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Kansas Corporation Commission
/S/ Patrice Petersen-Klein

In the Matter of the Application of)
Kansas Gas Service, A Division)
of ONEOK, Inc. for Adjustment of) DOCKET 12-KGSG-835-RTS
its Natural Gas Rates in the State)
of Kansas)

Received
on
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by
State Corporation Commission
of Kansas

DIRECT TESTIMONY

OF

JOHN R. ELLERMAN

ON BEHALF OF

KANSAS GAS SERVICE

A DIVISION OF ONEOK, INC

DIRECT TESTIMONY

OF

JOHN R. ELLERMAN

KANSAS GAS SERVICE

DOCKET NO. 12-KGSG-___-RTS

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, EMPLOYER, AND OCCUPATION.

A. My name is John R. Ellerman. My business address is Pay Governance LLC, 5601 Granite Parkway, Suite 270, Plano, Texas 75024. I am a management consultant.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?

A. I am testifying on behalf of Kansas Gas Service, a Division of ONEOK, Inc.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I am currently employed as a Partner with the firm of Pay Governance LLC. Pay Governance LLC is a management consultancy formed in 2010 following the decision by Towers Watson (formerly Towers Perrin) to scale back the size and scope of its executive compensation practice. I am one of 20 partners with Pay Governance; the firm currently has offices in 12 U.S. cities and has a current client roster of more than 300 U.S. companies. Pay Governance is an independent firm owned by its 20 partners and has no ties or affiliations with any other firm. I have both B.B.A. and M.B.A. degrees from Stetson University. I have held an appointment to the Division of Sponsored Research at M.I.T. I have also served two years in the Department of Defense as a systems analyst in Washington D.C.

I began my management consulting career in 1972 when I joined the firm of KPMG Peat

Marwick. I served as a senior management consultant in the general management strategy practice of KPMG Peat Marwick for six years. In 1978, I joined Towers Perrin as a compensation consultant in that firm's Atlanta office. I was transferred by Towers Perrin to the firm's Tampa office in 1981 where I initiated the firm's compensation consulting practice in Florida. I was elected a Principal in 1983 and a Vice President of Towers Perrin in 1988. In 1993, I transferred to the Dallas office of Towers Perrin to lead the firm's executive compensation practice in that office. In 1996, I was promoted to the role of Managing Principal with the responsibility for managing the executive compensation and rewards practice for the firm's Western region of the United States. I held that position until I retired from Towers Perrin in 2010 when I elected to join three other retired Towers Perrin partners in the formation of Pay Governance LLC.

I have specialized in the executive compensation and general compensation areas for the past 35 years. I consult with Fortune 500 companies on a daily basis regarding pay matters. I have also specialized in the design of incentive compensation plans that align company performance with reward opportunities. My clients are predominately in the energy services sector.

I am a frequent speaker on executive compensation and have given presentations at national forums of the Edison Electric Institute, the Conference Board, World at Work, and other prominent groups.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY STATE REGULATORY COMMISSIONS?

A. I have testified on compensation matters regarding rate cases before the regulatory commissions of Kansas and Oklahoma on behalf of ONEOK. In addition, I have supplied expert testimony on behalf of Atmos Energy Corporation to the regulatory authorities in the states of Texas and Tennessee.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been requested to provide expert testimony with respect to:

- The overall compensation philosophy and strategy of ONEOK/KGS;
- The market competitiveness of the ONEOK/KGS approach to compensation and employee benefits;
- An evaluation of the incentive compensation plans employed by ONEOK/KGS; and
- Conclusions regarding the compensation and employee benefits plans of ONEOK/KGS and whether such align with market practices of other comparably-sized utility organizations.

Q. WOULD YOU BRIEFLY STATE YOUR OVERALL CONCLUSIONS WITH RESPECT TO THE COMPENSATION AND EMPLOYEE BENEFITS PROGRAM OF ONEOK/KGS?

A. My overall assessment of the ONEOK/KGS total compensation program, including its employee benefits plans, is that the program is fair, equitable, and balanced and is aligned with the competitive practices of other large gas utility organizations with which ONEOK/KGS competes for human resources talent.

II. ONEOK/KGS COMPENSATION PHILOSOPHY AND STRATEGY

Q. WHAT IS THE OVERALL COMPENSATION PHILOSOPHY AND STRATEGY OF ONEOK/KANSAS GAS SERVICE?

A: ONEOK's employee base includes employees who are represented by collective bargaining groups as well as employees who are not represented by collective bargaining groups. Those employees who are covered by the collective bargaining process have their wage rates and employee benefits set through a formal negotiating process. Therefore, except where specifically referenced, I will focus my testimony on the ONEOK/KGS non-collective bargaining population, and all findings and conclusions cited in my testimony should be viewed as pertaining to the non-bargaining unit employees of the organization.

