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Issue:	**Incentive Compensation**
Witness:	**Mark C. Mispagel**
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Sponsoring Parties:	**Laclede Gas Company (LAC)** **Missouri Gas Energy (MGE)**
Case Nos.	**GR-2017-0215** **GR-2017-0216**
Date Testimony Prepared:	**October 17, 2017**

LACLEDE GAS COMPANY
MISSOURI GAS ENERGY

GR-2017-0215
GR-2017-0216

REBUTTAL TESTIMONY

OF

MARK C. MISPAGEL

October 2017

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I. WITNESS INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Mark C. Mispagel, and my business address is 700 Market Street, St. Louis, Missouri, 63101.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Laclede Gas Company, including LAC and MGE, now known as Spire Missouri Inc., or Spire, in the position of Managing Director in the Human Resources Department.

Q. PLEASE STATE HOW LONG YOU HAVE HELD YOUR PRESENT POSITION AND BRIEFLY DESCRIBE YOUR RESPONSIBILITIES.

A. I have held this position since June 1, 2015. I am responsible for all aspects of employee compensation and benefits programs.

Q. PLEASE DESCRIBE YOUR EXPERIENCE WITH LACLEDE.

A. I joined Laclede in June 2015 as Director, Compensation and Benefits. I was promoted to my current position in December 2015.

Q. WHERE DID YOU WORK PRIOR TO LACLEDE?

A. I have been working in the Compensation field since 1986. Prior to June 2015, I worked at Peabody Energy in the position of Senior Director of Compensation for approximately three and one-half years, from 2011 to 2015. I was responsible for leading a group of human resource professionals in areas of domestic, international, and executive compensation as well as employee relations for corporate and international divisions. I was also responsible for the company's compensation programs. From 1993 to 2010, I was employed with Anheuser-Busch. My last position there was as Group Director of Human Resources. Over my 17 years at Anheuser-Busch, I provided human resources support in the areas of domestic and international compensation and benefits, employee relations, executive compensation, talent acquisition, employee development and succession planning, and labor relations. Prior to Anheuser Busch, I was employed at McDonnell Douglas (now Boeing) from 1988-93, also in the areas of Compensation and Employee Relations.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I have a Bachelor of Science in Business Administration from Rockhurst University in Kansas City, Missouri, with an emphasis in Human Resources, and a Master's degree in Business Administration from St. Louis University.

Q. DO YOU HAVE ANY PROFESSIONAL DESIGNATIONS OR MEMBERSHIPS IN THE FIELD OF COMPENSATION AND BENEFITS?

A. I have been certified by the Society of Human Resources as a Senior Professional in Human resources (SPHR), and have been a member of the local chapter of the Society of Human Resource Management (SHRM), the Human Resource Management Association, and the Compensation and Benefits Network. I have served as an officer in the SHRM.

Q. HAVE YOU EVER SUBMITTED TESTIMONY BEFORE THIS COMMISSION?

A. No.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to certain issues regarding incentive compensation raised by witnesses for the Staff of the Missouri Public Service Commission ("Staff") and the Office of the Public Counsel ("OPC") in their direct testimonies in these proceedings, and to provide an overview of the Company's performance-based incentive plans. Specifically, I will discuss the purpose of these plans, how they are designed, and why it is appropriate for the Commission to reject the positions advocated by Staff and OPC and to permit recovery of the plan-related costs that the Company has included in its rate request.

Q. WHAT IS STAFF'S POSITION REGARDING INCENTIVE COMPENSATION?

A. Beginning at page 101 of the Staff's Cost of Service Report, Staff Witness Matthew Young addresses Laclede's Annual Incentive Plan ("AIP"), stating that "[t]his incentive compensation plan provides an annual cash payout to eligible union and non-union participants based on four components, each component with its own objectives: corporate performance, business unit performance, individual performance, and team unit performance." Mr. Young's summary statement announces that "Staff does not support the use of LAC's corporate, business unit, and individual AIP components for ratemaking purposes, but has included the cost of the AIP team unit performance." (*Id*., page 102). Mr. Young suggests that Staff has not included costs related to earnings-based metrics in LAC's or MGE's revenue requirements, a position purportedly consistent with prior Commission orders. Staff has also made adjustments to LAC's and MGE's historical additions to rate base to remove incentive compensation based on Staff's ratio of allowed costs to total costs.

