

Exhibit No.: _____
Issues: Policy
Witness: Steven W. Cattron
Sponsoring Party: Missouri Gas Energy
Case No.: GR-2001-292

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY
CASE NO. GR-2001-292

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Missouri Public
Service Commission

DIRECT TESTIMONY OF
STEVEN W. CATTRON

Jefferson City, Missouri

November 7, 2000

DIRECT TESTIMONY
OF STEVEN W. CATTRON
CASE NO. GR-2001-292
NOVEMBER, 2000

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

2 A. My name is Steven W. Cattron, and my business address is 3420 Broadway, Kansas
3 City, 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"), a
7 division of Southern Union Company.

8

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

10 A. I graduated from the University of Missouri-Kansas City with a B.B.A. and I have an
11 M.B.A from Rockhurst College.

12

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

14 A. I have been in my present position since June 1998.

15

16 The majority of my business management experience has been obtained through over
17 twenty years of involvement in the utility industry. My career began as a utility
18 auditor for this Commission. I then transitioned to a utility consultant with Troup,

1 Kehoe, Whiteaker & Kent and held various positions while employed with Kansas
2 City Power & Light Company for nearly sixteen years.

3
4 **Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?**

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

9
10 Finally, I will provide an overall perspective on the rate making process that MGE
11 has experienced historically, as well as suggestions for improvement of that process
12 now and in the future. In so doing, I will address certain critical policy issues that I
13 believe the Commission itself should address in setting rates for natural gas local
14 distribution companies in general, and MGE in particular.

15
16 **1. MGE IS COMMITTED TO BEING A LOW-COST PROVIDER OF QUALITY**
17 **CUSTOMER SERVICES**

18
19 **Q. PLEASE EXPLAIN THE FUNDAMENTAL BUSINESS STRATEGY YOU**
20 **ARE CONTINUING TO IMPLEMENT AT MGE.**

21 A. Our fundamental business strategy is to be a low-cost provider of quality customer
22 services. When I began my work at MGE in June of 1998, this overall direction was
23 already in place. Implementing this strategy requires a balance of cost management
24 and quality customer service.

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

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

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

My personal belief is that shareholders are not likely to be satisfied if customers are not pleased, and that customers are not likely to be satisfied if employees are not satisfied. Therefore, MGE places heavy emphasis on employee and customer satisfaction.

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 four 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 One of the first significant accomplishments MGE achieved during my tenure was the
17 execution, well in advance of the expiration date of the then-current contract, of a
18 five-year contract with our labor unions. We accomplished this contract through our
19 "partnership" without resorting to the traditional bargaining process.

20
21 We also conduct annual employee surveys that provide us with feedback in this area.
22

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

2 A. Overall, I think we have done a pretty good job and the employee surveys seem to
3 back this up. Nevertheless, we have not been entirely successful. We also know that
4 the passage of time is accompanied by new challenges. In order to meet these
5 challenges successfully, we need employees who understand where we are going and
6 believe in that direction. Thus, MGE will continue to place a heavy emphasis on
7 employee communication and satisfaction.

8

9 **Q. CAN YOU PROVIDE EXAMPLES OF HOW MGE HAS EMPHASIZED**
10 **CUSTOMER SATISFACTION?**

11 A. MGE's customer satisfaction efforts were well under way upon my arrival in June of
12 1998. Those efforts have continued through all of my two-and-one-half years tenure.
13 We encourage our employees to work with the "mind of a customer and the pride of
14 an owner," and most of them are doing so. We are continually striving to make it
15 easy for our customers to do business with MGE. As shown more specifically in the
16 direct testimony of MGE witness Karen M. Czaplewski, MGE has achieved superior
17 customer service performance levels. In addition, as explained in more detail below,
18 MGE has achieved this superior performance in a very cost-effective fashion.

19

20 The Company's role in the negotiation and approval of the Fixed Commodity Price
21 PGA, the first of its kind in Missouri, is an indication of our belief that price stability
22 is something that our customers desire. It is my sincere hope that factors will permit
23 the implementation of the Fixed Commodity Price PGA some time in the near future,

1 so that we can deliver true stability in the cost of gas to our customers. As explained
2 in the direct testimony of MGE witness F. Jay Cummings, the rate design we have
3 proposed in this case for non-gas rate elements would bring further price stability to
4 our customers.

5
6 Similar to our belief that employees both desire and need effective communications,
7 MGE emphasizes effective customer communications. When the possibility of high
8 gas prices became apparent this summer, MGE began to communicate early and often
9 about the issue with its customers. We promoted ABC (“average bill calculation”)
10 participation and emphasized simple energy conservation measures. Most recently,
11 MGE hosted an “Energy Forum” to discuss the high gas cost issue, and possible
12 responsive actions, with numerous affected entities (including community action
13 agencies, and state and local officials).