It is the goal of ONEOK to provide executives and all employees with a fair, equitable, and competitive total compensation program. Total compensation includes both direct compensation (base salary, annual incentives, and in certain cases, equity or long-term incentives) and employee benefits. The total compensation program is designed to assist the organization with the attraction, motivation, and retention of employees by targeting total compensation at the 50th percentile (median) of the competitive market in which the organization competes for talent. ONEOK and KGS Human Resources Department carefully monitor the total compensation program to ensure that it fairly serves all constituents: employees, customers, shareholders, and other Company stakeholders.

In its most recent proxy statement to shareholders (reference: annual proxy statement to shareholders released on April 3, 2012), ONEOK has carefully articulated in its Compensation Discussion and Analysis its compensation philosophy for executives. This compensation philosophy permeates the ONEOK organization and is applicable to all ONEOK and KGS non-bargaining employees. Key highlights from the 2012 proxy statement's Compensation Discussion and Analysis include:

> "We believe that an employee's compensation should be tied directly to the achievement of our strategic, financial and operating goals, all of which are designed to deliver value to our shareholders. Therefore, a significant part of each executive's pay is "at risk," in the form of an annual short-term incentive award and long-term, equity-based incentive grants…………"
>
> "We believe that a competitive compensation program is an important tool to help us attract and retain talented executives capable of leading our company in the competitive business environment in which we operate. When targeted levels of performance are achieved, we seek to pay experienced executives at approximately the median level of total compensation for energy companies and other organizations with whom we compete for executive talent………"
>
> "When targeted levels of executive personal performance and company financial performance are achieved, the Committee seeks to pay our named executive officers a base salary and short- and long-term incentives at approximately the median level of pay for that position at energy services

> companies with which we compete for executive talent as referenced in the market data. In determining 2011 compensation levels, the Committee determined that the company's financial performance and the named executive officers' performance with respect to the reference criteria each met targeted levels. As a result, the Committee targeted the total direct compensation for each of the named executive officers at between the 25^{th} and 50^{th} percentiles, with adjustments made depending on the executive's tenure with the company, level of responsibility and time in position…………"[1]

In my examination of the ONEOK/KGS compensation program for non-bargaining employees, I found evidence that the tenets and guiding principles of the organization's approach to executive compensation pertains to the compensation of all ONEOK/KGS employees. All non-bargaining employees are compensated using the same pay for performance philosophy. Each non-bargaining employee group, whether executive, middle management, professional, technical, or clerical, are offered target pay opportunities which are built around a 50^{th} percentile target market philosophy. There is a consistent and balanced approach to compensation throughout the entire ONEOK/KGS organization for non-bargaining employees.

III. ONEOK/KGS's MARKET PERCENTILE TARGET, REFERENCE POINTS AND PAY RANGES

Q. IN TARGETING ITS COMPENSATION PROGRAM TO ALIGN WITH THE COMPETITIVE MARKETPLACE, AT WHAT MARKET PERCENTILE DOES KANSAS GAS SERVICE FOCUS UPON? DOES THE MARKET PERCENTILE TARGET FOR ONEOK/KGS DIRECT COMPENSATION APPLY TO BOTH EXECUTIVE PAY AS WELL AS PAY FOR THE GENERAL EMPLOYEE POPULATION?

A: As noted in the answer immediately above, ONEOK/KGS targets the 50^{th} percentile (median) in establishing compensation opportunities for both executives and the total employee population who are not represented by collective bargaining groups. Even though the Company targets the median in setting its market reference point for

[1] ONEOK April 3, 2012 annual proxy statement to shareholders, pages 53 and 56.

salaries, and sets target incentive award opportunities referencing median market data, actual compensation levels may fall slightly above or below the median levels based upon assessments of company performance, business unit performance, personal performance, employee tenure, and other considerations. In reality, my analysis of ONEOK/KGS actual compensation levels for non-bargaining employees reveals that the organization consistently pays between the 25th and 50th percentiles with respect to most positions. This will be illustrated with my competitive assessment of market data and organization actual compensation levels versus the market discussed later in this testimony.

In establishing a compensation strategy for non-bargaining employees aligned with the marketplace 50th percentile, the organization is setting its target compensation at a point which represents the competitive positioning where 50 percent of market competitors pay above the median level and 50 percent of market competitors pay below the median level. The following table illustrates a hypothetical example of survey market data and the determination of the 50th percentile (median) as well as 25th and 75th percentiles.

Table 1 – Hypothetical Market Data – Survey Annual Salaries of 15 Companies	
$30,000	
$31,000	
$32,500	-------25th Percentile (1st Quartile)
$33,000	
$33,333	
$33,500	
$33,800	-------50th Percentile (Median)
$34,000	
$34,000	
$34,500	
$34,950	-------75th Percentile (3rd Quartile)
$35,000	
$36,500	
$39,000	

By targeting the 50th percentile, the Company is setting compensation targets which are fair, competitive, and objectively established and reflective of the middle of the labor markets in which the Company competes for employees.

