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Issue: Joint and Common Costs

Witness: Michael J. McLaughlin

Exhibit Type: Rebuttal Testimony

Sponsoring Party: Missouri Gas Energy

Case No.: GR-2004-0209

Date Filed: May 24, 2004

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

REBUTTAL TESTIMONY

OF

MICHAEL J. MCLAUGHLIN

ON BEHALF OF MISSOURI GAS ENERGY

Jefferson City, Missouri

May 2004

**REBUTTAL TESTIMONY OF MICHAEL J. MCLAUGHLIN
ON BEHALF OF
MISSOURI GAS ENERGY**

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**REBUTTAL TESTIMONY OF MICHAEL J. MCLAUGHLIN
ON BEHALF OF
MISSOURI GAS ENERGY**

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Michael J. McLaughlin. My business address is One PEI Center, 2nd Floor,
3 Wilkes-Barre, PA 18711-0601.

4
5 **Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?**

6 A. I am employed by Southern Union Company ("Company"), and I am currently serving as its
7 Assistant Treasurer.

8
9 **Q. PLEASE DETAIL YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

10 A. I received a Bachelor of Science in Accountancy from Villanova University in May 1990. In
11 December, 1991, I joined Pennsylvania Gas and Water Company ("PG&W") in its General
12 Accounting Department as an Accountant I. In August, 1992, I was promoted to a position in
13 the Rates & Finance Department of PG&W as a Rates & Finance Analyst, where I was
14 assigned duties regarding base rate case filings for PG&W's gas and water divisions and took
15 part in work related to PG&W's financings. In February, 1996, PG&W sold its water
16 operations and PG&W was renamed PG Energy Inc. ("PG Energy"). In May, 1998, I was
17 named Manager, Rates and Finance, of PG Energy. In November, 1999, Southern Union
18 Company acquired PG Energy and PG Energy became a division of Southern Union
19 Company ("Company"). I worked extensively on PG Energy's base rate filings before the
20 Pennsylvania Public Utility Commission ("PPUC") in 1996, 1998 and 2000, and I presented

1 testimony before the PPUC in the latter case at Docket No. R-00005119 on the subject of
2 Average Use Per Account. In October, 2001, I was promoted to Treasury Manager of the
3 Company, with responsibility for overseeing the day-to-day operations of the Company's
4 cash management, banking relationships, remittance processing, borrowings and short-term
5 investments. In July, 2003, I was promoted to Assistant Treasurer of the Company, where I
6 have responsibility for the aforementioned treasury management functions, as well as
7 preparation of financial forecasts and the maintenance of the Company's Joint and Common
8 Cost Model ("JCC Model").
9

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

11 A. The purpose of my rebuttal testimony is to respond to several of the issues raised and claims
12 made by Missouri Public Service Commission's Staff ("Staff") witness Charles R. Hyneman
13 with respect to corporate costs, and to address comments of Staff witness Oligschlaeger
14 regarding the Company's commitment to provide certain information on changes in
15 corporate costs as a result of the Panhandle acquisition.
16

17 **Q. WHAT PORTION OF MR. HYNEMAN'S DIRECT TESTIMONY DO YOU WISH**
18 **TO ADDRESS?**

19 A. In his direct testimony, Mr. Hyneman claims that one of the cost allocation factors in the
20 Company's JCC Model is flawed (Page 25, Line 1 – Page 28, Line 22) and certain types of
21 costs contained in the JCC Model are not properly allocable to Missouri Gas Energy
22 ("MGE") ratepayers, specifically salaries of personnel in the Chairman of the Board's office

1 (Page 30, Line 16 – Page 32, Line 6), and costs associated with the rental of the Company's
2 offices in New York City (Page 32, Line 18 – Page 33, Line 2).

