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Service Commission

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14

Issues: Policy

Witness: James Oglesby

Sponsoring Party: Missouri Gas Energy

Case No.: GR-2004-0209

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2004-

DIRECT TESTIMONY OF

JAMES OGLESBY

Jefferson City, Missouri

November 2003

DIRECT TESTIMONY

OF JAMES OGLESBY

CASE NO. GR-2004-

NOVEMBER 2003

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DIRECT TESTIMONY

OF JAMES OGLESBY

CASE NO. GR-2004-

NOVEMBER 2003

1 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?**

2 A. My name is James Oglesby, and my business address is 3420 Broadway, Kansas City,
3 Missouri 64111.

4

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

6 A. I am the President and Chief Operating Officer of Missouri Gas Energy ("MGE" or
7 "Company"), a division of Southern Union Company.

8

9 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

10 A. I attended Franklin Technical School and studied business administration at Missouri
11 Southern State College in Joplin, Missouri.

12

13 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.**

14 A. I have been in my present position since September 2001.

15

16 Prior to being named Chief Operating Officer of MGE, I served as Vice President of
17 Operations beginning in December 1998. I joined the Company in 1968 as a service
18 technician, and since then held a variety of positions of increasing responsibility

1 within the operations area, ranging from meter reader to operating supervisor before
2 joining the Company's leadership team. I served as Chief Steward of the
3 Steelworkers Local for a number of years and was one of the founders of the
4 Company's Labor-Management Partnership Group.

5
6 **Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?**

7 A. I will explain the fundamental business model I continue to implement at MGE. In
8 the course of this explanation I will reiterate the emphasis that MGE has placed, and
9 will continue to place, on quality customer service and try to bring forward specific
10 examples of how MGE is seeking to implement this business model.

11
12 Finally, I will provide an overall perspective on the rate making process that MGE has
13 experienced historically, as well as suggestions for improvement of that process now
14 and in the future. In so doing, I will address certain critical policy issues that I believe
15 the Commission itself should address in setting rates for natural gas local distribution
16 companies in general, and MGE in particular.

17

18 1. **MGE IS COMMITTED TO BEING A LOW-COST PROVIDER OF QUALITY**
19 **CUSTOMER SERVICE**

20

21 **Q. PLEASE EXPLAIN THE FUNDAMENTAL BUSINESS STRATEGY YOU**
22 **ARE CONTINUING TO IMPLEMENT AT MGE.**

23 A. Our fundamental business strategy is to be a low-cost provider of quality customer
24 service. When I began my work as MGE's Chief Operating Officer in September of

1 2001, this overall direction was already in place. Implementing this strategy requires
2 a balance of cost management and quality customer service.
3

4 **Q. WHAT GUIDING PRINCIPLES DO YOU USE IN FURTHERANCE OF**
5 **MGE'S FUNDAMENTAL BUSINESS STRATEGY OF BEING A LOW-COST**
6 **PROVIDER OF QUALITY CUSTOMER SERVICE?**

7 A. Safety is our first priority. Although natural gas is safe when contained, it is a
8 combustible commodity and can be hazardous if not contained. We are well aware of
9 this and therefore take very seriously the need to safeguard our customers and
10 employees as well as the public generally. We also emphasize safety throughout the
11 business in everyday activities like driving vehicles, lifting objects, etc.
12

13 For a business to be a lasting success, its management must successfully balance the
14 interests of three key constituencies: employees, customers and shareholders. We try
15 to keep this fact in mind whenever we make decisions.
16

17 I believe that shareholders are not likely to be satisfied if customers are not pleased,
18 and that customers are not likely to be satisfied if employees are not satisfied.
19 Therefore, MGE places heavy emphasis on employee and customer satisfaction.
20
21
22

1 **Q. CAN YOU PROVIDE EXAMPLES OF HOW MGE HAS EMPHASIZED**
2 **EMPLOYEE SATISFACTION?**

3 A. We continue to build upon our relationship with our employees through a
4 “partnership” process, pursuant to which we have regular periodic meetings to
5 address issues of mutual concern and help build a more efficient and effective
6 company.

