

In the Matter of the Application of)
Kansas Gas Service, A Division)
of ONEOK, Inc. for Adjustment of) DOCKET NO. 06-KGSG-____-RTS
its Natural Gas Rates in the State)
of Kansas)

STATE CORPORATION COMMISSION

MAY 15 2006

 Docket
Room

**DIRECT TESTIMONY
OF
BRADLEY O. DIXON
ON BEHALF OF
KANSAS GAS SERVICE
A DIVISION OF ONEOK, INC**

DIRECT TESTIMONY
OF
BRADLEY O. DIXON
KANSAS GAS SERVICE
DOCKET NO. 06-KGSG-___-RTS

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

2 A. My name is Bradley O. Dixon. My business address is 7421 West 129th Street,
3 Overland Park, Kansas 66213.

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

5 A. I am President of Kansas Gas Service, a division of ONEOK, Inc. ("Kansas Gas
6 Service" or the "Company").

7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
8 **PROFESSIONAL EXPERIENCE.**

9 A. I received a Bachelor of Business Administration Degree from Washburn University
10 in 1975. Since that time, I have been primarily employed in the utility industry. I
11 held various positions in the accounting, customer service and gas supply areas of
12 Western Resources, Inc. In December 1997, I became an employee of Kansas Gas
13 Service. I initially served as Director of Gas Supply with responsibility for the
14 administration, acquisition, and negotiation of new gas supply, transportation, and
15 storage contracts for the Company. I subsequently became Vice President, Western
16 Region, Transmission and Gas Supply with responsibility for the distribution
17 operations of the western region of Kansas Gas Service. While in that position, I
18 assumed responsibilities related to the Gas Supply, Transmission Operations,

1 Transportation Services and FERC Regulatory Departments of Kansas Gas Service.

2 In January 2005, I was appointed to my current position.

3 **Q. HAVE YOU TESTIFIED BEFORE THE KANSAS CORPORATION COMMISSION?**

4 A. Yes. I testified before this Commission in Docket No. 98-KGSG-475-CON. I also
5 submitted prefiled testimony in our last rate case, Docket No. 03-KGS-602-RTS.

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

7 A. My testimony provides an overview of Kansas Gas Service's operations. I introduce
8 our Company witnesses in this case and identify the principal factors driving the
9 need for our requested rate increase of \$73,300,788. Detailed financial information
10 underlying the request will be provided by the Company's other witnesses. I do,
11 however, discuss Kansas Gas Service's extremely low earnings levels and describe
12 our efforts to control costs and improve productivity. I would note that a large
13 percentage of our revenue request is attributable to significant expense increases. I
14 also discuss actions we have taken and investments we have made to assist and
15 better serve our customers. Finally, I identify two matters we are proposing that will
16 require Commission approval – a new “customer-choice” rate design for residential
17 and general service customers and a tariff rider covering certain pension and
18 employee benefit costs.

19 Our case reflects a fundamental and continuing commitment to address our
20 historical low earnings, to enhance customer choices, and to invest in the future of
21 Kansas utility operations. We ask for an affirming and progressive Commission
22 response.

23 **Q. PLEASE INTRODUCE THE KANSAS GAS SERVICE WITNESSES WHO WILL BE
24 PROVIDING DIRECT TESTIMONY IN THIS CASE.**

25 A. In addition to my testimony, Kansas Gas Service will present the direct testimony of
26 eight other witnesses. Don Whitlock, the Company's Director of Financial Services,

