First, it should be noted that the decrease in the summer bills is proportionately larger than the increase in the winter bills, which occur at a time when electric bills are lowest. Second, if one's goal is to avoid loading too much cost in the winter period, the best rate design is SFV, which spreads distribution costs evenly over the seasons. The second best rate design is our revised proposal. The worst rate design is the one advocated by Public Counsel because its reliance on a volumetric charge loads more costs in the winter.

Q. **Does a customer who would like to avoid the sculpted rate design have any options?**

A. Yes. In fact, implementation of the sculpting proposal will actually enhance the options residential and small general service customers now have in how they structure and time bills in the summer versus the winter. The sculpting proposal allows customers to pay more for gas in the winter when they value it more, and less in the summer when they value it less. It also allows customers to levelize their *entire* energy bill by paying more in the winter for their natural gas service when electric bills are lower and, conversely, paying more for their electric service in the summer when the cost of natural gas service is lower.

Customers who do not want to pay in this manner can enter into a budget billing arrangement or levelized payment plan under which they can pay the same exact amount for their gas service every month. If customers want to do that and equalize their gas payments throughout the year nothing in the sculpting proposal will change that.

Q. **Is the establishment of different customer charges for the winter and summer seasons consistent with rate design principles typically followed by utility commissions?**

A. Yes. There is a long and robust history of utility commissions adopting different rates and charges for the same customer class based on seasonal considerations. For example, Laclede has had different rates for its summer and winter usages charges for many years. Electric utilities have also had different usage rates for winter and summer usage. In terms of customer charges, different levels have been set depending on the seasonal period and different customer charges have been established depending on whether the customer is a seasonal or full time customer. This Commission has also sought to address the impact of customers disconnecting during the summer period by authorizing reconnection charges that seek to recapture a portion of avoided customer charges (up to three and half months of such charges) at the time a customer reconnects. The sculpted rate and reconnection proposal in this case is an effort to address this same issue through a modest mix of both tools.

Q. **Is the Company's proposal to increase reconnection charges also another tool for mitigating the incidence and impact of customers discontinuing service during the summer?**

A. Yes. By reducing the financial benefit of discontinuing service by charging more when reconnection occurs, such a proposal reduces the incentive to disconnect. At the same time, increasing the amount to reconnect is fair to other customers because it requires those who have disconnected to pay a greater proportion of their share of the fixed costs of distributing gas once they reinstitute service rather than have such costs shifted to other customers who take service year round.

Q. If a customer discontinues taking and paying for service during the summer months, why are you suggesting that this means they are not paying their fair share of the Company's fixed distribution cost?

A. Since the Company currently collects its distribution costs throughout the year in the form of an equal monthly customer charge, a customer who disconnects for say 6 months during the summer, is only paying half of the distribution cost responsibility that other customers taking service throughout the year are paying. Unfortunately, the cost to serve that customer has not declined by half. The pipes, meters and other fixed costs necessary to be able to serve the customer once he or she returns to the system have not been reduced, let alone eliminated. The Company believes that increasing the reconnection to require the customer to pay a small share of this foregone cost responsibility (i.e. about one month's worth of customer charges) upon reconnection is a step towards treating all customers fairly in terms of their relative contribution to these fixed costs.

Q. Has the Commission previously recognized the appropriateness of such an approach?

A. Yes. In prior cases, the Commission has previously determined that recapturing up to three and a half months of foregone customer charges is appropriate. Obviously, the Company's proposal in this case is a partial move in that direction.

TREATMENT OF ENVIRONMENTAL COSTS

Q. **In his direct testimony, OPC witness Ted Robertson proposes that the Commission exclude from the Company's cost of service, certain costs incurred to comply with various environmental requirements. Do you agree with this recommendation?**

A. No. These costs are all necessary and appropriate costs associated with assets that have served customers over many years. There is simply no basis for excluding them from the Company's costs of service in this case.