7
8 We also devote substantial efforts to ensuring that we communicate effectively with
9 employees. The MGE senior management team conducts “all-employee” meetings
10 two times a year throughout our service territory. We have also instituted what we
11 call our “leadership forum,” during which virtually all employees with supervisory
12 responsibilities are provided with in-depth information around critical company
13 activities so they may provide effective responses to questions from the employees
14 who report to them.

15

16 We also conduct employee surveys, typically on an annual basis, that provide us with
17 feedback in this area.

18

19 **Q. HOW DO YOU RATE MGE’S EMPLOYEE SATISFACTION EFFORTS?**

20 A. Overall, I think we have done a good job and the employee surveys back this up.
21 Nevertheless, we are not satisfied. We also know that the passage of time is
22 accompanied by new challenges. In order to meet these challenges successfully, we
23 need employees who understand where we are going and believe in that direction.

1 Thus, MGE will continue to place a heavy emphasis on employee communication and
2 satisfaction.

3

4 **Q. CAN YOU PROVIDE EXAMPLES OF HOW MGE HAS EMPHASIZED**
5 **CUSTOMER SATISFACTION?**

6 A. MGE's customer satisfaction efforts were well under way upon my promotion in
7 September of 2001. Those efforts have continued through all of my two-plus years
8 tenure. We encourage our employees to work with the "mind of a customer and the
9 pride of an owner," and most of them are doing so. We are continually striving to
10 make it easy for our customers to do business with MGE. As shown more
11 specifically in the direct testimony of MGE witness Carlton A. Ricketts, MGE has
12 achieved and generally maintained high quality customer service performance levels.
13 In addition, as explained in more detail below, MGE has achieved this high quality
14 performance in a very cost-effective fashion.

15

16 Similar to our belief that employees both desire and need effective communications,
17 MGE emphasizes effective customer communications. When the possibility of high
18 gas prices became apparent this spring, MGE began to communicate early and often
19 about the issue with its customers. We began in April by running a bill insert alerting
20 customers to the potential for higher winter prices. Those customer communication
21 efforts continued throughout the year in the form of:

- 1 • Specific outreach to the senior citizen community throughout MGE's
- 2 service territory with educational programs on energy assistance,
- 3 energy conservation, and understanding gas service;
- 4 • Specific efforts to reach out and engage resources in the faith
- 5 community by hosting a panel of financial assistance and
- 6 weatherization/conservation experts;
- 7 • Printed materials about MGE and national energy policy issues
- 8 provided to state and local policy makers;
- 9 • September bill insert focusing on price of gas information, ABC
- 10 ("Average Bill Calculation") plan and conservation tips; and
- 11 • Radio spots regarding a variety of messages, including energy
- 12 efficiency, conservation and the ABC plan.

13 Perhaps most important is the process MGE began in the winter of 2000-2001 to
14 enhance the delivery of assistance to special needs customers by introducing the
15 "Energy Forum" in cooperation with the Mid America Assistance Coalition
16 ("MAAC"). Through that effort, MGE and others agreed to continue to work beyond
17 that single winter to create a more seamless system for delivering assistance to
18 Missourians. MGE has contributed to increasing the capacity of the assistance
19 delivery system by partnering with MAAC to provide additional matching funds for
20 Neighbors Helping Neighbors and paying the MAACLink fees for agencies that
21 provide assistance to MGE customers. In addition, MGE has been instrumental in
22 creating a coalition to expand utilization of Earned Income Tax Credits in Missouri.

1 Q. HOW DO YOU RATE MGE'S CUSTOMER SATISFACTION EFFORTS?

2 A. Overall, I think we have done a good job.

3

4 Q. DO YOU HAVE ANY INFORMATION SHOWING HOW MGE'S COSTS
5 COMPARE TO OTHER REASONABLY COMPARABLE NATURAL GAS
6 LOCAL DISTRIBUTION COMPANIES IN MISSOURI?