1 sponsors our overall revenue requirement and the bulk of the Minimum Filing
2 Requirement (MFR) schedules and pro forma adjustments to test year costs. Darrell
3 Bledsoe, a manager in the Rates and Regulatory Department, sponsors selected
4 MFR schedules and adjustments to test year revenues and costs. A significant
5 component of Mr. Bledsoe's testimony is the presentation of the Company's cash
6 working capital requirements, which is the product of a comprehensive lead/lag study
7 conducted under Mr. Bledsoe's supervision. Apart from the cash working capital
8 determination, Mr. Bledsoe's testimony focuses on revenue-related adjustments and
9 schedules. Paul Raab, an independent economic consultant, sponsors the class
10 cost of service study we relied upon to develop proposed new rates. Mr. Raab will
11 also explain and sponsor a new two-tier "customer-choice" rate design proposal for
12 residential and general service customers. Dr. Ronald E. White, Executive Vice
13 President and Senior Consultant of Foster Associates, Inc., presents a depreciation
14 study conducted at our request. As a result of the study, Dr. White recommends
15 adjustments in the Company's depreciation rates that reduce the Company's
16 depreciation expense by nearly \$5 million. Dr. William E. Avera, a principal in
17 Financial Concepts and Applications, Inc., testifies regarding Kansas Gas Service's
18 capital structure, a reasonable cost of equity, and the overall cost of capital that
19 should be used to set Kansas Gas Service's rates. Robin Hagerty, a consulting
20 actuary with Mercer Health and Benefits Consulting, provides testimony addressing
21 employee benefit costs, the treatment of Kansas Gas Service's prepaid pension
22 asset, and the proposed Pension and Employee Benefit Rider. Richard H.
23 Tangeman, Director, FERC Regulatory and Strategy, will testify regarding the use,
24 status, and proposed treatment of assets that were acquired by Kansas Gas Service
25 from the Mid-Continent Market Center in 2002. Frank Garver, Senior Analyst, Rates
26 and Regulations, sponsors and explains the proposed tariff modifications necessary

1 to implement the requested rate changes and other proposals included in this
2 Application.

3 **Q. PLEASE DESCRIBE KANSAS GAS SERVICE'S BUSINESS OPERATIONS.**

4 A. Kansas Gas Service currently serves more than 642,000 natural gas customers in
5 336 Kansas communities. Our customer base consists of approximately 585,000
6 residential customers, 52,800 commercial customers, 100 industrial sales customers,
7 and 4,300 transportation customers. We have a Kansas-based work force of
8 approximately 1,052 employees. Our utility plant includes 6,400 miles of service
9 lines and over 10,000 miles of distribution and transmission lines. I have included a
10 map of our Kansas service territory as Exhibit ___ (BOD-1).

11 **Q. WHAT ARE THE PRINCIPAL FACTORS REQUIRING KANSAS GAS SERVICE**
12 **TO FILE THIS RATE APPLICATION?**

13 A. First, I must point to the historically low earnings levels that have characterized
14 Kansas Gas Service's utility operations since ONEOK acquired the Kansas gas
15 properties of Westar Energy, Inc. in November 1997. The Commission will recall
16 that in the acquisition proceeding, we presented testimony showing a revenue
17 deficiency of approximately \$29.0 million. In the Order approving the transaction, the
18 Commission itself expressed the belief that "existing rates are within the low end of a
19 'zone of reasonableness.'" Docket No. 97-WSRG-486-MER. Notwithstanding, these
20 low rates, Kansas Gas Service operated its Kansas utility properties with no rate
21 increase for almost 6 years before the rate increase authorized in our 2003 rate case
22 was implemented. In that case, as a result of a stipulated agreement, the
23 Commission approved a base rate increase of \$45.0 million that became effective in
24 October of 2003. It is important to note, however, that approximately \$10.0 million of
25 the \$45.0 million increase simply reflected a shift in the recovery of certain costs from
26 the Company's Cost of Gas Rider to its base rates. As a consequence, the

1 magnitude of the revenue increase actually realized by Kansas Gas Service was
2 approximately \$35.0 million – only slightly more than the revenue deficiency
3 identified 6 years earlier. It is the reality of these historically low earnings, in the
4 current environment of increasing expenses, which underlies this rate request.

5 The Company's publicly reported earnings provide stark evidence that
6 Kansas Gas Service today is not earning a reasonable, compensatory return for our
7 Kansas utility operations. This is most graphically shown in our 2005 FERC Form 2
8 Annual Report. On net utility plant of \$840.8 million, our reported net utility
9 operating income was \$27.2 million -- or approximately 3.24% percent. In 2004, our
10 reported net utility operating income was \$37.1 million on net utility plant of \$823.0
11 million -- again, an income level that is far below any "zone of reasonableness."
12 From 2004 to 2005, our net utility operating income declined by approximately \$10.0
13 million. Even more troubling is the fact that our net income for 2005, as reported in
14 the FERC Form 2, was a **negative** \$3.4 million.