Q. How have these costs been treated for purposes of this filing?

A. These costs have been treated as a normal ongoing operating expense or as a normal cost of doing business for a local distribution company.

Q. Has the Commission previously indicated its belief that these FMGP remediation costs are ongoing in nature?

A. Yes. In a Report and Order issued on December 17, 2008 in Commission Case No. GU-2007-0480, the Commission made the following findings in regard to MGE's FMGP sites and its remediation costs:

1) "Cleanup costs are certain to occur in the near future;"

2) "Remediation of former manufactured gas plant sites is a normal cost of doing business for a local distribution gas company;" and,

3) "Remediation of FMGP sites is typical of a natural gas utility."

Q. OPC witness Robertson suggests in his direct testimony that MGE'S costs associated with the remediation of FMGP sites should be utilized in setting rates for the Company because the sites are not used and useful in providing service to current customers. Are the subject sites currently used by MGE to provide natural gas service?

A. Yes. While the manufacture of gas has long ago ceased, the sites themselves are, or prior to remediation were, used for various aspects of MGE's current operations.

Q. Please describe the current use of those sites.

A. The St. Joseph FMGP #1 site is the St. Joseph service center. Shortly before the remediation of that site began, MGE leased another facility in St. Joseph and temporarily moved its operations to the leased facility. The clean-up of the St. Joseph site is substantially completed and MGE employees have moved back to that location. The Independence FMGP site currently houses the MGE training facilities and it is the fleet headquarters. The site has been entered into the Voluntary Clean-up Program and clean-up has begun. The Joplin FMGP site is the location of the Joplin service center and public business office. Remediation activities have not begun at that site at this time. The last two Company owned sites are what is known as Station A and Station B in Kansas City, Mo. The Company's Kansas City service center (known as the "Central Plant") was previously housed at Station B. A substantial portion of the planned environmental remediation activity has been completed at Station A and Station B and they currently serve as an inventory facility where the Company stores pipe and other construction materials.

Q. The Staff Report on Cost of Service suggest that MGE should receive recovery of these costs in a normalized amount by averaging the annual costs over the last three year period. Do you agree with the Staff's normalized amount?

A. Yes. I find the use of the average of the last three years expenses to normalize the environmental costs to be reasonable for purposes of this case.

Q. Do you believe that a tracker or other form of adjustment mechanism is appropriate to handle recovery of environmental costs?

A. Yes. If there is a concern about the possible variability of the environmental costs and insurance recoveries, a tracker is a good alternative to address net cost recovery. This approach would account for the costs in a way that would reduce the chances that the Company would either under or over-recover its environmental costs. Such an approach would also mitigate the significance of the estimated amount used for the purpose of setting rates. I would also note that Missouri law also authorizes the Commission to adopt rules that would permit gas corporations, like MGE, to recover the costs they incur to comply with environmental rules, laws and other environmental requirements. The Commission has previously approved such rules for electric and water corporations and such rules would certainly be an appropriate vehicle for addressing these costs for gas corporations. For now, however, the Commission should, at a minimum, permit the recovery such costs through the more traditional approach of including an appropriate allowance for such costs in rates.

INCENTIVE COMPENSATION

Q. **On pages 61-67 of its Report on Revenue Requirement and Cost of Service (Staff Report), the Staff addresses incentive compensation. Staff's case includes incentive compensation for a three year average for safety and customer service metrics. Do you agree with Staff's position?**

A. No, I do not. Staff's incentive compensation allowance provides for about $300,000 on a payroll of about $44.4 million. That is an incentive amount of less than .7% of payroll, which is not close to the amounts actually paid by MGE or by Laclede.