Q. HOW DOES ONEOK/KGS ESTABLISH MARKET REFERENCE POINTS AND PAY RANGES?

A: ONEOK participates in various national and industry-specific compensation surveys to determine market guidelines for each position. ONEOK and KGS job descriptions are matched to survey job descriptions and data is submitted annually for each survey. ONEOK's Human Resources Department reviews the annual survey results, which are consolidated for all participating companies, and determines the market guidelines for matched positions. Base salary market guidelines may be determined from a single survey, or from the average of several surveys, depending on the availability of matches for each job or position.

From the survey data, ONEOK uses the 50th percentile or median to establish the base salary Market Reference Point. It is my experience that most companies use the 50th percentile to establish salary market guidelines in their attempts to remain competitive in their respective labor markets. Then, ONEOK develops a set of base salary market guidelines built around each position. The market guidelines are based upon a range of 70 percent for the minimum of the Market Reference Point up to a maximum equal to 120 percent of the Market Reference Point. The following example illustrates.

Market Reference Point: $50,000 (market 50th percentile for position)

Minimum: $35,000 ($50,000 X 70 percent)

Maximum: $60,000 ($50,000 X 120 percent)

The resulting market guidelines ($35,000 to $60,000 in the example) allow supervisors the flexibility to take into account various factors that may impact market salary for a position including a unique skill set, value-added experience or expertise, proficiency, performance over a sustained time period, and geographical differences. The Market Reference Points are established using national market surveys for base salaries, as well as incentive opportunities, and the resultant market guidelines are broad enough to allow ONEOK to make geographical adjustments to actual pay rates if warranted. The ONEOK Human Resources Department subscribes to geographical pay studies conducted by the Economic Research Institute (ERI), and supervisors may be provided this data as well when assessing individual employee salaries and pay levels.

Market Reference Points and the resultant market guidelines are established for base salary. The incentive opportunities associated with each position are also based upon 50th percentile market rates and are expressed as a percent of each position's base salary rate.

Q. DO KANSAS GAS SERVICE EMPLOYEES RECEIVE REGULAR ADJUSTMENTS TO THEIR BASE SALARIES AND/OR PERIODIC COST OF LIVING INCREASES?

A: The Company does not make cost of living adjustments of any kind to non-bargaining employees with respect to direct wages and compensation. It is the Company's policy to constantly monitor marketplace trends and developments, and it is the supervisors' responsibility at the local market level to stay abreast of local market competitive conditions. When salary adjustments are made, the supervisor is instructed to take into account the individual employee's quality of work, skillset, proficiency level, experience, sustained performance level, and overall value to the position. Other considerations such as workforce availability, employer needs, location, and economic conditions are also factors that can also influence individual compensation adjustments.

Q. WHAT CONCLUSIONS HAVE YOU DRAWN FROM YOUR EXAMINATION OF THE COMPETITIVE POSITIONING OF THE ONEOK/KANSAS GAS SERVICE COMPENSATION LEVELS?

A: I have reviewed and assessed the competitiveness of ONEOK/KGS compensation levels and will share that assessment in my testimony.

ONEOK evaluates its compensation program and the compensation levels of its employees by reviewing competitive data each year from a number of national surveys conducted by major human resources consulting firms and other third-party sources. The surveys regularly reviewed by ONEOK include the following:

- Altman Law (may be listed as ILI Law)
- American Gas Association (AGA)
- AON Hewitt Natural Gas Transmission Industry (NGTI)
- AON Hewitt TCM (may be listed as Online Executive or Management and Professional)
- Mercer Energy (may be listed as Mercer – ECS – CROSS, Field, Generic, or MTCS)
- Pearl Meyer Natural Gas Gathering/Processing Industry (NGGPI) (was Hewitt)
- Southern Gas Association (SGA)
- Towers Watson Energy Marketing and Trading, Mid-management and Professional, Office and Business Support (or CSR Office Support), Liquid Pipeline Roundtable

In Table 2 which follows, I have reported a competitive analysis of ONEOK and KGS compensation levels using the survey data compiled by ONEOK's Human Resources Department from the aforementioned survey sources. The analysis in Table 2 is based upon an assessment of both target and actual pay levels reported for 16 job families or functions. The executive positions include job functions and employees serving at the ONEOK corporate level and operating company managerial levels. The remaining 15 job families include jobs and employees dedicated solely to KGS. Table 2 reports the percent difference between the ONEOK/KGS compensation levels with that of the survey average of the 50th percentile data reported from each of the survey sources with the following elements of compensation:

