

1 deal with the record as it's developed in front of you.
2 You can't ignore the record evidence, otherwise you won't
3 stand appeal.

4 Q. Well, I'm trying to understand how we
5 balance that altogether, Mr. Quain. The idea that we have
6 record evidence -- and you're an attorney -- we have
7 record evidence and then you say we have to consider
8 public policy.

9 A. Well, you know as well as I do that when
10 you have record evidence, particularly in rate of return
11 you end up with a number of ranges, and those ranges are
12 then tested by cross-examination for veracity and
13 reliability and the correct application of the models that
14 underlie the recommendations. But it is rare that you see
15 in any rate -- I've never seen any rate proceeding every
16 witness come in with a single rate of return
17 recommendation. There's always a range.

18 And so when you set -- when you go to adopt
19 a specific rate of return, because in the final order you
20 can't adopt a range, adopt a number, and that number is
21 directed towards the evidence of record that support the
22 law that's applicable, including Hope and Bluefield and
23 the public policy objectives that you're trying to
24 achieve. It's got to be based within the range of the
25 rates of return in evidence.

1 Q. So it's your understanding that the only
2 return on equity -- for example, let's say you have a
3 return on equity recommendation at the low end 10 percent,
4 at the high end 12 percent. A public service commission
5 can't grant a company a 13 percent return on equity?

6 A. If there is no evidence of record that
7 supports, if no -- if I understand your question right --
8 let me just repeat it.

9 Q. Yes, sir. There's no other record
10 evidence. 10 percent?

11 A. No, you cannot.

12 Q. 12 percent?

13 A. You cannot set a rate of return above or
14 below a number that's put forth in the record.

15 Q. You talk about a recent study by the
16 Regulatory Research Associates regarding return on equity.

17 A. Uh-huh.

18 Q. Is there a more updated one than that, that
19 you're aware of?

20 A. Yes, I believe they come out quarterly.

21 Q. And do you have a copy of that?

22 A. I just saw one recently, yes.

23 Q. Do you have a copy with you today?

24 THE WITNESS: Do you have that, Brian?

25 MR. MICHEEL: We can go off the record, if

1 you guys need a minute.

2 (AN OFF-THE-RECORD DISCUSSION WAS HELD.)

3 THE WITNESS: As you just heard Mr. Hack
4 say, this is -- my testimony spoke to the RRA report as
5 of -- the first report as of '03. This is the -- this is
6 the final report for '03.

7 MR. MICHEEL: Could I take a copy of this
8 final report for '03?

9 MR. HACK: Let me just make sure there's no
10 scratching on it. There's not on this one.

11 THE WITNESS: You know, certainly you can.
12 I just recall that there are copyright considerations for
13 this kind of thing, and I don't pretend to know, other
14 than when you pass them out we've got to make some
15 disclosure what they can be used for.

16 BY MR. MICHEEL:

17 Q. I don't have any friends that are
18 interested in anything that I do in my job. I can assure
19 you it won't --

20 A. I know that feeling.

21 Q. -- it won't leave this area, sir, if I
22 could.

23 A. Then that's the first quarter '04.

24 Q. I want to -- you answered a data request
25 that I asked you to get a copy of the report that you

1 talked about in your testimony, did you not?

2 A. The RRA report?

3 Q. Yes, sir.

4 A. Yes.

5 Q. And let me hand that to Mr. Hack, if I
6 could, and ask him to take a look at that report, and what
7 I'm looking at is page 2 of that report for the 1997. I
8 think I have a yellow sticky.

9 MR. HACK: Yeah.

10 BY MR. MICHEEL:

11 Q. And would you agree with me that
12 January 22nd, 1997 was in the first quarter of 1997?

13 A. Sure.

14 Q. And if we looked at the -- and, Mr. Hack
15 can confirm this. I'm looking at the report that you gave
16 me for gas utilities 1997 first quarter, and it indicates
17 there that return on equity for gas utilities was
18 11.31 percent.

19 MR. MICHEEL: And Mr. Hack, if you can
20 confirm that.

21 MR. HACK: I'm sorry.

22 MR. MICHEEL: First quarter 1997.

23 MR. HACK: Yes. Yes. I am looking at the
24 company's response to OPC Data Request No. 5005, page 2,
25 1997, and it shows 11.31 percent under gas utilities.