Q. How much incentive compensation was paid to MGE employees in the past couple of years?

A. For 2012, MGE management employees earned $779,000 in incentive compensation for safety and customer service metrics, and $743,000 in incentive compensation for MGE's business unit EBITDA (earnings before interest, taxes, depreciation and amortization). This payment of $1.52 million represents about

11.6% of MGE's management payroll. In 2013, MGE was paid $1.55 million for these same MGE business unit metrics. Both of these compensation programs were in the test year as updated, and both were paid by MGE. MGE's Union employees did not participate in these incentive compensation plans.

Q. Did the 11.6% payout include executives who are no longer working for MGE?

A. Yes. Removing those executives from the plan would result in an average payout of 10% of management payroll.

Q. Does Laclede have an incentive compensation plan?

A. Yes. As acknowledged by Staff, MGE management employees will be included in Laclede Gas' incentive compensation plan, which covers the period October 1, 2013 – September 30, 2014. In addition, in 2013, Laclede Gas Union employees began to participate in the Company's incentive compensation plan, and Laclede is offering the same opportunity to MGE union employees for the 2013-14 plan. This is consistent with senior management's view that all employees should be financially incented to achieve superior results in how we serve our customers and the costs we incur to do that.

Q. What level of incentive compensation payout has Laclede Gas experienced?

A. For 2012, Laclede Gas paid its non-officer management employees incentive compensation totaling 13.3% of their salaries. However, it should be noted that these participants were mid and upper level non-officer management. For 2013, all management employees participated in the Company's incentive plan and the payout for this larger group was 5.8% of salaries.

Q. What level of incentive payments did the Laclede Gas Union personnel experience?

A. For 2013, Laclede Gas Union personnel received incentive compensation in the amount of 4.2% of their base pay.

Q. What type of incentives did Laclede personnel have in 2013?

A. For Union personnel, supervisors and managers, 50% of their incentive was tied to individual or team performance goals in customer service, safety and efficiency/productivity; 30% was tied to their business unit (Laclede Gas) operating income [i.e. operating revenues less operating expenses], and 20% was linked to Laclede Group earnings per share. It should be noted that a significant majority of Laclede Group earnings are derived from its major subsidiary, Laclede Gas Company. For Director level management, 30% of the incentive was tied to individual metrics pertaining to customer service, safety and efficiency/productivity, 40% was derived from Laclede Gas operating income, and 30% was linked to Laclede Group earnings. These same parameters can be expected for 2014 for both Laclede Gas and MGE personnel.

Q. Does Staff agree that rates should include incentive compensation for customer service and safety metrics?

A. Yes. Staff cites previous Commission decisions that support including such compensation in rates.

Q. Does Staff agree that rates should include incentive compensation for financial metrics?

A. Not necessarily. Staff cites Commission decisions stating that rates should not include financial metrics that "chiefly benefit shareholders," adding that customers should not pay for incentive compensation programs that “primarily, if not solely...[support] shareholder wealth maximization” and are not driven by the interests of ratepayers. [Staff Report at 62-63] Staff also quotes the Commission’s decision in MGE’s 2004 rate case (GR-2004-0209) that “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 impact on ratepayers.” [Staff Report at 63] In that same light, Staff also quotes from a KCP&L order in ER-2006-0314, that “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…” [*Id.*]

Q. Do you agree with this reasoning?

A. Yes and no.

Q. Please explain.

A. I agree that customers should not be asked to pay for an incentive program that benefits only shareholders and not the customers themselves, or that benefits shareholders at the expense of customers. I can also see where it would be inequitable to ask customers to pay an incentive for a utility employee to obtain a large rate increase. However, it makes perfect business sense for customers to support an incentive program that aligns the interests of customers and shareholders. The Commission agrees with this theory. In the same KCP&L case cited above and on page 63 of the Staff Report, Case No. ER-2006-0314, the Commission stated the principle that “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 the cost of service." [Case No. ER-2006-0314; Report and Order, December 21, 2006, p. 58]

Q. Can you provide an example where customer and shareholder interests are aligned in a financial incentive?

A. Yes. One of the efficiency/productivity goals in the Laclede Gas incentive compensation program mentioned above is a financial incentive that targets reduction of O&M expense per customer. When Laclede Gas employees work to reduce this expense, customers directly benefit through the reduction in rates resulting from a lower rate case revenue requirement. Such a rate reduction is a gift to customers that keeps on giving because those rates remain in place until the next rate case, which may be years away. Meanwhile, in between rate cases, shareholders will benefit from further O&M expense reductions, at least temporarily until such benefits go to customers in the next rate case.

