

Exhibit No.:
Issue: Advertising
Witness: JOHN M. BOCZKIEWICZ
Sponsoring Party: MoPSC Staff
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

JOHN M. BOCZKIEWICZ

LACLEDE GAS COMPANY

CASE NO. GR-99-315

Jefferson City, Missouri
August, 1999

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1 treatment of advertising costs between companies and even for the same company's
2 advertising in different time periods." The Staff does not believe this process is either
3 expensive or overly time consuming. Most of the ads can be easily placed into one of the
4 five categories mandated by the Commission. Also the Staff has consistently applied the
5 Commission's standard in every rate case and complaint case since the standard was
6 adopted in 1985.

7 Q. Please state Mr. Hargraves' second reason why he believes the
8 Commission is using an inappropriate standard for advertising and the Staff's response.

9 A. Mr. Hargraves states "It has proven to be very difficult, if not almost
10 impossible, to meet the standard for including promotional advertising costs in rates. In
11 fact, the Staff has admitted in its response to Laclede DR No. 69 that no company has
12 ever met this standard." While no company has met the cost justification standard, the
13 Staff is not aware of any attempt by a Missouri utility other than Laclede to show that
14 revenues received as a result of advertising exceed the costs associated with the
15 advertising. Additionally, the fact that no utility has met the cost-benefit standard should
16 not result in utilities having the right to include all promotional and institutional
17 advertising in the cost of service.

18 Q. Please state Mr. Hargraves' third reason why he believes the Commission
19 is using an inappropriate standard for advertising and the Staff's response.

20 A. Mr. Hargraves states "The Commission is required by the current standard
21 to force-fit ads into categories in a manner that is not consistent with the way that
22 advertising is budgeted by companies or the way that advertising is viewed by the
23 public." The Staff does not believe that a cost of service calculation must always

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1 correspond to the way a Company prepares its budget. There are many examples in
2 which this is not the case. For example, a company's annualized level of employees
3 included in the cost of service is often different from the number of employees included
4 in its manpower budget.

5 Q. On page 2 of his rebuttal testimony, Mr. Hargraves mentions that the Staff
6 and Office of Public Council categorized one of the ads differently. What is the Staff's
7 response to this point?

8 A. The Staff miscategorized this advertisement as institutional when it should
9 have been categorized as general. This advertisement does contain some institutional as
10 well as promotional aspects, however the primary message of the advertisement is
11 general. The cost for this ad will be included in the Staff's cost of service calculation.

12 Q. On pages 4 and 5 of his rebuttal testimony, Mr. Hargraves attempts to
13 show that Laclede and its customers benefit from advertising. He begins by comparing
14 Laclede's advertising to the advertising of Anheuser-Busch and IBM. Does the Staff
15 believe this is a relevant comparison?

16 A. No. Companies such as Anheuser-Busch and IBM operate in industries
17 where name brand recognition is crucial to selling their products. For example, if a
18 consumer wishes to purchase a beer, he could choose an Anheuser-Busch product or one
19 of the several hundred other products on the market. On the other hand, if an individual
20 moves into a home in the St. Louis, Missouri area and wishes to have gas service, he
21 generally has only one choice, Laclede Gas Company. Additionally, according to the
22 Company's Board of Directors' minutes, approximately 98% of customers moving into

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1 new homes choose Laclede as their energy provider. Obviously, competition is not
2 nearly as much of an issue for Laclede as it is for non-regulated companies.

3 Q. On page 5 Mr. Hargraves says that Laclede's ratepayers benefit from
4 advertising because 1) they receive information that they would not obtain elsewhere and
5 2) they benefit to the extent that the advertisements result in a larger customer base over
6 which Laclede's fixed costs can be spread. What is the Staff's response to this statement?

7 A. First, the Staff believes that information about natural gas can be obtained
8 from many sources other than advertising including contractors and builders, consumer
9 reports, and word of mouth. Second, until the Company performs a study that shows that
10 revenues are increased from advertising, any assertion that advertisements result in a
11 larger customer base is purely speculative.

12 Q. On page 5 of his rebuttal testimony, Mr. Hargraves states that information
13 received from advertising is useful to ratepayers in making informed energy decisions
14 regarding the wise use of energy resources. Has Staff allowed ads informing customers
15 about the wise use of energy resources?