- Actual Base Salary = the average base salary for all incumbent ONEOK and/or KGS employees for 2011 versus the average of the 50th percentile actual base salary competitive data from the applicable survey sources.
- Actual Annual Incentive = the average annual incentive (bonus) paid to all incumbent ONEOK and/or KGS employees for 2011 versus the average of the 50th percentile annual incentives paid from the applicable survey sources.
- Actual TCC (Actual Total Cash Compensation) = the average base salary plus annual incentive (bonus) paid to all incumbent ONEOK and/or KGS employees for 2011 versus the average of the 50th percentile base salary and bonus at the 50th percentile paid from the applicable survey sources.
- Target Incentive = the targeted amount of annual incentive award to be paid to a ONEOK/KGS employee for the applicable job level in 2011 versus the average of the 50th percentile target annual incentive reported from the applicable survey sources.
- Target TCC (Target Total Cash Compensation) = the amount of base salary plus target annual incentive award to be paid to a ONEOK/KGS employee for the applicable job level in 2011 versus the average of the 50th percentile base salary and target annual incentive to be paid from the applicable survey sources.
- LTI (Long-Term Incentive) = the annualized value in dollar terms of the fair value of long-term incentive compensation to be granted in 2011 in the form of restricted stock, stock options, performance shares, or other form of long-term equity incentive compensation. It should be noted that not all positions and/or job families receive long-term incentive compensation.

- Actual TDC (Total Direct Compensation) = the aggregate amount of direct compensation in the form of actual base salary, actual annual incentive, and actual long-term incentive paid to a ONEOK/KGS employee in 2011 versus the average of the median actual base salary, actual annual incentive, and actual long-term incentive for the same position as reported in the applicable survey sources.
- Target TDC (Target Direct Compensation) = the aggregate amount of direct compensation in the form of actual base salary, target annual incentive, and long-term incentive paid to a ONEOK/KGS employee in 2011 versus the average of the median actual base salary, average target annual incentive, and average long-term incentive for the same position as reported in the applicable survey sources.

Table 2 - ONEOK/Kansas Gas Service 2011 Competitive Market Analysis: Competitive Levels Versus Average of 50th Percentile Market Data

Job Family	Actual Base Salary	Actual Annual Incentive	Actual TCC	Target Incentive	Target TCC	LTI	Actual TDC	Target TDC
ONEOK Executives	-15%	-27%	-20%	--	--	16%	8%	--
KGS Director	-16%	-22%	-18%	1%	-16%	-3%	-19%	-15%
KGS Supervisor	-21%	-44%	-24%	1%	-22%	--	--	-23%
KGS Manager	-13%	-23%	-14%	1%	-14%	1%	-14%	-13%
KGS Finance/Accounting	-13%	-30%	-16%	1%	-14%	--	--	-16%
KGS Legal	-27%	-50%	-33%	5%	-30%	-3%	-29%	-26%
KGS Government & Regulatory Affairs	-24%	-44%	-24%	1%	-24%	--	--	-29%
KGS Human Resources	-22%	-46%	-23%	1%	-22%	--	--	-25%
KGS IT	-12%	--	--	2%	-14%	--	--	-14%
KGS Engineering/Environmental & Technical Services	-20%	-45%	-21%	2%	-20%	--	--	-25%
KGS Purchasing/Material Management	-20%	-35%	-21%	1%	-21%	--	--	-23%
KGS Marketing/Sales/PR	-13%	-9%	-13%	0%	-13%	--	--	-13%
KGS Call Center/Customer Service	-17%	-21%	-17%	0%	-17%	--	--	-17%
KGS Office Support/Clerical	-21%	-39%	-22%	2%	-22%	--	--	-26%

Data Source: Market analysis from various published industry survey resources compiled and provided by ONEOK Human Resources.

As the analysis in Table 2 shows, ONEOK/KGS compensation levels are consistently below the 50th percentile of competitive compensation levels. The only element of compensation where average compensation rates fall above the average of median levels reported by the competitive surveys is the long-term incentive element for selected executive positions. Conclusions that I have drawn from the data reported in Table 2 include:

- Average base salaries for ONEOK/KGS incumbent employees are 12 percent to as much as 27 percent below the 50th percentile competitive data, depending upon job family;
- Actual annual incentives for ONEOK/KGS incumbent employees are 9 percent to as much 50 percent below the 50th percentile competitive data, depending upon job family;
- Actual total cash compensation (base salary plus annual incentive paid) for ONEOK/KGS incumbent employees are 13 percent to as much as 33 percent below the 50th percentile competitive data, depending upon job family;
- Long-term incentive grant fair values for ONEOK/KGS employees range from 16 percent above market 50th percentile to 3 percent below market 50th percentile competitive data, depending upon job family; and
- The total direct compensation (base salary plus annual incentive plus long-term incentive) paid to ONEOK executives are reported to be 8 percent above the 50th percentile competitive data for 2011; all other job families are reported to have total direct compensation levels ranging from 14 percent to 29 percent below the competitive 50th percentile benchmark.

This analysis reveals that ONEOK and KGS actual pay levels fall below the stated pay philosophy of establishing compensation levels at the 50th percentile of the competitive benchmark. Even though ONEOK/KGS builds its compensation philosophy and strategy around a 50th percentile market profile, actual compensation is delivered at pay levels below the 50th percentile. As to the compensation of ONEOK executives identified in the last bullet above (reference, “Long-term incentive grant fair values….”), KGS informed me that for ratemaking purposes, they are normalizing its test year costs for Long-Term Incentives and Short-Term Incentives. My overall conclusion is that ONEOK/KGS targets compensation levels for all employee groups and job families at the 50th percentile of the competitive marketplace. However, ONEOK/KGS employees’ actual pay levels, including all elements of compensation except for long-term incentives awarded to executives in 2011, are delivered at levels well below the 50th percentile benchmark and are at levels between the 25th and 50th percentiles.