Q. So reducing O&M expense benefits customers, but what about EBITDA, or operating earnings?

A. Incentive compensation that rewards increases in the operating earnings of a utility directly benefits customers and should be included in rates. The fact is that everything the utility does to boost revenues and control costs benefits both customers and shareholders. Increasing earnings is simply a function of increasing revenues relative to costs, or conversely, reducing costs relative to revenues. So if a utility's revenues are $30 million below its costs, it will file a rate case asking for customers to pay $30 million more in rates. If that utility can incentivize its employees to boost revenues by $2 million and reduce costs by $5 million, the utility's shortfall is reduced to $23 million, as is the amount of its rate case request. The customers would save $7 million in rates because the utility increased its earnings by $7 million. It is not an exaggeration to suggest that such an incentive compensation program is more valuable to customers than the run of the mill salaries that we all agree should be paid by customers.

Q. But what about the point made in the orders cited by Staff that financial incentives could hurt customers by causing the utility to cut costs to the detriment of ratepayers?

A. I agree that the interests of customers in continuing to receive high quality customer service is a factor that has to be taken into account in the design of any incentive program. Fortunately, both Laclede's and MGE's incentive programs have always done that with numerous metrics and individual objectives that base incentive payouts on results that maintain and advance customer service. Accordingly, I believe our programs address this concern. However, I believe it is unwise to approve incentives related to customer service and safety while declining to approve reasonable financial incentives that are aimed at increasing revenues or reducing costs.

Q. Why?

A. Prior Commissions were concerned that financial incentives without customer service incentives would lead to cheap, but poor quality service. However, customer service incentives without financial incentives could lead to higher quality, but more expensive service. So discouraging financial incentives by refusing to allow them in rates is not the best approach. The optimal solution in incentive compensation is to include both customer service incentives and financial incentives in rates. In this manner employees are motivated to provide higher quality service at lower costs; the best of both worlds for customers.

Q. So are you saying that all financial incentives are good?

A. No, as stated by the Commission, customers should not be asked to pay for an incentive program that benefits only shareholders and provides no tangible benefit to the customers themselves. So an incentive that focuses on dividends or stock price, for example, need not be borne by customers. Nor should customers be asked to pay for the component of an incentive plan that is tied to earnings other than the earnings of the customers' utility. So for example, MGE customers were rightly not asked to shoulder the portion of an incentive tied to Southern Union's non-MGE earnings.

Q. So what is your recommendation for including a fair amount of revenue requirement in rates?

A. I recommend an amount in rates of $1.522 million. Under Southern Union, MGE management employees alone received $1.5 million in each of the last two years based on customer service, safety and MGE financial metrics. As a check on the reasonableness of this amount under Laclede ownership, I applied Laclede's average payout from 2013 for both management and Union employees to MGE's payroll. This yielded incentive compensation of $1.803 million, which supports the amount paid in the past by Southern Union.

Group	MGE Payroll	Laclede Payout	Factor	Total
Mgmt. & non-union	$12.6M	5.8%	.86	$.628M
Union	$31.8M	4.2%	.88	$1.175M
Total	$44.4M			$1.803M

Q. What does the factor represent?

A. The factor is the percentage of the payout that MGE customers should bear. For example, for Union employees, it includes 50% for team metrics on customer service, safety and efficiency/productivity, 30% on MGE business unit financial performance (operating income), and 40% of the remaining 20% (40% of 20% = 8%) of Laclede Group earnings that inure to MGE customers. Shareholders and Laclede Gas customers would bear the remainder of this incentive compensation program.