3
4 **Including Customer Numbers in the Derivation of Allocation Factors**

5 **Q. MR. HYNEMAN CONTENDS THAT THE COMPANY'S JCC MODEL CONTAINS**
6 **IMPROPER ALLOCATIONS OF GENERAL CORPORATE COSTS DUE TO THE**
7 **INCLUSION OF THE NUMBER OF CUSTOMERS AS A FACTOR IN THE**
8 **GENERAL CORPORATE COST ALLOCATOR. DO YOU AGREE WITH HIS**
9 **POSITION?**

10 **A.** Yes, I partially agree with his position regarding the appropriateness of using the number of
11 customers to allocate costs to the Company's Panhandle Eastern Pipe Line subsidiary
12 ("Panhandle"). In prior rate proceedings in multiple jurisdictions, including before this
13 Commission in Case No. GR-2001-292, the Company had used a four factor allocation
14 method for general corporate cost allocations, which was developed by giving equal
15 weighting to each unit's (1) investment; (2) revenues; (3) expenses; and (4) customers in
16 order to determine the appropriate allocation percentage for each business unit. However,
17 with the acquisition of Panhandle, the Company has ventured outside of its traditional LDC
18 business into the regulated interstate pipeline business, which has a far lower number of
19 customers and would skew the results of the four-factor calculation towards a lower
20 allocation to Panhandle.

1 Q. DOES THE COMPANY AGREE WITH MR. HYNEMAN'S CALCULATION OF A
2 GENERAL ALLOCATION FACTOR BASED UPON THE REMAINING THREE
3 FACTORS?

4 A. Yes, the Company agrees with the general allocation factors as calculated by Mr. Hyneman
5 of 16.872% for MGE, compared to the 25.041% as filed by the Company through its JCC
6 Model. However, Mr. Hyneman improperly applied this factor to all corporate payroll and
7 non-payroll costs, not just those corporate costs which utilize the general corporate cost
8 allocator.

9
10 Q. DOES THE COMPANY HAVE A REVISED CLAIM FOR CORPORATE COSTS
11 BASED UPON ITS CHANGE TO A THREE-FACTOR ALLOCATION AND OTHER
12 CHANGES THAT WERE MADE TO THE JCC MODEL?

13 A. Yes. The Company's adjusted claim for Corporate Costs in this proceeding, other than
14 insurance costs, is \$2,418,245.

15
16 Salaries of Messrs. Lindemann and Brennan and Support Staff

17 Q. PLEASE DESCRIBE MR. HYNEMAN'S ADJUSTMENT WITH RESPECT TO
18 SALARIES PAID TO PERSONNEL WHO WORK IN THE OFFICE OF THE
19 CHAIRMAN OF THE BOARD OF DIRECTORS OF THE COMPANY?

20 A. Mr. Hyneman's direct testimony indicates that the Staff views Mr. Lindemann and Mr.
21 Brennan's "relationship to Southern Union is more as members of the Board of Directors
22 than executive officers." (Page 30, Lines 19-20) He proceeds to recommend a total level of

1 compensation for Mr. Lindemann, the Chairman and Chief Executive Officer of the
2 Company since 1990, and Mr. Brennan, the Vice Chairman and Assistant Secretary of the
3 Company since 1990, both of whom are members of the Executive Committee of the Board
4 of Directors of the Company, of \$100,000 per year each, including the costs of fringe benefits
5 and payroll taxes. He also removes the costs associated with the two administrative support
6 personnel who are based in the New York office.

7
8 **Q. DO YOU AGREE WITH MR. HYNEMAN'S CHARACTERIZATION OF THE**
9 **RELATIONSHIP OF MESSRS. LINDEMANN AND BRENNAN WITH THE**
10 **COMPANY AND THE LEVEL OF THEIR INVOLVEMENT IN THE COMPANY'S**
11 **OPERATIONS?**

12 A. No. While Mr. Hyneman admits to "recognizing that Messrs. Lindemann and Brennan play a
13 more significant role than the average Board member" (Hyneman Direct, Page 30, Lines 21-
14 22), he proceeds to make an arbitrary valuation of each employee's reasonable total
15 compensation from the Company based upon the relative compensation of members of the
16 Board of Directors of the Company who are not executive officers of the Company. Messrs.
17 Lindemann and Brennan constitute two-thirds of the Executive Committee of the Board of
18 Directors of the Company, which also includes Mr. Karam, the President and Chief
19 Operating Officer of the Company.