V. KANSAS GAS SERVICE’S SHORT-TERM INCENTIVE PLAN

Q: DOES KGS PROVIDE ANNUAL INCENTIVE COMPENSATION OPPORTUNITIES TO ALL EMPLOYEES? PLEASE DESCRIBE THE PRINCIPAL FEATURES OF THIS PLAN.

A: All ONEOK/KGS regular full-time employees, except for those employees affiliated with the collective bargaining units, are participants in an annual incentive compensation plan. The plan is known as the Short-Term Incentive Plan (hereinafter referred to as “STIP”), and its principal terms and provisions are applicable to all employees including executive, middle management, professional, technical, and clerical employee groups.

The general purpose of the STIP is to provide an employee with a direct interest in the performance of the Company, an employee’s operating company if applicable, and the employee’s personal performance and contributions. Threshold levels of company performance must be attained before STIP awards are paid. The amount of incentive is based on several criteria, including overall company financial performance as well as safety performance, and ultimately is based on a comprehensive assessment of an employee's performance and contributions during the fiscal year. The safety criteria were added to the plan as a performance metric in 2009 and reflect ONEOK's focus on measuring performance in matters related to the environment, safety, and health.

For the 2011 STIP plan year, the following specific performance criteria generated the funding pool of incentive awards:

- Diluted earnings per share (EPS) for ONEOK, weighted 50 percent at target
- Return on invested capital (ROIC) for ONEOK, weight 40 percent at target
- Recordable incident rate (safety as measured by OSHA incidents per 200,000 hours worked), weighted 5 percent at target
- Preventable vehicle incident rate (safety as measured by vehicle incidents per 1 million miles driven), weighted 5 percent at target

Once the incentive pool is funded, the CEO makes an assessment of business-unit performance to determine how much of the incentive pool will be allocated to individual business units and how much will be allocated to corporate interests. The assessment of business unit performance and contribution to ONEOK's cumulative success is based upon the business unit's 2011 operating income compared with the 2011 financial plan, the business unit's safety and environmental compliance, and other factors as determined by the CEO in his discretion. Then, an employee's individual performance is assessed by the immediate supervisor with the determination of an individual performance factor. Safety and customer satisfaction are critical components in the individual employee evaluation process. Such assessments result in an employee receiving a stated percentage of his or her targeted annual incentive compensation award opportunity.

KGS informed me that for ratemaking purposes, it is normalizing its test year costs for Short- Term Incentives.

Q. WITH RESPECT TO THE ONEOK/KGS STIP INCENTIVE PLAN, ARE THE PERFORMANCE METRICS BENEFICIAL TO CUSTOMERS AS WELL AS SHAREHOLDERS?

A. Positive financial performance is beneficial to both customers and shareholders. Financial performance metrics consider revenues and expense levels in measuring employee performance. Positive financial performance requires the achievement of rate-based revenues while at the same time controlling expense levels. Therefore, higher productivity, careful control of operations and maintenance, attention to customer service levels and customer retention, and other customer-based actions can assist in minimizing expenses and improving net income. For these reasons, the financial metrics of EPS and ROIC should be considered important criteria for the benefit of shareholders and customers.

During the past three years, ONEOK/KGS has added the two safety measures to the mix of performance metrics to emphasize the importance of safety to the organization, its customers, and employees. The two safety measures, recordable incident rate and preventable vehicle incident rate, are directly within the influence of all employees who are engaged in daily operations and customer service. Improved safety performance translates into more efficient operations and greater customer satisfaction. Clearly, both of these safety measures are aligned with the direct interests of customers and shareholders.

It is my judgment that the STIP plan benefits all constituents of ONEOK/KGS: shareholders, customers, and employees. The STIP is a variable expense and directly tied to improvements in performance, productivity, service, cost management, and other performance factors that directly impact EPS, ROIC, and safety. Variable incentive plans like the STIP allow top management to motivate, recognize, and reward employee performance. Such plans are only funded and paid if performance warrants, thereby creating a variable expense that is directly performance-based.

Q. IN YOUR JUDGMENT, SHOULD THE COSTS OF THE INCENTIVE COMPENSATION PLAN (STIP) BE INCLUDED IN RATES?

A. Incentive compensation, including the cost of the STIP plan, should be recovered in Kansas Gas Service's cost of service, especially when the plan creates an incentive for employees to achieve goals in the form of performance metrics that are important to shareholders, customers, and employees. The cost of the STIP is a regular component of the ONEOK/KGS payroll expense.