Q. Would including incentive compensation at these levels cause employee compensation to be excessive?

A. No. MGE's employee compensation is in line with the compensation approved four years ago for MGE in its last rate case, given an allowance for time. As indicated above, the total incentive compensation requested herein is well under 5% of payroll. Were MGE to have simply paid such amount in salaries, total compensation would not be excessive. Basing some portion of employee pay on incentives is ubiquitous among American businesses and is simply good management. The fact that a portion of MGE's employee compensation, albeit a small portion, is used to motivate employees to meet goals designed to improve service and lower costs for customers should be viewed in a very positive light, and not as a subject of a disallowance.

TREATMENT OF PENSION ASSET AMORTIZATIONS

Q. **In its Report, the Staff recommends that a negative amortization relating to pension assets accumulated by the Company be reflected in the Company's**

cost of service in this case to return what the Staff says are over-collections of that asset. Do you agree with this recommendation?

A. I agree with some aspects of Staff's recommendation but disagree with others.

Q. **What do you disagree with?**

A. I do not agree with the Staff's attempt to create a regulatory liability and apply negative amortization balances to the 2004 and 2006 pension amortizations. The way these amortizations were treated under the Stipulation and Agreement approved by Commission in MGE's previous rate case, Case No. GR-2009-0355, did not provide for negative amortizations of their balances. Rather the balances were to be amortized to zero, which they were. Staff's attempt to amortize those balances past zero is a violation of the agreement approved by the Commission in Case No. GR-2009-0355.

Q. What do you agree with?

A. While MGE is not willing to change the prior agreement retroactively, MGE is willing to work with Staff and others to structure pension amortizations in a different manner in this case on a going forward basis. Rather than continue to have separate amortization balances from each rate case, MGE is willing to roll the unamortized prepaid pension balance from the 2009 rate case, at the time rates go into effect, in with the current balance that has accumulated since the 2009 rate case through the true-up period of 12/31/13. MGE understands and accepts that the netting of these two balances will result in regulatory liability which will have a negative amortization balance.

TARIFF AND OTHER CHANGES

Q. Does the Company continue to believe that a low-income program aimed at helping customers to maintain utility service during the summer period is appropriate?

A. Yes. In fact, we believe the need for such a program has only increased since this case was filed as a result of several factors. These include significantly colder than normal winter weather that will put upward pressure on customer bills, escalating natural gas prices, and a recent reallocation of LIHEAP moneys to provide additional assistance to propane customers.

Q. Has the Company continued to discuss this proposal with the other parties?

A. Yes. And while no consensus has been reached on whether to have a program or exactly what form that program would take, I have tried to develop the outline of such a program for further discussion by the parties. I have attached that outline, in the form of specimen tariff sheets, to my rebuttal testimony as Rebuttal Schedule MRN-1.

Q. Does the Company agree with Division of Energy witness John Buchanan that MGE should remove the requirement on Tariff Sheet No. 103.1 to allocate 90% of energy efficiency incentives to residential programs and 10% to commercial programs?

A. Yes, Mr. Buchanan's point is well-taken. Currently, MGE's commercial energy efficiency programs are only available to small commercial customers, those in the SGS service class. In order to promote consistency and drive efficiencies between MGE and Laclede programs, MGE has proposed to expand its commercial programs to include the same type of measures that are available to larger commercial and industrial customers in Laclede Gas territory. If MGE's programs are expanded to serve this unmet market, the residential/commercial ratio of 90%/10% is impractical and unworkable and should be removed.