7 A. As shown in the direct testimony of MGE witness Michael R. Noack, MGE provides
8 service in a considerably more cost-effective fashion than other Missouri LDCs. The
9 following chart, which is based on Mr. Noack's analysis, compares MGE's operations
10 and maintenance ("O&M") costs to other reasonably comparable Missouri LDCs. In
11 comparison to these other Missouri LDCs, MGE provides service in a considerably
12 more cost-effective fashion.

	<u>MGE</u>	<u>Laclede</u>	<u>AmerenUE</u>	<u>MoPub</u>
13 1998	\$116.85	\$166.35	\$167.82	\$185.21
14 1999	\$115.37	\$162.00	\$167.01	\$180.30
15 2000	\$119.81	\$164.89	\$184.86	\$212.23
16 2001	\$141.59	\$188.43	\$215.26	\$224.42
17 2002	\$117.35	\$193.29	\$274.22	\$252.15

19

20 Also as shown in the direct testimony of MGE witness Michael R. Noack, a
21 comparison of annual residential bills on the basis of margin rates (monthly customer
22 charge plus volumetric delivery rates) shows that MGE is considerably lower-priced
23 than these companies. The following chart, based on Mr. Noack's analysis, shows
24 that MGE is the lowest price provider.

	<u>MGE</u>	<u>Laclede</u>	<u>AmerenUE</u>	<u>MoPub</u>
25	\$231.76	\$323.29	\$296.70	\$323.09

26

27

28

1
2
3 **Q. AS SOMEONE WITH A GREAT DEAL OF EXPERIENCE IN THE AREA OF**
4 **UTILITIES, WOULD YOU CONSIDER IT REASONABLE TO RELY ON**
5 **MR. NOACK'S ANALYSIS FOR THE PURPOSE OF COMPARING MGE'S**
6 **COSTS AND PRICES TO OTHER MISSOURI COMPANIES?**

7 A. Yes.

8
9 **Q. MR. OGLESBY, IS MGE COMMITTED TO ACHIEVING CUSTOMER**
10 **SERVICE PERFORMANCE LEVELS IN THE FUTURE SIMILAR TO**
11 **THOSE WHICH HAVE BEEN ACHIEVED IN THE PAST FEW YEARS?**

12 A. Yes. But the Commission needs to put the service quality MGE has provided over the
13 past few years in context. While the warm weather we experienced in our service
14 territory in FY98, FY99, FY00 and FY02 hurt MGE's financial performance and
15 achieved returns, that same warm weather helped almost all of its customer service
16 performance statistics. Typically, warm weather translates into lower gas bills, which
17 in turn usually translates into fewer customer contacts. Wholesale gas prices were
18 also relatively low during much of this period of time (July 1997-June 2000 and the
19 winter of 2001-2002). The weather in FY01 and FY03 (e.g., July 2000-June 2001
20 and July 2002-June 2003, as measured over the course of twelve months) was much
21 closer to "normal" and also brought about significantly higher wholesale gas prices.
22 Nevertheless, MGE was able to maintain reasonable customer performance statistics

1 even with the increased customer contacts resulting from colder weather and higher
2 wholesale gas prices in FY01 and FY03.

3
4 The statistics show that achieving quality customer service is one thing while
5 maintaining that achievement is another. So while we are committed to providing
6 high quality service, we are also committed to providing service at a reasonable cost
7 to the customer. At the same time, our shareholders are entitled to a reasonable
8 opportunity to achieve the return authorized by the Commission. The bottom line is
9 that service quality must be balanced with cost and earnings considerations. I firmly
10 believe that the Commission needs to demonstrate the value it places on service
11 quality by fairly compensating MGE for the substantial achievements it has made in
12 this area and by providing a real opportunity to realize its Commission-authorized
13 return.