15 This earnings information is consistent with the testimony of Don Whitlock
16 who explains that our pro forma rate of return (based on operating income) during
17 the 2005 test year was only 3.2438%. Simply and directly put, our rates do not now
18 permit, nor have they historically permitted, Kansas Gas Service to earn a fair and
19 reasonable rate of return on our Kansas utility investment. That is the context for the
20 development and submission of this rate application.

21 **Q. IN ADDITION TO THE COMPANY'S HISTORICALLY LOW EARNINGS, WHAT**
22 **OTHER FACTORS CONTRIBUTE TO THE CURRENT REVENUE DEFICIENCY?**

23 Kansas Gas Service has continued to invest approximately \$50.0 million per year in
24 its Kansas utility plant to improve reliability and to meet our service obligations. The
25 need to earn a return on this investment, as well as the associated depreciation
26 expense, significantly impacts our revenue requirement. For example, the increased

1 depreciation expense on this new investment alone was nearly \$5.0 million in the
2 test year. Overall, our rate base has increased by \$130.0 million since the test year
3 utilized in the 2003 rate case. Approximately \$75.7 million of this increase reflects
4 the inclusion of the Company's prepaid pension assets in rate base. The cost of our
5 gas inventory has also increased substantially due to higher gas costs. The amount
6 of the gas inventory increase is \$30.2 million. Another factor driving our rate request
7 is an ad valorem tax increase of \$5.2 million. This amount is now recovered through
8 the Ad Valorem Surcharge Rider and, as statutorily required, is being moved to base
9 rates. As a consequence, it does not increase revenues recovered from our
10 customers, but does affect the magnitude of the requested increase in base rates.
11 Additionally, our revenue requirement is affected by increasing retiree medical costs
12 and employee pension and benefits costs (approximately \$8.4 million since 2003),
13 notwithstanding significant efforts to manage those costs.

14 **Q. HAVE THE COMPANY'S EARNINGS ALSO BEEN IMPACTED BY THE TREND**
15 **OF DECLINING GAS CONSUMPTION?**

16 A. Yes. Average residential customer consumption has experienced a continuing and
17 significant decline. The trend of using natural gas more efficiently will continue to
18 reduce individual customer consumption and erode the Company's revenues.

19 **Q. WHAT, IF ANY, STEPS HAS KANSAS GAS SERVICE TAKEN TO MANAGE**
20 **COSTS AND IMPROVE EARNINGS?**

21 A. Kansas Gas Service has consistently looked for prudent ways to increase operating
22 efficiencies and hold down costs without sacrificing service quality and reliability. We
23 have also taken significant steps to control health care and retirement costs. In the
24 area of operating efficiencies, I would point out that the number of customers per
25 employee has increased from 584 to 610 since the last rate case. We believe this
26 increase in employee efficiency has been achieved through enhanced productivity.

1 Specific efficiency programs we are implementing include the continued expansion of
2 the use of in-truck terminals for field employees and the placement and use of
3 increasing numbers of meters that can be read electronically. The in-truck terminals
4 permit service technicians to receive work orders electronically in their vehicles. As
5 a result, they can respond more quickly to customer service requests while
6 minimizing errors in receiving, interpreting and sending work orders and reports. The
7 electronic meters reduce meter reading errors and virtually eliminate the need for
8 meter re-reads.

9 In addition to managing costs through a continually expanding use of
10 technology, we have held down the rate of increase in our benefit costs by increasing
11 current employees' and retirees' contribution to their medical costs. Where possible,
12 our retiree prescription drug plan has been redesigned to take full advantage of the
13 recently implemented Medicare Part D drug program. Furthermore, the Company's
14 1999 action to exclude newly hired employees from receiving postretirement medical
15 benefits continues to hold down the rate of increase of our postretirement medical
16 costs. We have also taken steps to reduce the long-term increase in pension costs
17 through exclusion of new hires from the Company's defined benefit pension plan.