Q. Does expansion of MGE's commercial energy efficiency programs address any of the other party's criticisms?

A. While no party has opposed the energy efficiency program improvements proposed by MGE, Public Counsel witness Meisenheimer has expressed disappointment that MGE's level of spending on energy efficiency programs was not higher given the fact that MGE has an SFV rate design. MGE believes that expanding its commercial offerings to more closely resemble the Laclede program should increase energy efficiency investments and address Ms. Meisenheimer's concerns.

Q. **Staff has made an adjustment to eliminate $545,643 of costs related to the investigation of the explosion on the Plaza on February 19, 2013 (the "Incident") and recommended that those costs along with any other costs related to the Incident be deferred for determination of future recoverability pending the resolution of the matter. Do you agree with Staff's recommendation?**

A. I agree that the costs included in the test year related to the incident total $545,643. I would recommend that MGE be granted an AAO and be allowed to defer and record as a regulatory asset these and all other costs incurred or payments received by MGE in connection with the Incident, including, but not limited to: (a) all legal fees, outside expert fees, consulting fees or other similar fees and expenses incurred by or on behalf of MGE relating to the investigation and assessment of the Incident and any litigation activities associated with the

Incident; (b) all unreimbursed damages or costs incurred or paid by or assessed against MGE as a result of the Incident; (c) all costs incurred to recover such costs from potentially responsible third parties and insurance companies; and (d) all reimbursements and recoveries of costs and damages from third parties and insurance companies. MGE shall have the right to seek recovery of any deferred costs, net of third party recoveries, in its next general rate case proceeding, provided that other Parties shall have the right to review and propose a different treatment of such costs.

OFF-SYSTEM SALES

Q. **What is your understanding of OPC Witness Meisenheimer's change to MGE's Capacity Release and Off-System Sales Incentive Mechanisms?**

A. MGE currently earns an incentive based on the amount of off-system sales and capacity release (together, "OSS") net revenues it brings in. Sharing between the Company and the customers is divided into four tiers. MGE earns 15% of the first $1,200,000; 20% of the next $1,200,000; 25% of the next $1,200,000 and 30% of any amounts above $3,600,000. Conversely, customers receive the remaining percentages for each tier, being 85% in the first tier, 80% in the second tier; 75% in the third tier, and 70% for all OSS above $3.6 million. Public Counsel's proposal is to change the percentages and tiers to allow MGE to earn 0% of the first $1,500,000, 15% of the next $1,500,000, 20% of the next $1,500,000, and 25% of any amounts above $4,500,000. Conversely, the customers would earn by tier 100%, 85%, 80% and 75% respectively.

Q. What is the purpose of Public Counsel's change?

A. As far as I can tell, the purpose is simply to reduce the amount MGE can earn under the incentive. For example, if MGE brought in $4.5 million in OSS, under the current plan, MGE would earn $990,000 and customers would receive $3,510,000. Under Public Counsel's plan, if MGE brought in $4.5 million, MGE would earn $525,000 and customers would receive $3,975,000. However, given the lesser incentive, it is not clear whether MGE's actual performance would result in more or less revenues to customers.

Q. What is MGE's position on this change?

A. MGE opposes it. At its current tiers and percentages, the OSS incentive is working well and benefitting both customers and the Company. Public Counsel has offered no rationale for changing the status quo, and no evidence that its change would bring in more dollars for customers than are earned today. In fact, because the abundance of gas produced by horizontal drilling technology has substantially reduced the basis differentials, volatility and other historical factors that have provided greater opportunity to make more off-system sales at higher margin levels, now would be the exact wrong time to reduce the incentive for achieving success in this area. For all of these reasons, the Commission should, if anything, add another tier to the OSS plan to provide the Company with an additional incentive to achieve greater off-system sales in a very challenging market environment. A change permitting the Company to retain a 35% share to the extent it can generate net revenues in excess of $4.8 million – the average level of net revenues achieved over the past three years. This could increase the revenues to customers by further incenting MGE to achieve net revenues above and beyond the maximum levels that it has been able to produce under today's market conditions.