14
15 **Q. CAN YOU PROVIDE EXAMPLES OF HOW MGE HAS EMPHASIZED**
16 **SHAREHOLDER SATISFACTION?**

17 A. In addition to the significant efforts toward cost control that we devote every single
18 day (as evidenced by the cost comparisons to peer companies in Missouri discussed
19 earlier), the filing of this rate case is another example of the emphasis MGE places on
20 shareholder satisfaction. The filing of a general rate case, while necessary and a part
21 of doing business, is not something we take lightly. It is an expensive and time
22 consuming process that diverts substantial management attention away from the
23 Company's primary mission, which is to provide safe and reliable gas service to its

1 customers. Nevertheless, without sufficient earnings, the Company will be in no
2 position to provide the quality of service our customers expect and deserve.
3 Therefore, MGE has decided to file this rate case.
4

5 **Q. HOW DO YOU RATE MGE'S SHAREHOLDER SATISFACTION EFFORTS?**

6 A. Overall, I think we have a significant amount of work left to do. I cannot characterize
7 our efforts as successful in this area primarily because, as shown in the direct
8 testimony of MGE witness Michael R. Noack, MGE has never actually achieved its
9 Commission-authorized rate of return.
10

11 **2. RATE MAKING PRACTICE, POLICY AND IMPACTS**

12 **Q. WHAT IS YOUR UNDERSTANDING OF THE OVERALL OBJECTIVE OF**
13 **THE RATE MAKING PROCESS AND THE ROLE AND RESPONSIBILITY**
14 **OF THE COMMISSION?**

15 A. Although it can be said many different ways, my understanding is that rates should be
16 set so as to provide the Company with a reasonable opportunity to achieve its
17 authorized return. The authorized return itself must be sufficient to compensate the
18 Company's shareholders for the risk they bear while enabling the Company to attract
19 capital on reasonable terms. The Commission's responsibility is to balance the
20 multitude of competing interests that arise through this process (e.g., enhanced service
21 levels vs. lower rates; small customer interests vs. large customer interests; customer
22 interests vs. shareholder interests; etc.) and set rates that are just and reasonable.
23 Please refer to the direct testimony of MGE witness John M. Quain for more detail.

1

2

3 **Q. MR. OGLESBY, HAS MGE EVER ACHIEVED ITS COMMISSION-**
4 **AUTHORIZED RETURN?**

5 A. No, I don't believe so. Please refer to the direct testimony of MGE witness Michael
6 R. Noack for more detail.

7

8 **Q. CAN YOU EXPLAIN WHY MGE HAS NOT ACHIEVED ITS COMMISSION-**
9 **AUTHORIZED RETURN?**

10 A. First, although unanticipated expenditures do crop up from time to time which impair
11 achieved returns, the incidence of such events is relatively infrequent in MGE's
12 history. Overall, I believe MGE has effectively managed its "O&M" expenses, which
13 have effectively been "flat" for several years now, while at the same time delivering
14 high quality service to our customers. Effective management of O&M expenses
15 serves the dual interests of customers (through rates lower than they would otherwise
16 experience) and shareholders (through reduced earnings erosion).

17

18 In a nutshell, MGE has not achieved its authorized return primarily because of the
19 way in which its rates have been set in the past. The regulatory process has resulted
20 in rates for MGE that do not reflect the reality of MGE's operations. In particular,
21 rate design decisions have exposed the Company's returns to great variability due to
22 weather. Compounding this increased weather risk is the fact that the actual per-
23 customer usage experienced on MGE's system rarely, if ever, reaches the per-

1 customer usage employed in the regulatory process of setting MGE's rate levels. In
2 addition, although efforts are made in the rate setting process to determine, and
3 include in the calculation of customer rates, a "normal" level of bad debt expense,
4 MGE's actual experience as shown in the direct testimony of MGE witness Michael
5 R. Noack proves that—due to the significant variability in weather and gas costs—
6 there is no "normal" level of bad debt expense and, as a result, MGE's actual bad debt
7 expense exceeds its rate case allowance by approximately \$1.5 million annually, on
8 average. Achieved returns are further reduced due to the fact that the Commission
9 also routinely disallows from the rate setting equation certain costs deemed by the
10 Commission to be "unnecessary for the provision of gas service" but which, in reality,
11 the Company has no choice but to expend. My Company's experience also indicates
12 that while the Commission is willing to administer punishment for what it deems to
13 be inappropriate conduct, it is at the same time hesitant to administer rewards for
14 positive conduct. In my opinion, the foregoing add up to a regulatory environment in
15 which customer and shareholder interests are not fairly balanced and the Company is
16 left with no reasonable opportunity to achieve its authorized return.