18 **Q. WHAT ACTIONS HAS KANSAS GAS SERVICE TAKEN TO ASSIST AND**
19 **BETTER SERVE ITS CUSTOMERS?**

20 A. We completed the mobile home park distribution system replacement program at a
21 cost of over \$9.0 million to the Company. This program extended over a 5-year
22 period and involved the comprehensive analysis, upgrading, replacement, and
23 assumption of ownership of distribution systems located in mobile home parks in
24 Kansas. Since its inception, this program has resulted in the replacement and
25 upgrading of services for more than 6,800 residential mobile home park customers.

1 Investing in the future, Kansas Gas Service now offers a variety of customer
2 choice programs and payment options. Our automated voice response system and
3 interactive Web site are available 24 hours a day, 7 days a week. We recently
4 launched a program using payment kiosks in supermarkets and other heavily
5 traveled locations where customers may pay their bills in person. Customers can
6 choose to pay their bills in an increasing number of ways: in cash, by personal
7 check or bank draft, and, now, by credit or debit card. We believe this is a direct
8 benefit to our customers and may have some value in reducing the level of
9 uncollectible accounts.

10 We also recognize the financial burden that higher natural gas costs have
11 placed on our lower and fixed income customers. In response to these higher costs,
12 in February 2006 the ONEOK Foundation made a contribution of \$400,000 to the
13 Salvation Army to provide financial support to the Kansas-based Gift of Warmth
14 program.

15 **Q. PLEASE SUMMARIZE THE NEW PROPOSALS INCLUDED IN THIS**
16 **APPLICATION.**

17 A. In many respects, this rate application relies on well-established regulatory principles
18 and approaches in Kansas; however, we have retained innovative and progressive
19 programs previously approved by the Commission that lower gas costs or reduce
20 billing volatility. These include our gas hedging program, our weather normalization
21 adjustment program, and our As Available Gas Sales program.

22 Our new proposals include an innovative two-tier rate design for residential
23 and general service customers and a tariff rider for the timely and appropriate
24 recovery of pension and other employee benefit costs. The new rate design
25 proposal will permit residential and general service customers to choose the most
26 economical rate structure based on their own usage. Higher-usage customers can

1 choose the tier where the service charge is higher and the delivery charge is lower,
2 while lower-usage customers are best served by the older, traditional rate design
3 with a relatively lower service charge and a relatively higher delivery charge. As I
4 previously noted, the new rate design proposal is explained by Mr. Raab.

5 The pension and employee benefit rider strikes a balance between customer
6 and shareholder interests by ensuring that specific benefit costs will be recovered in
7 rates in a timely fashion. Although the costs of these benefits have increased
8 significantly in the past, they may decline in future periods. The rider is structured in
9 such a way as to permit Kansas Gas Service to recover only the variance between
10 costs that are in base rates and actual costs. If these benefit costs go up from the
11 level included in base rates, they can be recovered in the subsequent year through
12 the rider. Conversely, if costs go down, this reduction will be flowed through the rider.

13 **Q. DO YOU WISH TO MAKE A CONCLUDING STATEMENT REGARDING THIS**
14 **RATE APPLICATION?**

15 A. Yes. Since becoming a natural gas public utility, Kansas Gas Service has
16 demonstrated its commitment to being an efficient and innovative supplier of natural
17 gas services to Kansas customers. As I have tried to point out, however, our
18 authorized rates do not in any way provide a compensatory return on our Kansas
19 utility investment. Our commitment to continuing to provide quality service and to
20 make necessary future investments is unwavering. However, we also must be
21 concerned about maintaining the financial integrity of the Company for the benefit of
22 our shareholders and our customers. Our case is directed toward insuring such
23 integrity. We are most hopeful of a progressive and positive Commission response
24 to our real and fundamental financial needs.

25 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

26 A. Yes.

VERIFICATION

STATE OF KANSAS)
) ss.
COUNTY OF JOHNSON)

Bradley O. Dixon, being duly sworn upon his oath, deposes and states that he is President for Kansas Gas Service, a division of ONEOK, Inc.; 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.



BRADLEY O. DIXON

Subscribed and sworn to before me this 10th day of May 2006.