14
15 **Q. DO YOU HAVE ANY INFORMATION SHOWING HOW MGE’S COSTS**
16 **COMPARE TO OTHER REASONABLY COMPARABLE NATURAL GAS**
17 **LOCAL DISTRIBUTION COMPANIES IN MISSOURI?**

18 **A.** Based on information contained in annual reports filed with the Commission, it
19 appears that, in comparison to other Missouri LDCs, MGE provides service in a
20 considerably more cost-effective fashion. The following chart shows annual
21 operation and maintenance cost per customer for the years 1998 and 1999 for MGE,
22 Laclede Gas Company, AmerenUE (natural gas operations) and Missouri Public
23 Service (natural gas operations):

	<u>MGE</u>	<u>Laclede</u>	<u>AmerenUE</u>	<u>MoPub</u>
1998	\$104.52	\$163.71	\$167.82	\$185.21
1999	\$103.20	\$159.74	\$167.01	\$180.30

In addition, annual residential bill comparisons of these four companies on the basis of margin rates (monthly customer charge plus volumetric rates) in effect as of the time of this testimony shows that MGE is considerably lower-priced than these companies. This is shown in the following chart:

	<u>MGE</u>	<u>Laclede</u>	<u>AmerenUE</u>	<u>MoPub</u>
	\$218.04	\$283.42	\$305.03	\$330.94

Even if the Commission approves 100% of the rate increase requested by MGE in this proceeding, MGE's residential annual bill (excluding the PGA and applicable taxes) of \$280.59 (on the basis of 1,000 Ccf usage) will continue to be lower than these other Missouri companies.

Q. AS AN EXPERT IN THE AREA OF UTILITIES, WOULD YOU CONSIDER IT REASONABLE TO RELY ON THE FOREGOING INFORMATION FOR THE PURPOSE OF COMPARING MGE'S COSTS AND PRICES TO OTHER MISSOURI COMPANIES?

A. Yes.

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Q. IN ITS ORDER IN CASE NO. GR-98-140, THE COMMISSION FOUND THAT MGE HAD NOT YET FULLY COMPLIED WITH COMITMENTS MADE IN ITS PRIOR RATE CASE (NO. GR-96-285) AND REMINDED THE PARTIES THAT SUCH COMMITMENTS REMAIN IN EFFECT UNTIL SUCH TIME AS AN ORDER RELIEVING MGE OF SUCH COMMITMENTS IS ISSUED. ARE YOU AWARE OF THIS STATEMENT?

A. Yes. I take very seriously all commitments made by MGE to the Commission. It is my intention that MGE live up to each and every such commitment. As more specifically reported in the direct testimony of MGE witness Karen M. Czaplewski, it is my belief that, except for not yet reaching the ASA (“average speed of answer”) goal of 45 seconds, MGE has fulfilled all of the commitments it has made to the Commission.

We continue to implement the Commission-approved Safety Line Replacement Program and in fact just recently (by the end of October 2000) completed the replacement of the last of what have come to be known as “ten-year” service lines under that program. In 1999, we received approval to accelerate completion of replacement of “twenty-year” service lines from 2009 to 2004. We are on track for completion of the cast iron portion of this program on time by year-end 2000 and we continue to work with the Commission’s safety staff on how to proceed in the future.

1 Q. MR. CATTRON, IS MGE COMMITTED TO ACHIEVING CUSTOMER
2 SERVICE PERFORMANCE LEVELS IN THE FUTURE SIMILAR TO
3 THOSE WHICH HAVE BEEN ACHIEVED IN THE PAST YEAR?

4 A. Yes. But the Commission needs to put the service quality improvements MGE has
5 achieved over the past few years in context. While the warm weather we experienced
6 in our service territory in FY98, FY99 and FY00 hurt MGE's financial performance
7 and achieved returns, that same warm weather helped almost all of its customer
8 service performance statistics. Typically, warm weather translates into lower gas
9 bills, which in turn usually translates into fewer customer contacts. Wholesale gas
10 prices were also relatively low during this period of time (July 1997-June 2000).

11
12 Furthermore, achieving quality customer service is one thing and maintaining that
13 achievement is another. So while we are committed to providing superior service
14 quality, we are also committed to providing service at a reasonable cost to the
15 customer. At the same time, our shareholders are entitled to a reasonable opportunity
16 to achieve the return authorized by the Commission. The bottom line is that service
17 quality will have to be balanced with cost and earnings considerations. I firmly
18 believe that the Commission needs to demonstrate the value it places on service
19 quality by fairly compensating MGE for the substantial achievements it has made in
20 this area and by providing the opportunity to realize financial benefits for maintaining
21 or improving upon these achievements.