Rate base items adjusted include plant-in-service and depreciation reserve. Staff states that the team unit performance, applicable only to union employees, contains metrics, a majority of which, are customer-oriented goals. "Generally, Staff supports such metrics as successful achievement of these goals can lead to lower costs incurred by the utility, which lead to a lower cost of service. In this case, Staff has calculated a four-year average of historical achievement levels of the team unit metrics, and applied the average achievement to current union wages for inclusion in LAC and MGE's cost of service." (*Id*., page 103). Finally, in regard to the Company's Equity Incentive Plan ("EIP"), which pays employee awards with shares of Spire stock, Staff made adjustments to remove the expensed EIP payments from the cost of service, "because EIP does not have cash consequences for LAC or MGE." (*Id*., page 105).

Q. WHAT IS OPC'S POSITION REGARDING INCENTIVE COMPENSATION?

A. In his direct testimony, OPC Witness Charles Hyneman states that: "In the past OPC has supported incentive compensation based on employee goals and objectives that, if attained, provide a direct customer benefit, including employee safety goals. However, consistent with Commission policy and precedent, OPC does not support incentive compensation payments based on earnings metrics such as net income, earnings per share, or stock appreciation. OPC also does not support the inclusion of any short-term compensation based on incentives that do not directly benefit utility customers." Asked if OPC performed an audit of Laclede and MGE's short-term incentive costs for his direct filing, Mr. Hyneman responds: "No. OPC intends to review this issue further in rebuttal testimony. In past rate cases OPC has taken positions very similar to Staff's rate case auditors on this particular issue. If Staff's position on this issue has not changed, OPC expects it will support the Staff on this issue in this rate case as well." Finally, Mr. Hyneman states that OPC does not support rate recovery of stock-based compensation, and that OPC is proposing to remove all stock-based compensation costs that are reflected in Laclede and MGE's test year expense accounts as well as the amount capitalized to plant accounts in the test year.

III. <u>RESPONSE TO STAFF AND OPC TESTIMONY</u>

Q. WHY DOES THE COMPANY OFFER INCENTIVE PLANS?

A. Incentive plans are designed to motivate, reward and align the interests of employees with all stakeholders, including customers. Furthermore, the Company feels strongly that incentive plans are an important component of its compensation program, and are needed to remain competitive in attracting, motivating and retaining talent. It is important to note that Laclede's AIP and EIP plans have been approved by its shareholders. Most publicly-traded companies our size offer incentive plans that are similar to Laclede's plans, including plans like the AIP described below. Based on a proxy review of other companies that we consider peers, we found that all of them also offer plans similar to our AIP and EIP. These peers are companies that are similar in size, own gas utilities, and are publically traded. In fact, I am not aware of any publicly-traded company that does not offer an incentive plan to at least its leadership level employees.

Q. WHAT LEVELS OF EMPLOYEES PARTICIPATE IN THE AIP?

A. Laclede believes all employees should share in the Company's successful efforts to control costs and serve customers, and that our approach to employee compensation should reflect that. Therefore, the AIP applies to all employees at Laclede.

Q. HOW DOES LACLEDE DETERMINE THE AMOUNT OF AN AWARD FOR A PARTICIPANT IN THE AIP OR EIP?

A. The Company uses industry market data from surveys and other publicly available sources to help determine competitive individual target amounts based on the participant's level and role at the Company. The Company's internal value of the role is also factored in when determining targets. Targeted levels for the performance metrics in the annual and long-term incentive plans are set at levels that are challenging, yet attainable, and the target level may not be achieved all of the time.