16 A. Yes. The Staff has allowed advertisements informing customers how to
17 use natural gas resources wisely. However, the Staff did not allow advertisements
18 promoting the use of natural gas over heat pumps.

19 Q. On pages 5-7 of his rebuttal testimony, Mr. Hargraves mentions a benefit
20 analysis and Marketeam Associates survey submitted in response to Staff Data Request
21 No. 55. Does the Staff believe these items demonstrate adequate cost justification to
22 include Laclede's promotional advertising in the cost of service?

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1 A. No. The benefits analysis assumes that without advertising, the Company
2 would experience a 1% annual loss of its customer base. The Staff believes this
3 assumption is completely speculative and has no basis in fact. The Marketeam
4 Associates survey indicated that customers recalled, believed, and considered important
5 messages that were included in Laclede Gas advertising. However, it did not take the
6 analysis one step further and attempt to identify additional revenues received as a result
7 of the advertising.

8 Q. Did the survey seem to indicate that a large number of customers chose
9 natural gas heat because of Laclede's advertising?

10 A. No. Question No. 4 of the survey asked customers "What sources did you
11 use for information that led you to choose gas heat?" Only 4 people out of 103 even
12 mentioned television or media advertising. Nine other sources of information were
13 mentioned more frequently than advertising. Additionally, respondents were allowed to
14 list more than one source, meaning it is possible that none of the customers considered
15 advertising the most important source of information. There were no questions on the
16 survey asking customers if they would have chosen a heat pump over natural gas without
17 the benefit of advertising from Laclede.

18 Q. Please list the responses to the question "What sources did you use for
19 information that led you to choose gas heat" that were mentioned more frequently than
20 advertising and the number of respondents.

21 A. 1) Past experience with gas-35
22 2) Friends/other homeowners-21
23 3) Price comparisons-14

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- 1 4) Past experience with other fuels-12
- 2 5) Past experience (general)-9
- 3 6) Contractors/builders/heating technicians-9
- 4 7) Consumer reports/other periodicals-8
- 5 8) Didn't make the decision on furnace-6
- 6 9) None/myself/just decided-11

7 Q. On pages 7-8 of his rebuttal testimony, Mr. Hargraves mentions an
8 increase in residential service work since the Company began an advertising program in
9 1995. Does this prove that the ads related to residential service work should be included
10 in cost of service?

11 A. No. The Company has not performed any analysis to show that the
12 additional revenue resulted from the advertising program instead of some other factor.

13 Q. If the Company could prove that the additional revenue from residential
14 service work was a direct result of the advertising program, should ratepayers pay for this
15 advertising?

16 A. No. Even if it could be determined that an advertising program generated
17 additional revenues greater than the cost of the program, the Staff does not believe that
18 this would be sufficient cost justification. The Company would have to prove that the
19 increased revenue, less the expenses necessary to generate those revenues were greater
20 than the cost of the advertising program. Although the Company records the amount of
21 revenue it receives from residential service work, it does not keep track of the related
22 expenses. It is possible that additional residential service revenue results in higher rates

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1 because the resulting expenses exceed the revenue received. This subject is discussed
2 further in the testimony of Staff witness Arlene Westerfield.

3 Q. Please summarize your testimony.

4 A. The Staff believes the Company's proposal of allowing all advertising
5 expense up to a certain level is not appropriate for ratemaking purposes. The
6 Commission's current standard was first approved in 1985. It has been upheld in several
7 cases since that time. Most recently, in the Report and Order for Case No. GR-96-285
8 involving Missouri Gas Energy Company, the Commission stated "The Commission will
9 not encourage gas and electric companies to compete by passing those costs on to
10 ratepayers. Since these companies are still subject to rate base/rate of return regulation in
11 Missouri, it does not make sense to pass these types of expenses through to ratepayers.
12 Shareholders, not ratepayers, must bear the expense of advertisements designed to
13 increase sales of energy resources." The Staff does not believe the circumstances in this
14 case warrant a change in the Commission's policy on advertising.

15 The Staff also believes that the Company has not proved that increased revenues
16 from promotional advertising exceed the cost of promotional advertising. The benefits
17 analysis provided by the Company is highly speculative and the Marketeam Associates
18 study did not show any type of revenue to expense comparison.

19 Q. Does this conclude your surrebuttal testimony?

20 A. Yes, it does.