1 MR. MICHEEL: For the first quarter?

2 MR. HACK: For the first quarter of 1997.

3 MR. MICHEEL: And for the full year of
4 1997, does it show 11.29 percent?

5 MR. HACK: That is correct.

6 BY MR. MICHEEL:

7 Q. I think we agreed earlier on that MGE was
8 authorized a return on equity of GR-96-285, the case
9 decided on January 22nd, 1997, 11.30 percent return on
10 equity, correct?

11 A. Again, I don't recall the number, but sure,
12 that's fine.

13 Q. Let me make sure on the number. I don't
14 want to leave this deposition with you not recalling.

15 A. I'm sorry. I didn't mean the return
16 number. I meant the case number.

17 Q. Okay. So you're certain the return on
18 equity was 11.3 percent in GR-96-285?

19 A. That was my recollection from the
20 RRA report.

21 Q. Let me hand Mr. Hack the Report and Order.
22 I've got a yellow sticky.

23 MR. HACK: Right. And assisting Mr. Quain
24 here, this looks like a Mo. PSC report, page 437 of the
25 Volume 5 from the 3rd series. Turning to page 468, the

1 sentence applicable, I think, is the Commission finds that
2 the appropriate return on equity for purposes of MGE's
3 revenue in this case is 11.30 percent.

4 THE WITNESS: Okay.

5 BY MR. MICHEEL:

6 Q. And so the Missouri Commission in that case
7 was right on target with what other natural gas utilities
8 were receiving in terms of return on equity; is that
9 correct?

10 A. It would seem so, yes. But again, the
11 purpose of my testimony is not to go back and rehash what
12 happened in the past. The purpose is for the prospective
13 setting of rates into the future, and to make sure that
14 there is an opportunity to earn the rate of return as well
15 as set. That's the focus and purpose of my testimony.

16 Q. I understand that, Mr. Quain, and that
17 wasn't my question. So I'm going to ask just for the
18 record that everything after 11.3 percent be stricken
19 because it was nonresponsive.

20 MR. HACK: And our response simply would be
21 that the witness has a right to explain.

22 BY MR. MICHEEL:

23 Q. Are you aware that in GR-98-140 decided
24 August 21st, 1998, the Missouri Public Service Commission
25 authorized Southern Union Company, doing business as

1 Missouri Gas Energy, a 10.93 percent return on equity?

2 A. I'll accept that subject to check.

3 MR. MICHEEL: Looking at DR 505, Mr. Hack,
4 what was the -- and that's in the fourth quarter,
5 August 21st of '98. Would that be in the fourth quarter
6 of 1998?

7 MR. HACK: I think that would be in the
8 third quarter 1998.

9 BY MR. MICHEEL:

10 Q. Okay. Third quarter. Will you accept
11 that, third quarter? Is August in the third quarter?

12 A. It sure is.

13 MR. MICHEEL: And for the third quarter of
14 1998, does the report that was -- that was referenced in
15 Mr. Quain's testimony indicate that the return on equity
16 for gas utilities was 11.41 percent?

17 MR. HACK: That is correct.

18 MR. MICHEEL: And overall for that year it
19 indicates that the return on equity was 11.51 percent?

20 MR. HACK: That is correct.

21 BY MR. MICHEEL:

22 Q. And you have no reason to doubt that,
23 Mr. Quain?

24 A. I have no reason to doubt that.

25 Q. I just want to make sure that I'm not

1 taking Mr. Hack's deposition, and I understand why we're
2 doing that.

3 MR. MICHEEL: For the full year 1999, does
4 that report indicate that the return on equity for gas
5 utilities was 10.66 percent?

6 MR. HACK: The line for the full year 1999
7 shows 10.66 percent on page 2 of this RRA document.

8 BY MR. MICHEEL:

9 Q. Do you have any reason to doubt that,
10 Mr. Quain?

11 A. I have no reason to doubt that.

12 Q. Do you know, Mr. Quain, if MGE appealed
13 either of the two cases GR-96-285 or GR-98-140?

14 A. I do not know. My recollection is they did
15 not, but I don't know that for sure.

16 Q. If the company felt that the return on
17 equity was inadequate or didn't meet the Hope or Bluefield
18 standards, did they have -- do they have the right to
19 appeal?