1 **Q. PLEASE DESCRIBE THE FUNCTION OF THE EXECUTIVE COMMITTEE OF**
2 **THE BOARD OF DIRECTORS.**

3 A. An excerpt from the Company's 2003 Proxy Statement describes the Executive Committee
4 of the Board of Directors as follows:

5 "The Board of Directors has an Executive Committee, currently composed of
6 Messrs. George Lindemann (Chairman), Brennan and Karam. The Executive
7 Committee held four meetings and acted by unanimous written consent on
8 nineteen occasions during fiscal year 2003. During the intervals between
9 meetings of the Board of Directors, this committee has the authority to, and
10 may exercise all of the powers of, the Board of Directors in the management of
11 the business, property and affairs of the Company in all matters that are not
12 required by statute or by the Company's Restated Certificate of Incorporation or
13 Bylaws to be acted upon by the Board. This committee must exercise such
14 authority in such manner as it deems to be in the best interests of the Company
15 and consistent with any specific directions of the Board."

16
17 **Q. DOES THE EXECUTIVE COMMITTEE OF THE BOARD OF DIRECTORS**
18 **CONTINUE TO MEET FREQUENTLY DURING FISCAL YEAR 2004?**

19 A. Yes. The full Board of Directors has held seven meetings during Fiscal Year 2004, and the
20 Executive Committee of the Board of Directors has held four additional meetings and
21 provided numerous written consents in lieu of meetings. Since the three members of the
22 Executive Committee are actively involved in the day-to-day management of the Company,
23 the Board has allowed them to continue to act on behalf of the full Board, in lieu of calling a
24 meeting of the full Board.

1 **Q. ARE MESSRS. LINDEMANN AND BRENNAN COMPENSATED EXCESSIVELY**
2 **IN COMPARISON TO EXECUTIVES IN SIMILAR POSITIONS AT SIMILARLY**
3 **SITUATED COMPANIES?**

4 A. No. In fact Mr. Lindemann, as Chairman of the Board and Chief Executive Officer of the
5 Company, was the fourth-lowest in total cash compensation (salary plus bonus) for fiscal
6 year 2003 out of fifteen Chief Executive Officers employed at companies (including the
7 Company, but excluding Peoples Energy, which was acquired) that comprise the Company's
8 Peer Group of companies that were listed in Company witness Dunn's testimony in this
9 proceeding. (Dunn testimony – Page 43). Mr. Lindemann's three-year average salary would
10 have ranked him as the third-lowest paid Chief Executive Officer of the fifteen companies.
11 Mr. Brennan's total cash compensation ranked him fourth-highest out of the fifteen second-
12 highest ranking employees at the Peer Group companies for 2003, but only sixth-highest out
13 of fifteen on a three-year average basis. Please refer to the attached Exhibit MJM-1 for
14 details regarding executive pay within the Peer Group.

15
16 **Q. DOES THE STAFF'S RECOMMENDATION IN THIS PROCEEDING CONFLICT**
17 **WITH A PRIOR COMMISSION ORDER?**

18 A. Yes, it does. In its Report And Order in Case No. GR-96-285, the Commission authorized
19 50% of the compensation of Messrs. Brennan and Lindemann to be recovered through base
20 rates. There was no mention of any disallowance of salaries related to the support staff in the
21 New York office in that Report And Order.

1 Q. DOES THE COMPANY BELIEVE THAT A 50% RECOVERY OF THE
2 COMPENSATION COSTS RELATED TO MESSRS. LINDEMANN AND BRENNAN
3 IS SUFFICIENT?

4 A. No. The Company is of the opinion that Messrs. Lindemann and Brennan and their support
5 staff in New York are compensated fairly for the services that they provide to the Company
6 and that none of the costs related to the service and leadership that is provided by the
7 personnel based in the Company's New York office should be disallowed. Messrs.
8 Lindemann and Brennan have been providing their leadership to the Company's management
9 team since prior to the acquisition of MGE, and their management philosophy resonates
10 throughout the Company's operations. The Company strives to provide high quality, safe
11 service to its customers at reasonable rates, while providing a reasonable return to its
12 shareholders. Messrs. Lindemann and Brennan lead the Company's executive management
13 team, and their contributions as managers who help promote fiscal discipline throughout the
14 Company, which benefits both ratepayers and shareholders, should be fully recoverable
15 through rates.

16
17 Costs of New York Office

18 Q. MR. HYNEMAN HAS PROPOSED DISALLOWANCE OF THE CORPORATE
19 COSTS RELATED TO THE RENTAL OF OFFICE SPACE IN NEW YORK. DO
20 YOU AGREE THAT HIS ADJUSTMENT IS REASONABLE?