Q. IF THE COMPANY DID NOT OFFER INCENTIVE COMPENSATION, WOULD IT HAVE TO RAISE BASE SALARIES?

A. Absolutely. The Company uses industry market data from surveys and other publicly available sources to help determine competitive compensation, both on the base and incentive level, based on the participant's grade and role at the Company. The Company's internal value of the role is also factored in when determining targets. Compensation pay is made up of both base (fixed) and incentive (variable) components. Incentive compensation puts a part of the employee's earnings at risk in exchange for the opportunity to earn more than a normal earnings level. If it is Staff's position that the Company should not have earnings or individual performance metrics, then the Staff should raise the base salaries by 75% of the difference between the actual base salary and the base salary plus target incentive. This would be the midpoint between the threshold (50%) and target (100%) incentive, and the midpoint between the minimum (0%) and maximum (150%) payout. In my view, this would represent a good estimate of the base salary without the opportunity for incentives. By recommending 0% incentive to all management employees, Staff fails to provide a fair and reasonable compensation, even without a management incentive program. I would hasten to add that the Company does not believe that eliminating any of its incentive compensation programs would be in the best interest of customers, who benefit from the service, operational and financial performance achievements inspired by these programs.

Q. STAFF FEELS THAT CUSTOMERS DO NOT BENEFIT FROM A LARGE PART OF THE AIP. HOW DO YOU RESPOND?

A. Unlike a base salary or hourly rate, performance must exceed established threshold metrics before employees are rewarded from an incentive plan. These incentives have driven Laclede to improve operations so that it can become a more efficient and customer-oriented supplier of natural gas. The objectives set forth in the plans motivate participants to go above and beyond the norm in order to achieve higher results, which ultimately benefit customers. When employees respond to financial incentives by decreasing costs and/or increasing revenues, ratepayers ultimately reap the benefits through lower rates and less frequent rate cases. When employees respond to operational incentives, customers see the benefit of more effective service provided in a more efficient manner. When employees respond to customer service incentives, customers obviously benefit through improved service. Finally, the incentive plans have also allowed us to attract and retain talented employees, which also benefits customers.

Q. DOES THE FACT THAT THE PLANS ALSO FOCUS ON FINANCIAL RESULTS MEAN THAT THEY ARE DESIGNED TO BENEFIT SHAREHOLDERS RATHER THAN RATEPAYERS?

A. Not at all. The primary way of maximizing earnings is through operating more efficiently and effectively and/or increasing revenue. I understand that while such efforts to become more efficient or increase revenues may benefit shareholders by increasing net income between rate cases, it ultimately benefits customers through decreased costs and rates that are lower than they otherwise would have been. The fact that neither LAC nor MGE has raised rates above the ISRS charge in more than seven years is evidence that customers are capturing these benefits.

Q. WHY SHOULD CUSTOMERS PAY FOR EXECUTIVE INCENTIVES?

A. Because the incentive provided to executives may be the most important one for customers. For example, over the past several years, executives at Laclede, including the CEO, have received incentive compensation for meeting growth objectives. Growth arose from Laclede's acquisitions of MGE, Alagasco, Mobile Gas and Willmut Gas. Instead of the approximate 630,000 customers Laclede had in 2012, the Company now serves 1.7 million customers in three states. This growth has allowed the Company to increase its earnings by spreading its costs across a broader customer base, thus lowering its cost per customer. This in turn has resulted in higher earnings for the organization, while at the same time resulting in lower costs for customers, which they have enjoyed in the form of lower rate increases sought less frequently.

Growth has also allowed the Company to leverage operational efficiencies and knowledge across its expanded footprint, which also benefits customers. It is singularly unfair for Staff to insist that customers benefit from the savings achieved by Laclede, while at the same time refusing to ask customers to pay for the very compensation that motivated the achievement of those savings.

Q. WAS IT JUST CHANCE THAT LACLEDE'S EARNINGS INCREASE COINCIDED WITH COST CONTROLS AND OTHER INITIATIVES THAT BENEFITED CUSTOMERS?

A. Of course not. Earnings are nothing more than Revenues minus Costs. Earnings can be increased by increasing revenues, decreasing costs, or both. The Commission designs customer rates to collect revenues based directly on those costs. If Laclede can decrease costs, that decreases the revenue requirement, which decreases rates. If Laclede can grow revenues, that decreases the need for customers to pay those revenues, which decreases rates. The effect on revenues and costs that lead to increased earnings are the very same effects that lead to lower customer rates. Stated simply, higher earnings delay the company's need for higher customer rates. Thus, the shareholder and the customer are aligned with a common interest when it comes to company earnings. As evidence of this, OPC was so impressed with the Company's earnings in 2016 that it filed a complaint case to lower rates.