NOTARY PUBLIC

My appointment Expires:

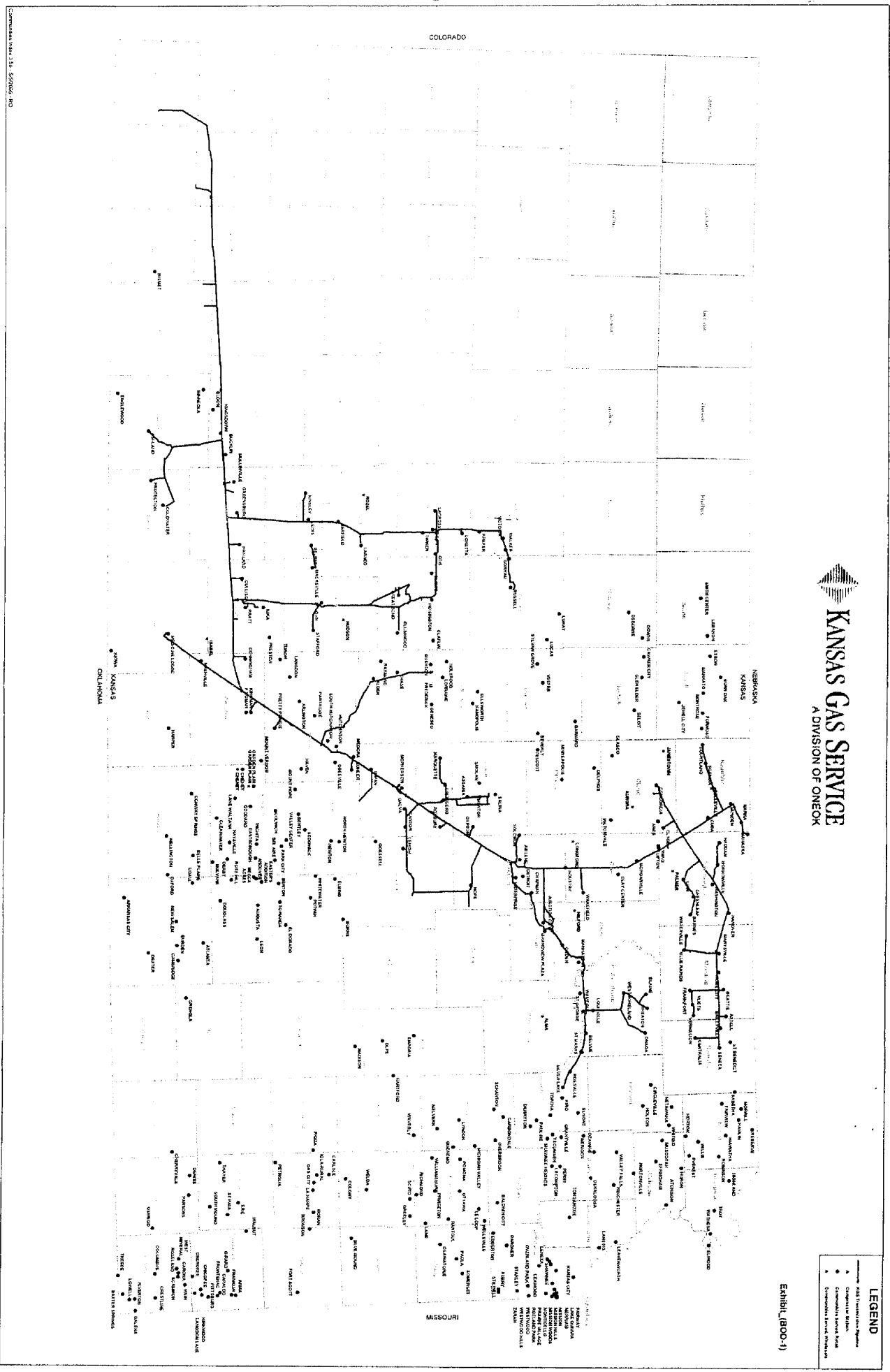


KANSAS GAS SERVICE
A DIVISION OF ONEOK

LEGEND

- Existing Pipeline
- Proposed Mainline
- Proposed Branch
- Proposed Local Distribution

Exhibit (B00-1)



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