

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

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**DIRECT TESTIMONY**

**OF**

**JEREMY K. HAGEMEYER**

**ATMOS ENERGY CORPORATION**

**CASE NO. GR-2006-0387**

*Jefferson City, Missouri  
September 2006*

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

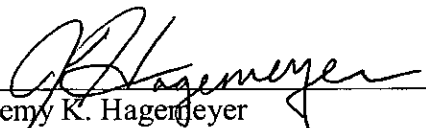
In the Matter of Atmos Energy Corporation's Tariff )  
Revision Designed to Consolidate Rates and )  
Implement a General Rate Increase for Natural Gas )  
Service in the Missouri Service Area of the )  
Company.

Case No. GR-2006-0387

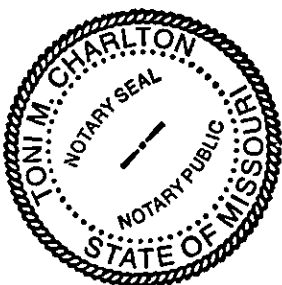
**AFFIDAVIT OF JEREMY K. HAGEMEYER**

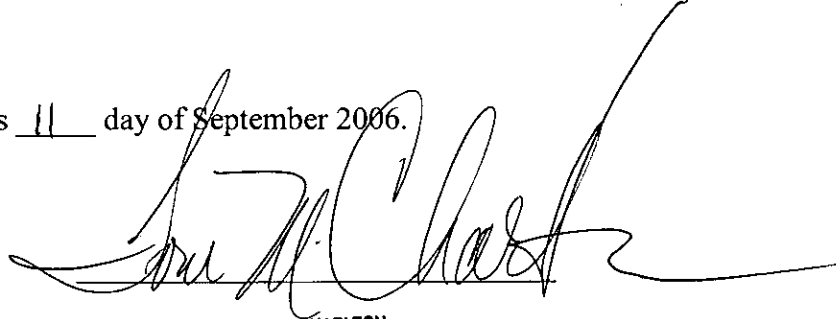
STATE OF MISSOURI     )  
                                      )  
COUNTY OF COLE     )     ss.

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

  
\_\_\_\_\_  
Jeremy K. Hagemeyer

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



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

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**JEREMY K. HAGEMEYER**  
**ATMOS ENERGY CORPORATION**  
**CASE NO. GR-2006-0387**

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

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

7 **EXECUTIVE SUMMARY**

8 Q. What matters will you address in your testimony?

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

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

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

22 Q. What is the purpose of your testimony?

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

6     **EMPLOYEE BENEFITS**

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

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

15     **INCENTIVE COMPENSATION & KATRINA BONUS**

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

17          A.     This adjustment removes the expense associated with Atmos' incentive  
18 compensation packages. The Management Incentive Plan, the Variable Pay Plan and the  
19 Long Term Incentive Plan (MIP, VPP and LTIP respectively) were based solely on  
20 Earnings Per Share (EPS) reaching a designated level. For the test year, the Company set  
21 a threshold of an EPS amount of \$1.53. If the Company reached \$1.53, participants in

1 the VPP would receive an award equaling 1% of their base salary. If EPS met the target  
2 of \$1.70, VPP participants would receive an award of 2% of their base salary. At the  
3 maximum level, EPS of \$1.87, participants would receive 3% of their base salary. The  
4 MIP also used these EPS amounts, but the awards percentages were based on pay grades.  
5 Depending on the employee's pay grade and the EPS achieved, MIP participants could  
6 receive an award of 7.5% to 120% of base salary.

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

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

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

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

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

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

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

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

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

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

22           Q.     Does the Company have any other incentive plans?

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

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

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

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

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

12           **INJURIES AND DAMAGES**

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

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

18           **INSURANCE**

19          Q.     Please explain your adjustment to Insurance.

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

4           **LOBBYING**

5           Q.     Please explain the Staff's lobbying adjustment.

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

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

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

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

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

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

11 **ADVERTISING**

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

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

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

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

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

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

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

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

(5) Political – advertising associated with political issues.

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

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

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

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

A. To date, the Company has only provided the advertisements that it did not eliminate from the cost of service. All of the advertisements that were not eliminated provide for the dissemination of information necessary to obtain safe and adequate service. These advertisements are classified as general or safety and represent allowable advertising. The Company has not provided any of the advertisements that it eliminated

1 from the cost of service in its case. As a result, these advertisements cannot be reviewed  
2 by the Staff and are assumed to be unallowable for inclusion in the cost of service.

3 **DUES, DONATIONS AND MISCELLANEOUS EXPENSES**

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

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

12 **PENSION AND OPEB EXPENSES**

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

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

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

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

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

7 A. The "corridor" approach defines the minimum amortization of  
8 unrecognized gains and losses required under FAS 87 and FAS 106. The amount of the  
9 unrecognized net gain (loss) balance that must be amortized under FAS 87 and FAS 106  
10 is the amount that exceeds 10% of the greater of the benefit obligation (PBO for pensions  
11 and APBO for OPEBs) or the market related value of the assets in the fund. Accordingly,  
12 the "corridor" is the amount equal to 10% of the PBO or market related value of assets,  
13 whichever is greater, as defined under FAS 87 and FAS 106. Since the PBO exceeds  
14 \$300 million and the APBO exceeds \$170 million, a significant amount of gains and  
15 losses are not considered for amortization under the corridor approach. Under the  
16 Company's calculation, gains and losses considered for amortization are amortized over a  
17 period exceeding 10 years. The effect of this calculation is to significantly lengthen the  
18 time it takes to fully amortize any unrecognized gains or losses. Staff believes that this  
19 lengthened amortization is unacceptable and therefore proposes that the corridor  
20 approach be eliminated and unrecognized gains or losses be amortized over a period of  
21 10 years.

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

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

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

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

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

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

22                During its audit, the Staff discovered that since Atmos acquired the Missouri  
23 territories of United Cities Gas in 1997 and Arkansas natural Gas in 2000, the Missouri

1 | portion of FAS 106 has not been funded. However, the Company has agreed to  
2 | actuarially calculate and then fund a “catch-up” contribution to address this situation.  
3 | The Staff received this calculation from the Company on September 11, 2006. As a  
4 | result the Staff may need to file supplemental direct testimony to address any problems  
5 | that it identifies after it has had adequate time to examine the Company’s calculation.

6 |       Q.     Does this conclude your direct testimony?

7 |       A.     Yes. It does.