17
18 **Q. PLEASE ELABORATE ON YOUR POINT ABOUT RATE DESIGN.**

19 A. Since MGE began operations in 1994, the majority of the revenue increases approved
20 by the Commission for MGE were placed on volumetric rate components. Because
21 volumetric rates are subject to variation in relation to weather, the percentage of
22 MGE's revenues at risk based on weather has increased. This increased financial risk
23 has not been recognized by the Commission in its authorized equity returns, for the

1 Commission has reduced the equity returns authorized for MGE in every rate case
2 since 1993.

3

4 **Q. PLEASE ELABORATE ON YOUR POINT ABOUT PER-CUSTOMER**
5 **USAGE.**

6 A. As shown in the direct testimony of MGE witness F. Jay Cummings, the per-customer
7 usage assumed through the rate setting process has routinely exceeded the usage per-
8 customer actually experienced on MGE's system. The following chart, based on the
9 analysis of Mr. Cummings, shows the shortfall of actual usage per-customer in
10 comparison to the usage per-customer assumed through the rate setting process over
11 the past five years. The following chart compares actual usage per customer to usage
12 per customer (residential) as utilized in calculating MGE's rates:

	<u>Actual Usage per-Customer</u>	<u>Rate Case Usage per-Customer</u>
13		
14	FY99 889.0 Ccf	1,047.4 Ccf
15	FY00 820.0 Ccf	1,047.4 Ccf
16	FY01 1,021.7 Ccf	1,047.4 Ccf
17	FY02 805.1 Ccf	965.8 Ccf
18	FY03 919.7 Ccf	965.8 Ccf

19

20 Because actual usage per-customer has not—even in the so-called cold years of FY01
21 and FY03—reached the rate case usage per-customer, MGE has not been able to
22 achieve its authorized rate of return.

23

24 **Q. PLEASE ELABORATE ON YOUR POINT ABOUT BAD DEBT EXPENSE.**

25 A. As shown in the direct testimony of MGE witness Michael R. Noack, bad debt
26 expense varies considerably from year to year. The following chart, which is based

on Mr. Noack's analysis, shows the relationship between actual bad debt experienced by the Company and the bad debt allowance included in rates for the past eight years. The following chart compares actual bad debt to the allowance for bad debt used in setting MGE's rates:

	<u>Actual Bad Debt</u>	<u>Bad Debt Allowance in Rates</u>
FY96	\$3,906,455	\$3,409,662
FY97	9,442,692	3,409,662
FY98	4,469,856	3,409,662
FY99	2,584,998	4,325,000
FY00	1,696,606	4,325,000
FY01	12,653,781	4,325,000
FY02	3,211,390	4,323,292
FY03	6,602,056	4,323,292

The foregoing shows that actual bad debt expense varies dramatically from year to year, so much so that it is difficult—if not impossible—to identify a “normal” level of bad debt expense. The foregoing shows that on average—over that eight-year period—MGE's actual bad debt expense exceeded its bad debt allowance in rates by more than \$1.5 million per year. This shortfall in the area of bad debt expense has also directly contributed to MGE's inability to achieve its authorized rate of return.

Q. PLEASE ELABORATE ON YOUR POINT ABOUT “TRADITIONAL” DISALLOWANCES.

A. The Commission has routinely excluded from the rate setting equation costs actually incurred by the Company on the Commission's belief that such costs are not necessary for the provision of gas service. Examples include costs associated with legislative activities, dues and donations, advertising costs, Community Relations and Public Affairs staffing. These adjustments have been made without any apparent regard, or

1 appreciation, for the fact, shown earlier in this testimony, that MGE's overall cost
2 structure (as measured by annual O&M expense per customer and average residential
3 margin rates) is well below that of the State's other larger LDC's (Laclede,
4 AmerenUE, and Missouri Public Service). This is a clear indication of efficiency that
5 ought to be encouraged by rewards, not discouraged. Furthermore, the notion that
6 such activities are not a necessary part of operating a utility is fundamentally at odds
7 with reality. MGE serves nearly 160 municipalities. We must communicate
8 effectively with officials in those cities, which requires that MGE personnel know
9 those people and visit them on a regular basis. We must also communicate effectively
10 with our customers as well as various entities to whom those customers may look for
11 information and service, including energy assistance providers, media outlets, and
12 policy makers. In addition, it is simply unreasonable for the Commission to believe
13 that a company of the size, geographic scope and complexity of MGE should ignore
14 the legislative process.