One of the factors this Commission considers when determining whether the salaries paid by the utility are reasonable and should therefore be included in rates is whether the total employee compensation level (base pay plus incentive pay) is at the average market salary[2]. As previously mentioned, based upon my review, ONEOK/KGS's total employee compensation level is already below the average market salary. Therefore, if the incentive compensation portion of the employee's salary, including the compensation paid under the STIP plan, is arbitrarily disallowed simply because it is classified as incentive compensation, then the cost of employee salaries included in rates would be even further below the average market salary. This would result in a compensation level in rates that is clearly not reasonable and not in conformance with the factor (average market salary) considered by the Commission to establish the level of employee compensation that should be included in rates.

VI. INCENTIVE COMPENSATION PLANS OF OTHER PUBLIC UTILITIES

Q. IS THE ONEOK/KGS PLAN COMPARABLE TO THAT OF OTHER PUBLIC UTILITIES?

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[2] See KCC Docket No. 99-WPEE-818-RTS, Order dated January 17, 2000, page 18, paragraph 38; KCC Docket No. 04-AQLE-1065-RTS, Order dated January 28, 2005, page 11, paragraphs 34-36.

A. In today's corporate environment, virtually all public utilities have adopted incentive compensation plans as an integral element of their compensation strategies. Annual incentive plans such as the STIP in which both management and the general employee population participate have become prevalent throughout the gas utility industry. Competitive gas utility organizations recognize the importance of offering annual incentive opportunities (bonuses) to employees to drive performance throughout the organization.

In 2011, the American Gas Association with the assistance of management consulting firm Towers Watson conducted its annual survey of gas utility compensation nationally. The 2011 survey included 64 participating organizations which submitted data to the survey consultant. In Table 3 on the following page, I have included competitive data from the 2011 AGA survey reporting the prevalence of annual bonus and other forms of incentive compensation prevalent among the 64 survey participants. The survey data in Table 3 includes various cuts of the data including a breakout of distribution companies, organizations with more than 1,000 full-time equivalent employees, organizations in the South Central region of the U.S., as well as the entire sample of 64 companies. Table 3 is presented on the top of the following page:

Table 3 - Prevalence of Incentive or Bonus Plans - 64 Gas Utilities in 2011 AGA National Survey

	% of Organizations with at Least One Plan	# of Responses	Bonus
Entire Sample			
Executive	82.0%	61	96.0%
Management, Excluding Executives	82.0%	61	94.0%
Exempt, Non-Management	78.7%	61	93.8%
Nonexempt	77.0%	61	89.1%
Company Type = Distribution			
Executive	84.2%	19	100.0%
Management, Excluding Executives	84.2%	19	93.8%
Exempt, Non-Management	84.2%	19	87.5%
Nonexempt	78.9%	19	85.7%
Organization Size = 1,000 FTEs or More			
Executive	89.5%	38	97.1%
Management, Excluding Executives	89.5%	38	97.1%
Exempt, Non-Management	86.8%	38	93.9%
Nonexempt	84.2%	38	83.9%
Geography = South Central US			
Executive	83.3%	12	100.0%
Management, Excluding Executives	83.3%	12	100.0%
Exempt, Non-Management	83.3%	12	100.0%
Nonexempt	83.3%	12	80.0%

Data Source: Towers Watson 2011 American Gas Association Survey

The competitive data indicates the wide acceptance and use of short-term incentive plans by gas utilities. It is important to note that companies having such plans (more than 80 percent of the organizations participating, regardless of data cut) regularly extend incentive opportunities throughout the organization and that exempt, non-management employees and non-exempt employees are participating in such plans like their management and executive counterparts.

VII. ONEOK/KANSAS GAS SERVICE'S LONG-TERM INCENTIVE PLAN

Q. WHAT LONG-TERM INCENTIVES ARE PROVIDED TO ONEOK/KGS EXECUTIVES AND KEY EMPLOYEES? DO OTHER UTILITIES PROVIDE THESE SAME TYPES OF LONG-TERM INCENTIVES?

A. The Company maintains the Long-Term Incentive Plan and the Equity Compensation Plan, pursuant to which various types of long-term equity incentive awards are available for grant to executives and key employees. In 2011, ONEOK/KGS granted two forms of long-term incentive compensation: restricted stock units and performance units.

Long-term incentives are approved and granted on an annual cycle, usually in the first quarter of each fiscal year. The ONEOK Board of Directors Compensation Committee oversees the long-term incentive program and officially approves all grants and awards. The restricted stock units are granted for a term of three years from the date of grant, with the participant being vested and entitled to receive one share of ONEOK common stock for each restricted stock unit granted following three years of employee service. Performance units granted in 2011 vest three years from the date of grant, at which time the participant is entitled to receive a percentage of the performance units granted in shares of ONEOK common stock. The number of shares of common stock awarded will range from 0 to 200 percent of the number of units granted based upon the Company's performance as measured by three-year total shareholder return (TSR) versus a designated peer group.