22

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

3 A. The filing of this rate case is an example of the emphasis MGE places on shareholder
4 satisfaction. The filing of a general rate case, while necessary and a part of doing
5 business, is not something we take lightly. It is an expensive and time consuming
6 process that diverts substantial management attention away from the company's
7 primary mission, which is to provide safe and reliable gas service to its customers.
8 Nevertheless, without sufficient earnings, the company will be in no position to
9 provide the quality of service our customers expect and deserve. Therefore, MGE has
10 decided to file this rate case.

11
12 **3. RATE MAKING PRACTICE, POLICY AND IMPACTS**

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

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

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Q. MR. CATTRON, HAS MGE EVER ACHIEVED ITS AUTHORIZED RETURN?

A. No, I don't believe so.

Q. CAN YOU EXPLAIN WHY MGE HAS NEVER ACHIEVED ITS COMMISSION-AUTHORIZED RETURN?

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

In a nutshell, MGE has never achieved its authorized return primarily because of the way in which its rates have been set in the past. In particular, rate design decisions in our last two rate cases have exposed the Company's returns to greater variability due to weather. Compounding this increased weather risk is the Commission's normalization of weather based on the thirty-year period ending 1990 as opposed to a shorter period of time ending more contemporaneously to the period when rates set will be in effect. Returns are further reduced due to the fact that the Commission also

1 routinely disallows from the rate setting equation certain costs deemed by the
2 Commission to be "unnecessary for the provision of gas service" but which, in reality,
3 the Company has no choice but to expend. My Company's experience also indicates
4 that while the Commission is willing to administer punishment for what it deems to
5 be inappropriate conduct, it is at the same time hesitant to administer rewards for
6 what it deems to be positive conduct. In my opinion, the foregoing add up to a
7 regulatory environment in which customer and shareholder interests are not fairly
8 balanced and the Company is left with no reasonable opportunity to achieve its
9 authorized return.

10
11 **Q. PLEASE ELABORATE ON YOUR POINT ABOUT RATE DESIGN.**

12 A. Since January of 1997, the Commission has authorized revenue increases for MGE of
13 more than \$20 million. Virtually all of those revenue increases (the exception being a
14 \$2 increase to the SGS customer charge in the 1997 case) were placed on volumetric
15 rate components. Our current residential customer charge of \$9.05 was fixed in 1993
16 and, as of the date of this filing, has not changed for more than seven years. Because
17 volumetric rates are subject to variation in relation to weather, the percentage of
18 MGE's revenues at risk based on weather has increased substantially since 1993.
19 This increased financial risk has not been recognized by the Commission in its
20 authorized equity returns, for the Commission has reduced the equity returns
21 authorized for MGE in every rate case since 1993.

1 Q. PLEASE ELABORATE ON YOUR POINT ABOUT WEATHER
2 NORMALIZATION.

3 A. My understanding is that the Commission has consistently adopted the Staff's
4 recommendation to normalize the weather impact on billing determinants (and, hence,
5 revenues) through the use of the most recent NOAA-adjusted thirty-year period
6 available. For MGE's last two rate cases, this period has been 1961-1990. Because
7 no more recent NOAA-adjusted data is available, we expect the Staff to recommend
8 the same thirty-year normal in this case. Unfortunately for MGE's shareholders, this
9 "normal" has not often been achieved in MGE's service territory. For example, in
10 only four of the last fifteen years have the heating degree days ("HDD") actually
11 experienced in Kansas City been equal to or in excess of the number of HDD
12 produced by the Staff's thirty-year normalization methodology.

13
14 Until the Commission uses a measure of "normal" weather that more closely
15 approximates actual experience, it is doubtful that MGE will ever have a reasonable
16 opportunity to achieve its authorized return.

17
18 Q. PLEASE ELABORATE ON YOUR POINT ABOUT "TRADITIONAL"
19 DISALLOWANCES.

20 A. The Commission routinely excludes from the rate setting equation costs actually
21 incurred by the Company on the Commission's belief that such costs are not necessary
22 for the provision of gas service. Examples include costs associated with legislative
23 activities at both the state and municipal level, dues and donations, advertising costs,

1 Community Relations and Public Affairs staffing. These adjustments have been
2 made without any apparent regard, or appreciation, for the fact, shown earlier in this
3 testimony, that MGE's overall cost structure (as measured by annual operations and
4 maintenance expense per customer and average residential margin rates) is well below
5 that of the State's other larger LDC's (Laclede, AmerenUE and Utilicorp). This is a
6 clear indication of efficiency that ought to be encouraged by rewards, not
7 discouraged. Furthermore, the notion that such activities are not a necessary part of
8 operating a utility is fundamentally at odds with reality. MGE serves nearly 160
9 municipalities. We must communicate effectively with the officials in those cities,
10 which requires that MGE personnel know those people and visit them on a regular
11 basis. We must also communicate effectively with our customers. In addition, it is
12 simply unreasonable for the Commission to believe that a company of the size,
13 geographic scope and complexity of MGE should ignore the legislative process.