20 A. Absolutely they have the right to appeal.

21 Q. And to the extent they didn't appeal, what
22 does that mean to you?

23 A. I couldn't put myself in the position of
24 what management would decide to do or not do with regard
25 to any appeal. I don't know the individual rate

1 components and decision-making process as to the results
2 or whether to appeal a Commission decision or not.
3 There's a lot of thought that goes into that for lots of
4 different reasons why you would want to do or why you
5 wouldn't want to do it.

6 Again, the point here is we're not trying
7 to rehash what happened in the past. We're trying to
8 develop for this Commission a recommendation for the
9 future.

10 Q. And yet we're talking about the fact in the
11 past in MGE's belief allegedly they've never earned their
12 return on equity; isn't that correct?

13 A. In the past, they -- you're talking about
14 authorized rates of return. I was talking about earned
15 returns.

16 Q. And there are a lot of different things
17 that can go into earned return, wouldn't you agree?

18 A. There's absolutely a lot of different
19 things.

20 Q. Give me an idea some of the things that go
21 into earned returns.

22 A. Certainly there are the elements that
23 Mr. Noack talked about. The rate components that bring
24 together the rate element that you use in applying to your
25 customer base could be set inadequate. There are also

1 concerns that you have to look at with regard to the
2 management of the company, what they have done with the
3 ability to manage the company in the way that would allow
4 them to earn their return. You would have to look at the
5 weather situation that was applicable at that period of
6 time.

7 But the problem is here when you've got a
8 whole series of years, year after year after year in a
9 row, my recommendation simply is the Commission needs to
10 analyze what's going on here that would require a company
11 year after year with no allegations of mismanagement and
12 cold years and warm years, et cetera, that authorized rate
13 of return fails substantially against -- the earned return
14 fails substantially against the authorized rate of return.

15 Q. What about the general rate of economy, is
16 that something that should be impacted, would impact
17 possibly?

18 A. Certainly possibly. Not necessarily.
19 Possibly.

20 Q. You didn't just give me an exhaustive list,
21 did you?

22 A. Absolutely not. Absolutely not. There are
23 a lot of reasons.

24 Q. Did Mr. Noack perform any studies with
25 respect to the management of the company that you know of?

1 A. You would have to ask Mr. Noack.

2 Q. You didn't inquire?

3 A. I did not inquire.

4 Q. Did Mr. Noack perform any studies with
5 respect to the general economy?

6 A. Again, you'll have to ask Mr. Noack that
7 question.

8 Q. As far as you know, did Mr. Noack only look
9 at the three items that he set out in his direct
10 testimony?

11 A. No. I think he looked at a whole bunch of
12 items set forth in his schedule. They're the three major
13 items.

14 Q. What else did he look at as set forth in
15 his schedule?

16 A. I think he looked at the weather. I think
17 he looked at the ability to collect from customers,
18 customer turnoffs. I think he looked at rate base
19 numbers. I think he looked at additions to rate base and
20 the normal things that you would expect a revenue witness
21 to look at in terms of trying to analyze what the actual
22 results of a certain set of earnings are as against those
23 that you would expect it to achieve.

24 Q. Are you aware that MGE's last rate case,
25 GR-2001-292, was settled by unanimous stipulation and

1 agreement?

2 A. Yes, I'm aware.

3 Q. And you're aware there was no specific
4 return on equity?

5 A. Yes, I'm aware that there was no specific
6 return on equity.

7 Q. Has the company told you that there was an
8 implied return on equity?

9 A. If they did, I don't recall.

10 Q. Do you believe that investors perceive that
11 the return granted to Southern Union Company, doing
12 business as Missouri Gas Energy in its last rate case was
13 inadequate?

14 A. Please repeat the question.

15 Q. Do you believe that investors perceive that
16 the return granted to Southern Union Company in its last
17 rate case was inadequate?

18 A. The last litigated rate case you're talking
19 about?

20 Q. Sure.

21 A. I have no opinion on that. Again, my
22 testimony goes to the focus of not what happened in the
23 past but what we're going to look for as an appropriate
24 return to attract capital in the future.

25 Q. Do you believe MGE is providing safe and

1 adequate service to its customers?