21 A. No. The Company believes that costs associated with providing office accommodations to
22 its Chairman and Vice Chairman and their support staff are properly recoverable through

1 rates. The Company's New York office provides a workspace for both those employees who
2 are stationed in the New York office, plus those Company personnel who travel to New York
3 to transact Company business. The New York office is roughly equidistant from Providence,
4 Rhode Island, where the Company's New England Gas division is headquartered, and
5 Wilkes-Barre, Pennsylvania, where both Corporate headquarters and the Company's PG
6 Energy division's headquarters are located. The New York office provides the Company
7 with a location from which it is convenient to schedule meetings with credit rating agencies,
8 energy companies, bankers and the investment community. Meeting with credit rating
9 agencies, bankers and investors is crucial to the ratepayer as it enhances the ability of the
10 Company to raise capital in a cost-efficient manner.

11
12 **Reports on Changes in Corporate Costs**

13 **Q. STAFF WITNESS OLIGSCHLAEGER INDICATES, AT PAGES 9-10 OF HIS**
14 **DIRECT TESTIMONY, HIS BELIEF THAT SOUTHERN UNION HAS NOT**
15 **FULFILLED A COMMITMENT IT MADE IN PARAGRAPH III.3.G. OF THE**
16 **STIPULATION AND AGREEMENT IN CASE NO. GM-2003-0238 (THE**
17 **PANHANDLE ACQUISITION PROCEEDING). DO YOU AGREE WITH MR.**
18 **OLIGSCHLAEGER?**

19 **A. No. That paragraph of the Stipulation and Agreement provides as**
20 **follows:**

21 "Southern Union agrees that within six (6) months of the closing of the
22 Transaction, it shall perform, provide, and discuss with all interested parties subject to
23 a Commission protective order a study of the impact of the acquisition and operation of
24 SUPC and its Successor Entities on Southern Union's structure, organization, and costs.

1 This study will address the specific impacts of the acquisition and operation of SUPC
2 and Successor Entities on Southern Union's administrative and general ("A&G")
3 expense and cost allocation methodology. Southern Union will specifically identify the
4 process used to allocate A&G costs and expenses to its regulated, merger and
5 acquisition, sale and non-regulated functions of its regulated divisions as well as its
6 non-regulated subsidiaries. Southern Union agrees that the types and availability of
7 raw data necessary to perform allocations of corporate overhead costs shall be
8 discussed at the meeting to occur within six (6) months of the close of the
9 Transaction. The raw data to be discussed should include, but not be limited to,
10 regulated and non-regulated information concerning customer numbers and billing
11 information, revenue data, asset information (gross and net plant, etc.), management
12 work time allocations, employee numbers and other payroll data, and the Missouri
13 jurisdiction rate of return on investment ("ROR") and return on equity ("ROE"). The
14 allocation procedures to be disclosed shall include, but need not be limited to, the use
15 of cost allocation manuals, timesheets, time studies, and/or other means of tracking and
16 allocating costs. The allocation procedures agreed upon should provide a means to
17 identify and substantiate the portion of each individual corporate employee's time and
18 associated payroll cost being allocated to Southern Union's regulated divisions."
19

20 Southern Union complied with the study requirements of this paragraph by preparing
21 and providing, within 6 months of the closing of the acquisition, to the Staff and the
22 Office of the Public Counsel its Joint and Common Cost ("JCC") Model as of June 30,
23 2003. Southern Union also updated this JCC Model through December 31, 2003, and
24 provided that update to the Staff and Public Counsel also.
25

26 Southern Union also prepared and provided to the Staff and Public Counsel a special
27 study of staffing changes in the corporate organization occurring between June 30,
28 2003 (less than three weeks following the closing of the acquisition) and December 31,
29 2003.
30

31 I believe that the foregoing actions by Southern Union fulfill the special study

requirements of paragraph III.3.G. of the Panhandle stipulation. Nevertheless, we remain willing to discuss these matters with the Staff and Public Counsel.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's
Tariff Sheets Designed to Increase Rates
for Gas Service in the Company's Missouri
Service Area.