Q. BUT ISN'T STAFF CORRECT THAT COMMISSION DECISIONS HAVE HISTORICALLY DISALLOWED INCENTIVES BASED ON EARNINGS?

A. Unfortunately, Staff has a point. It is disappointing that in the past flawed arguments that earnings-based incentives benefit only shareholders and not customers have prevailed. I hope this Commission will be able to see that customers benefit not only from operational and service-oriented incentives, but from financial incentives as well. A company with service incentives but no financial incentives motivates employees to improve service without regard to costs, which can lead to higher customer rates. The Commission should not only compensate management for financial and operational incentives, but should question any company that does not have such incentives.

Q. SOME WOULD ARGUE THAT FINANCIAL INCENTIVES CAN BE COUNTER-PRODUCTIVE FOR CUSTOMERS BY LEADING EMPLOYEES TO CUT COSTS WHILE SACRIFICING SERVICE. HOW DO YOU RESPOND?

A. That is a possibility, which is why it is important to pursue a balanced scorecard that rewards good service results along with good financial results. Laclede's incentives are, and should be, tied to both service and financial metrics. For example, at the same time operations management is motivated to control costs, it is also incented to lower the time it takes to respond to leak calls, which it has been successful in doing. Financial incentives without customer service incentives can lead to low cost, low quality service. Customer service incentives without financial incentives can lead to high cost, high quality service. A company that offers both financial and customer service incentives can achieve safer service, which is better than adequate, at or below a reasonable cost.

Q. MUST EVERY INCENTIVE MEASURE BENEFIT CUSTOMERS DIRECTLY?

A. Incentives should work to attract and encourage a competent, stable, focused and motivated workforce. They will undoubtedly benefit customers in some way, directly or indirectly. Some may argue that an incentive to obtain a higher revenue requirement in a rate case may seem counter to customer goals, but a fair rate case outcome will keep the Company financially healthy and sound, and able to maintain good service and compete for financing on favorable terms.

Q. SHOULD CUSTOMER RATES INCLUDE INCENTIVES THAT BENEFIT UNREGULATED AFFILIATES OR OUT-OF-STATE UTILITIES?

A. No. In a shared service organization, it is natural for some employees to have, for example, one incentive measure that applies to a Missouri utility, and another one that applies to an Alabama utility. Such employees' payroll and incentive compensation should be, and are being, allocated to the proper business and jurisdiction.

Q. HOW DO YOU ADDRESS STAFF'S ACCUSATION AT PAGE 103 THAT SOME MANAGEMENT METRICS FAIL TO MEET FIVE GOALS SET BY STAFF?

A. I agree with the first three goals that objectives should (i) provide an incentive to perform above normal job requirements; (ii) be objective and measurable; and (iii) should be related to regulated Missouri operations. I disagree that the Company's objectives fail to meet these goals in any material way. Goals and performance are reviewed and approved by supervisors and evaluated by my department. I further disagree that a goal must require improvement over past performance or, as discussed above, have a direct, and not an indirect, link to overall ratepayer benefit. To always require improvement over past performance will in relatively short order set a bar so high as to either be or seem unachievable. Laclede will lose good workers who consistently perform above the norm because it would be against their interest to stay.

Q. SHOULD LAC AND MGE ALSO RECOVER THE CAPITALIZED PORTION OF INCENTIVE COMPENSATION?

A. Yes. The Company should recover both the expensed and capitalized portion of applicable employee incentive compensation.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Request to Increase its Revenues for Gas Service	)))	File No. GR-2017-0215
In the Matter of Laclede Gas Company d/b/a Missouri Gas Energy's Request to Increase its Revenues for Gas Service	)))	File No. GR-2017-0216

AFFIDAVIT

STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)

Mark C. Mispagel, of lawful age, being first duly sworn, deposes and states:

1. My name is Mark C. Mispagel. I am Managing Director, Total Rewards for Laclede Gas Company. My business address is 700 Market St., St Louis, Missouri, 63101.

2. Attached hereto and made a part hereof for all purposes is my direct testimony on behalf of Laclede Gas Company and MGE.

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.

Mark C. Mispagel
Mark C. Mispagel

Subscribed and sworn to before me this 16th day of OCTOBER 2017.

Marcia A. Spangler
Notary Public

MARCIA A. SPANGLER
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: Sept. 24, 2018
Commission # 14630361