14
15 **Q. PLEASE ELABORATE ON YOUR POINT ABOUT THE COMMISSION'S**
16 **WILLINGNESS TO PUNISH CONDUCT IT DEEMS INAPPROPRIATE**
17 **WHILE IT IS APPARENTLY RELUCTANT TO REWARD POSITIVE**
18 **CONDUCT.**

19 A. The Office of the Public Counsel and the Commission's Staff are quick to
20 recommend--and the Commission in the past has been nearly as quick to administer--
21 punishment for what is deemed to be inappropriate conduct (examples include the
22 downward return on equity adjustment on account of customer service concerns in
23 Case No. GR-96-285; complaints regarding billing issues in 1996 and 1997;

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

13
14 **Q. DO OTHER FACTORS INTERFERE WITH MGE'S ABILITY TO ACHIEVE**
15 **ITS AUTHORIZED RETURN?**

16 **A.** Yes. MGE's Safety Line Replacement Program requires annual capital expenditures
17 of more than \$15 million annually. This investment is required for MGE to comply
18 with Commission rules and orders and does not generate additional revenues. In
19 addition, MGE is required to relocate facilities every year to accommodate public
20 improvement projects by municipalities and other governmental entities. These
21 capital expenditures amount to \$4 to \$5 million annually, are not reimbursed by the
22 governmental entity requiring the facilities relocation and generate no additional
23 revenues.

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Q. DO YOU HAVE ANY RECOMMENDATIONS FOR THE COMMISSION?

A. Yes. The Commission needs to take a fresh look at the way in which it sets rates for natural gas local distribution companies in general, and MGE in particular. Simply taking a “business as usual” approach will not work. In particular, the Commission needs to moderate the financial risk MGE experiences due to weather by reducing the proportion of MGE’s revenue stream that varies on the basis of weather. The Commission should also think long and hard before it adopts the Staff’s thirty-year weather normal (based on the years 1961-1990) over the company’s recommended twenty-year normal (based on the years 1981-2000). The Commission also needs to reconsider whether all of its “traditional” disallowances make sense in today’s environment. Finally, the Commission needs to bring symmetry to its treatment of MGE by showing a willingness to reward positive conduct, through adoption of an upward rate of return adjustment and approval of the Customer Service Effectiveness/Gas Safety Program Experimental Incentive Plan.

4. SUMMARY OF TESTIMONY

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. This rate case is not simply an exercise in determining MGE’s authorized revenue requirement. MGE is entitled to a reasonable opportunity to achieve that authorized return. MGE’s achieved returns over the past three years have shown that unless the Commission materially alters the manner in which it sets and designs rates, MGE will

1 have no reasonable opportunity to achieve its Commission-authorized return. In
2 particular, MGE asks the Commission to:

- 3 1. Reduce the variability of MGE's revenue streams due to weather fluctuations
4 by adopting MGE's improved rate design;
5
- 6 2. Adopt a more realistic approach to measuring "normal" weather by use of data
7 based on a twenty-year period ending in 1999 instead of the Staff's usual
8 approach of using data based on a thirty-year period ending in 1990;
9
- 10 3. Reconsider the "traditional" disallowances that are in reality essential
11 functions for a company such as MGE and therefore necessary costs of doing
12 business; and
13
- 14 4. Show willingness to reward positive conduct by adjusting rate of return
15 upward for management efficiency and superior customer service quality and
16 adopting the Customer Service Effectiveness/Gas Safety Program
17 Experimental Incentive Plan.
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20 In addition, I have reiterated the Company's intent, and my personal commitment, to
21 achieving superior levels of customer service quality at a reasonable cost to customers
22 while achieving compensatory returns for the shareholder.

23
24 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

25 **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.) Case No. GR-2001-292

AFFIDAVIT OF STEVEN W. CATTRON

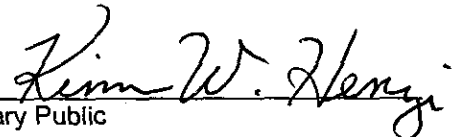
STATE OF MISSOURI)
) ss.
COUNTY OF JACKSON)

Steven W. Cattron, 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.



STEVEN W. CATTRON

Subscribed and sworn to before me this 6th day of November 2000.



Notary Public

My Commission Expires: _____

KIM W. HENZI
Notary Public - Notary Seal
State of Missouri
Jackson County
My Commission Expires Feb 3, 2003