Most gas utility organizations grant long-term incentive compensation to executives and key employees. In the American Gas Association survey referenced earlier, 44 of 60 responding companies indicated that they had some form of long-term incentive compensation integral to their compensation strategy. Approximately 33 percent of the companies participating in the AGA survey were either privately-owned or owned by a governmental or regulatory authority, and typically organizations of this type do not have equity incentive plans. Long-term equity incentive plans are commonplace in investor-owned, publicly-traded utilities, and 67 percent of the surveyed companies in the AGA survey fit this category. In Table 4 below, we have reported the prevalence of long-term incentive compensation as reported in the 2011 American Gas Association survey.

Table 4 - Prevalence of Long-Term Incentives - 60 Gas Utilities in 2011 AGA National Survey

	Non-Qualified Stock Option Plan	Incentive Stock Option Plan	Performance-Based Stock Options	Stock Appreciation Rights (SARs)	Restricted Stock Plan	Restricted Stock Unit Plan	Performance-Contingent Restricted Stock Plan
Entire Sample							
Executive	39.5%	26.3%	21.1%	18.4%	57.9%	26.3%	21.1%
Management, Excluding Executives	34.6%	26.9%	11.5%	19.2%	57.7%	19.2%	26.9%
Exempt, Non-Management	30.0%	30.0%	10.0%	10.0%	80.0%	20.0%	30.0%
Company Type = Distribution							
Executive	30.0%	10.0%	20.0%	20.0%	20.0%	40.0%	20.0%
Management, Excluding Executives	33.3%	16.7%	16.7%	33.3%	33.3%	50.0%	33.3%
Exempt, Non-Management	0.0%	0.0%	0.0%	0.0%	50.0%	50.0%	50.0%
Organization Size = 1,000 FTEs or More							
Executive	45.2%	32.3%	25.8%	22.6%	58.1%	29.0%	22.6%
Management, Excluding Executives	39.1%	30.4%	13.0%	21.7%	56.5%	21.7%	26.1%
Exempt, Non-Management	37.5%	37.5%	12.5%	12.5%	75.0%	25.0%	25.0%
Geography = South Central US							
Executive	9.1%	18.2%	18.2%	9.1%	45.5%	18.2%	0.0%
Management, Excluding Executives	12.5%	25.0%	12.5%	0.0%	50.0%	25.0%	0.0%
Exempt, Non-Management	25.0%	25.0%	0.0%	0.0%	50.0%	50.0%	0.0%

Data Source: Towers Watson 2011 American Gas Association Survey

ONEOK's approach to granting both restricted stock units and performance units compares favorably with the practices of other publicly-traded utility organizations.

In addition to the survey data reported by the AGA, I have evaluated the proxy statements most recently filed by 16 prominent national gas utility organizations. In Table 5, the competitive data reports the types of long-term incentive vehicles used by each of the 16 utility organizations. The competitive data clearly shows a prevalence of time-lapse restricted stock and performance-based awards (either shares, units, or restricted shares) which compares favorably with the practice of ONEOK/KGS.

Table 5 - Type of Long-Term Incentives Utilized by Selected National Gas Utility Organizations

Company	Long-Term Incentive Vehicles Awarded					
	Stock Options	Stock Appreciation Rights	Time-Lapse Restricted Stock	Performance-Based Restricted Stock	Performance Shares or Units	Other
AGL Resources				✓	✓	
Atmos Energy			✓	✓		
CenterPoint Energy			✓	✓	✓	
National Fuel Gas		✓	✓		✓	
New Jersey Resources			✓		✓	
NiSource Energy Services					✓	
OGE Energy Corp					✓	
Piedmont Natural Gas					✓	
Sempra Energy				✓		
Southern Union	✓	✓	✓			
Southwest Gas Corp			✓		✓	
Spectra Energy					✓	✓
UGI Corporation	✓				✓	
Vectren Corp					✓	
WGL Holdings					✓	
Wisconsin Energy	✓		✓		✓	
ONEOK			✓		✓	

Data Source: Pay Governance LLC analysis of annual proxy statements filed by respective companies

This is further evidence that the long-term incentive plans employed by ONEOK are aligned with the competitive practices of other large utility organizations.

Q. WHAT PERFORMANCE METRICS ARE USED WITH RESPECT TO THE ONEOK/KGS LONG-TERM INCENTIVES GRANTED? ARE THESE VALID MEASURES OF PERFORMANCE WHICH REFLECT THE INTERESTS OF BOTH CUSTOMERS AND SHAREHOLDERS? DOES THE LONG-TERM PLAN THAT TIES AWARDS TO TOTAL SHAREHOLDER RETURN (TSR) COMPARED TO PEER COMPANIES INFLATE THE PAY OF PARTICIPANTS?