15
16 **Q. PLEASE ELABORATE ON YOUR POINT ABOUT THE COMMISSION'S**
17 **WILLINGNESS TO PUNISH CONDUCT IT DEEMS INAPPROPRIATE**
18 **WHILE IT IS APPARENTLY RELUCTANT TO REWARD POSITIVE**
19 **CONDUCT.**

20 **A.** The Office of the Public Counsel and the Commission's Staff have not been reluctant
21 to recommend—and the Commission in the past has been willing to adopt—
22 punishment for what is deemed to be inappropriate conduct (examples include the
23 downward return on equity adjustment on account of customer service concerns in

1 Case No. GR-96-285; complaints regarding billing issues in 1996 and 1997;
2 complaints regarding gas safety incidents; disallowance of billing improvement costs
3 in Case No. GR-98-140; disallowance of allegedly "imprudent" gas supply
4 expenditures). MGE could perceive fairness in this approach if the converse was also
5 true, that rewards would be recommended by OPC and the Commission's Staff—and
6 adopted by the Commission—for positive conduct. When was the last time the
7 Commission's Staff or the Office of the Public Counsel recommended that the
8 Commission adopt an upward rate of return adjustment on account of high
9 management efficiency? This case presents the Commission with an opportunity to
10 bring such balance to the regulatory process. As shown in the direct testimony of
11 MGE witness Carlton A. Ricketts, MGE provides high quality customer service. In
12 addition, as shown earlier in this testimony, MGE is very cost-effective.

13
14 **Q. DO YOU HAVE ANY RECOMMENDATIONS FOR THE COMMISSION?**

15 A. Yes. The Commission needs to take a fresh look at the way in which it sets rates for
16 natural gas local distribution companies in general, and MGE in particular. Simply
17 taking a "business as usual" approach will not work because an examination of past
18 results establishes that MGE has not had the reasonable opportunity to achieve its
19 authorized return to which it is entitled. In particular, the Commission needs to
20 moderate the financial risk MGE experiences due to weather by reducing the
21 proportion of MGE's revenue stream that varies on the basis of weather. The
22 Commission should also take a close look at the usage per customer (e.g., billing
23 determinants) and bad debt levels proposed for MGE's rates to ensure that such usage

1 and bad debt levels actually have some reasonable likelihood of being achieved. The
2 Commission also needs to reconsider whether all of its "traditional" disallowances
3 make sense in today's environment. Finally, the Commission needs to bring
4 symmetry to its treatment of MGE by showing a willingness to reward positive
5 conduct, through adoption of an upward rate of return adjustment on account of
6 management efficiency.

7
8 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

9 **A.** Yes, at this time.

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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AFFIDAVIT OF JAMES OGLESBY

STATE OF MISSOURI

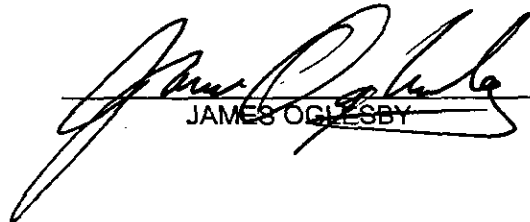
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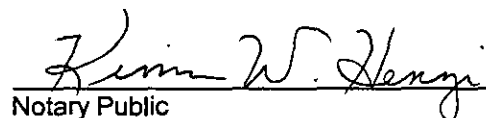
COUNTY OF JACKSON

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


JAMES OGLESBY

Subscribed and sworn to before me this 29th day of OCTOBER 2003.


Notary Public

My Commission Expires: Feb. 3, 2007