)
)
)
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Case No. GR-2004-0209

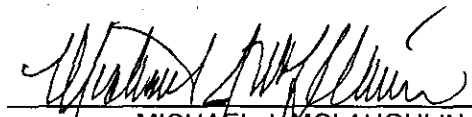
AFFIDAVIT OF MICHAEL J. MCLAUGHLIN

STATE OF PENNSYLVANIA)


)
) ss.
)

COUNTY OF LUZERNE)

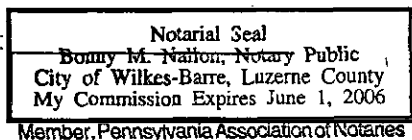
Michael J. McLaughlin, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the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


MICHAEL J. MCLAUGHLIN

Subscribed and sworn to before me this 21st day of May 2004.


Notary Public

My Commission Expires:



SOUTHERN UNION COMPANY
MISSOURI GAS ENERGY
PROXY GROUP
CEO SALARIES

Line No.	COMPANY	2001	2002	2003	3YR. AVERAGE
1	CASCADE NATURAL GAS	\$ 354,549	\$ 265,752	\$ 278,284	\$ 299,528
2	PIEDMONT NATURAL GAS	238,692	283,462	373,077	298,410
3	NUI CORP	553,300	459,000	450,000	487,433
4	SOUTH JERSEY INDUSTRIES	459,175	478,115	528,454	488,581
5	LACLEDE GAS COMPANY	386,667	444,400	616,450	482,506
6	NORTHWEST NATURAL GAS	329,445	338,009	640,000	435,818
7	NEW JERSEY RESOURCES	556,923	657,711	736,154	650,263
8	NICOR INC	1,132,277	670,769	901,000	901,349
9	SOUTHWEST GAS CORP	820,022	907,491	952,458	893,324
10	ATMOS ENERGY CORP	972,388	889,778	989,616	950,594
11	WGL HOLDINGS INC	840,000	672,000	1,054,100	855,367
12	AGL RESOURCES, INC.	1,262,499	1,368,951	1,459,615	1,363,688
13	UGI CORP	1,262,809	1,226,107	1,832,989	1,440,635
14	KEYSPAN CORP	1,761,897	1,221,643	2,027,056	1,670,199
15	AVERAGE	<u>\$ 813,546</u>	<u>\$ 739,803</u>	<u>\$ 966,228</u>	<u>\$ 839,859</u>
16	SOUTHERN UNION COMPANY	<u>\$ 310,619</u>	<u>\$ 341,589</u>	<u>\$ 459,587</u>	<u>\$ 370,598</u>

SOUTHERN UNION COMPANY
MISSOURI GAS ENERGY
PROXY GROUP
VICE CHAIRMAN OR SECOND-MOST SENIOR OFFICER SALARIES

Line No.	COMPANY	2001	2002	2003	3YR. AVERAGE
1	CASCADE NATURAL GAS	\$ 221,114	\$ 180,250	\$ 189,622	\$ 196,995
2	NEW JERSEY RESOURCES	238,654	255,269	261,231	251,718
3	PIEDMONT NATURAL GAS	237,731	252,308	267,116	252,385
4	LACLEDE GAS COMPANY	235,833	254,833	344,267	278,311
5	SOUTHWEST GAS CORP	225,348	244,571	393,618	287,846
6	SOUTH JERSEY INDUSTRIES	258,446	270,131	393,750	307,442
7	NORTHWEST NATURAL GAS	310,301	299,900	338,833	316,345
8	NUI CORP	364,500	325,138	285,000	324,879
9	ATMOS ENERGY CORP	320,202	321,466	362,451	334,706
10	NICOR INC	443,212	316,154	508,244	422,537
11	WGL HOLDINGS INC	375,000	353,000	573,500	433,833
12	UGI CORP	440,426	473,307	689,260	534,331
13	AGL RESOURCES, INC.	348,462	679,343	700,000	575,935
14	KEYSPAN CORP	608,870	598,338	757,958	655,055
15	AVERAGE	<u>\$ 347,361</u>	<u>\$ 365,707</u>	<u>\$ 467,833</u>	<u>\$ 393,634</u>
16	SOUTHERN UNION COMPANY	<u>\$ 186,750</u>	<u>\$ 367,468</u>	<u>\$ 609,039</u>	<u>\$ 387,752</u>