A. The performance metric used for measuring performance pursuant to the ONEOK performance units is ONEOK's three-year TSR versus the TSR of a designated group of 23 peer utility companies over the same three-year measurement period. TSR represents the change in share price over the period and the value of dividends paid and reinvested in shares during the three-year performance period. If ONEOK's TSR equals the 50th percentile of the TSR earned by the peer companies over the measurement period, participants will earn 100 percent of the performance units granted. A performance scale calibrates the potential number of performance units earned, with 25th percentile TSR performance versus the peer group equating to a payment of 50 percent of the performance units granted, and 90th percentile performance versus the peer group equating to a payment of 200 percent of the performance units granted.

If ONEOK's TSR fails to equal the 25th percent TSR of the peer group or higher, participants will not receive a payment for any of the performance units granted at the start of the measurement period. TSR versus the relative TSR performance of a designated peer group of companies is a common measure of long-term performance associated with utility performance plans such as the ONEOK performance unit plan.

The use of TSR comparisons between ONEOK and peer companies does not result in inflated compensation for ONEOK executives. The relative TSR measurement over the three-year measurement period is simply the performance metric for determining the number of performance units earned. There is no compensation inflation from such comparison with the peer group because the peer group's compensation is never measured in this process and there is no correlation between ONEOK executive compensation and peer company compensation as a result of the TSR measurement.

Q. WHAT IS THE SHARE AWARD PROGRAM OF ONEOK?

A. ONEOK has a share award program applicable to all ONEOK employees in which all KGS employees, including bargaining unit employees, participate. Under provisions of the plan, the organization awards one share of ONEOK common stock to each employee every time ONEOK's share price reaches a new milestone price. The share price milestone is measured in one dollar share price increments. KGS informed me that for ratemaking purposes, it is normalizing its test year costs for the Share Award Program.

VIII. BENEFITS PROGRAM

Q. PLEASE DESCRIBE THE OVERALL EMPLOYEE BENEFITS PROGRAM OF ONEOK/KANSAS GAS SERVICE. IS THE PROGRAM THE SAME FOR BOTH EXECUTIVES AND EMPLOYEES?

A. ONEOK has retirement and health and welfare plans available for its employees. ONEOK has made several changes to its plans in an effort to hold down costs. In 2005, all newly hired, non-bargaining unit employees were no longer eligible to participate in ONEOK's defined benefit retirement plan, and are now covered by a new defined contribution retirement plan. Newly hired bargaining unit employees were also shifted to the new defined contribution retirement plan in 2010 and 2011 for the IBEW and gas unions, respectively. Also, new non-bargaining unit employees hired after December 31, 1998, are no longer eligible for post-retirement medical benefits paid for by the Company. Similarly, newly hired members of the IBEW and gas unions are no longer eligible for post-retirement medical benefits paid for by the Company for employees hired after June 30, 2003, and July 1, 2004, respectively. ONEOK also has a standard 401(k) plan. ONEOK also provides healthcare benefits which have increasingly shifted costs from the Company to the employee through higher premium assessments, higher deductibles and higher co-pays.

Q. WHAT IS YOUR OVERALL ASSESSMENT OF THE ONEOK/KANSAS GAS SERVICE TOTAL COMPENSATION PROGRAM FOR EMPLOYEES AND MANAGEMENT?

A. I conclude that ONEOK/KGS offers its employees and executive management a fair, equitable, and balanced total compensation program. I have reached this conclusion with consideration of the following:

- The direct compensation program is targeted to provide competitive compensation levels that are aligned with the 50th percentile of the competitive marketplace, with the competitive marketplace being defined to include other utilities and large employers competing for human resources talent;
- Although the direct compensation program is targeted to pay at the marketplace 50th percentile, the organization's actual compensation levels generally fall between the 25th and 50th percentiles of the marketplace as evidenced by competitive survey benchmarking;
- ONEOK extensively uses incentive compensation to control the expense of the direct compensation program while at the same using incentives to focus employee behaviors on ONEOK, business unit, and individual performance that are beneficial to shareholders, customers, and employees alike;
- The ONEOK employee benefits program is currently competitive with marketplace norms and benchmark practices with a proper focus on offering competitive benefit levels while controlling costs;
- ONEOK has taken steps in recent years to control the costs of its employee benefits and has executed important strategic actions to improve its approach to both employee and executive retirement and retiree medical benefits delivery; and
- The ONEOK/KGS total compensation and benefits program exhibits a thoughtful and balanced approach for attracting, motivating, and retaining a viable employee workforce commensurate with the needs and requirements of the organization, its service areas, and all of its constituents.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

VERIFICATION

STATE OF TEXAS)
) ss.
COUNTY OF DALLAS)

John Ellerman, being duly sworn upon his oath, deposes and states that he is Partner for Pay Governance, LLC; that he has read and is familiar with the foregoing Direct Testimony filed herewith; and that the statements made therein are true to the best of his knowledge, information, and belief.

NAME

Subscribed and sworn to before me thisl8th day of May 2012.

NICOLE RUSTIN
Notary Public, State of Texas
My Commission Expires
July 08, 2013

NOTARY PUBLIC

My Appointment Expires:

7/8/2013