Q. Does this conclude your rebuttal testimony?

A. Yes it does.

Laclede Gas Company, For For all Missouri Gas Energy Service Areas
Name of Issuing Corporation or Municipality Community, Town or City

RULES AND REGULATIONS

Low-Income Energy Affordability Program

Effective April, 2014, the Company shall implement a new experimental low-income energy affordability program as set forth on Sheet Nos. _______________ of this Tariff.

1. The Program will be jointly administered by the Company and selected Community Action Agencies (CAA) in the MGE service territory. Compensation to the CAA for these duties will be negotiated between the Company, Staff, Public Counsel and the CAA subject to an overall limitation of no more than ___%. All households with incomes equal to or less than 150% of the Federal Poverty Level shall be eligible to participate in the program.

2. All households enrolling in the Program will be required to register with a CAA, apply for any energy assistance funds for which they might be eligible, agree to allow a program evaluation team to review their account information, and review and agree to implement cost-free, self-help energy conservation measures identified by the CAA. In addition, all applicants will be provided with basic budgeting information, as well as information about other potential sources of income such as the Earned Income Tax Credit. The CAA may use household registration from other assistance programs for the sole purpose of determining eligibility for the Program.

3. The Program shall be include a Bill Payment and Assistance Program and Arrearage Repayment Program and shall be funded at a total annual level of up to $500,000. Such total funding level shall not be increased or decreased prior to the effective date of rates in the Company's next general rate case proceeding, provided that any amounts not spent in any annual period shall be rolled over and used to fund the Programs in the next annual period. Upon termination of the Programs, any unspent amounts shall be used to fund low-income energy assistance, low-income weatherization, or energy efficiency programs for customers who receive natural gas services from MGE.

4. Bill Payment Assistance Program. A monthly bill credit equal to $____ per month shall be made available during the seven summer months for all participating customers. The Company will not establish a levelized payment plan for a participant during the summer months, unless the participant opts for levelized billing within 45 days after enrollment. To participate in the Bill Payment Assistance Program, a customer must pay the balance due each month, net of the bill credits.

DATE OF ISSUE April 1, 2014 (Month Day Year) DATE EFFECTIVE May 1, 2014 (Month Day Year)

ISSUED BY Craig Dowdy, Senior Vice President, External Affairs, 720 Olive St., St. Louis, MO 63101
Name of Officer Title Address

RULES AND REGULATIONS

Low-Income Energy Affordability Program (continued)

5. Any customer entering the Bill Payment Assistance Program who has arrearages shall also be required to enroll in the Arrearage Repayment Program.

6. Arrearage Repayment Assistance Program (ARP). Customers may receive pledges to assist them in paying arrearages in the same amounts and consistent with the same criteria applicable to customers receiving LIHEAP grants during the fall and winter heating seasons.

7. The Company may terminate the customers participation in the program if the customer fails to make timely payments of current bills.

8. When a customer's arrearage has been repaid, he or she will no longer be eligible for the ARP, but will continue to participate in the Bill Payment Assistance Program, if eligible.

9. While the customer is successfully participating in the ARP, he or she will not incur late payment charges on the outstanding arrearage balance amounts covered under the Program agreement; however, a customer will be allowed one late payment without losing eligibility to remain in the Program, provided that the customer pays all amounts owed under the Program by the next applicable billing payment date.

10. If a customer fails to satisfy the requirements of the ARP, then he or she will be terminated from the Program, unless the CAA determines and notifies the Company that, in its judgment, there have been 'extenuating circumstances' that make this action inappropriate and the Company agrees with such determination.

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	)	Case No. GR-2014-0007
For Natural Gas Service	)	

<u>A F F I D A V I T</u>

STATE OF MISSOURI	)	
	)	SS.
COUNTY OF JACKSON	)	

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 rebuttal 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
Michael R. Noack

Subscribed and sworn to before me this 24TH day of February, 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