2 A. I've done no independent analysis with
3 regard to that.

4 Q. Do you believe that the principal goal of
5 the ratemaking process is to enhance the utility's
6 creditworthiness?

7 A. It is a goal, along with lots of goals in
8 the ratemaking process. Hope and Bluefield says that you
9 have to take that into consideration.

10 Q. What other goals?

11 A. The list is exhaustive. Obviously you have
12 to look at the rates being just and reasonable. You have
13 to make sure that the cost causation by customer class is
14 appropriate. You have to look at the rate base additions
15 and the propriety of those rate base additions. You have
16 to look at the element of setting rates in a way that's
17 fair to all the customer classes, including the utility.

18 There are lots of competing interests that
19 go on, which is why this job is so difficult to do.

20 Q. Do you think the Commission will do that in
21 this case?

22 A. I think the Commission will have a record
23 and recommendations in a way that allow them to make the
24 best possible decision they can, and I'm sure they will
25 take everything into consideration, including the public

1 policy objectives of perceptions they're going to be
2 sending the investor community when they set rates, yes.

3 Q. You indicate in your testimony that
4 regulators generally have a broad sense of what similarly
5 situated utilities are authorized to earn. What do you
6 mean by that?

7 A. The Regulatory Research Associates that
8 we've been talking about in the past oftentimes would
9 bring commissioners to New York to talk to the investment
10 community and talk about rates of return, the need for
11 adequate rates of return for the investment community,
12 what was happening in other parts of the country.
13 Certainly we talked about those kind of things at the
14 National Association of Regulated Utilities Commissioners
15 and the regional meetings.

16 So I think all regulators want to do the
17 best job they can, and performing their obligations, which
18 are very serious ones, to take into consideration as much
19 information as they think is relevant and helpful to them
20 as possible. And part of that is determining what's going
21 on in other states.

22 Q. What companies do you believe are similarly
23 situated to Southern Union Company, doing business as
24 Missouri Gas Energy?

25 A. I've done no analysis nor do I offer myself

1 out as an expert with regard to similarly situated
2 companies.

3 Q. How would you define a similarly situated
4 company?

5 A. I think Hope and Bluefield does that fairly
6 nicely.

7 Q. And tell me how Hope and Bluefield does
8 that, sir.

9 A. Corresponding risk in the general area
10 of -- the general area of the country.

11 Q. And how do we determine whether it's a
12 corresponding risk?

13 A. That's why you have rate of return
14 witnesses, which I am not.

15 Q. Well, when you were a commissioner, how did
16 you do that?

17 A. I looked at the rate of return witnesses'
18 analysis and looked at the cross-examination against that
19 testimony and determined who I thought had done the most
20 appropriate model and who had the most effective rationale
21 backing up their recommendations.

22 Q. So you just looked within the record?

23 A. Of course.

24 Q. So your trip to New York City to meet the
25 Regulatory Research Associates didn't have any impact on

1 that decision?

2 A. Didn't have any -- it had an impact on the
3 decision when it comes to the application of public
4 policy, but again, that application can only occur within
5 the range of returns that are on the record. You cannot
6 be outside the record.

7 Q. Is it your belief that the only reason that
8 Southern Union Company, doing business as MGE, has
9 allegedly failed to achieve its authorized return is the
10 way in which the Missouri Public Service Commission sets
11 rates?

12 A. I think there's a serious question that the
13 Commission needs to look at to make that exact
14 determination. What is causing the inability for this
15 company to earn its authorized rate of return in several
16 consecutive years in a row? And a fresh look needs to be
17 taken at what's behind that problem. I think Mr. Noack
18 makes a pretty convincing case.

19 Q. And my question to you is, sir, is it your
20 opinion, your expert opinion that it's the way the
21 Missouri Public Service Commission sets rates that is
22 causing MGE not to earn its return?

23 A. My expert opinion is relying upon the
24 testimony of Mr. Noack and his opinion that is part of the
25 reason.

1 Q. So you've adopted Mr. Noack's opinion?

2 A. I'm relying on Mr. Noack's opinion in terms
3 of offering my recommendations to the Commission, yes,
4 sir.

5 Q. You just indicated that was part of the
6 reason. Is that the whole reason or is that all of the
7 reason?

8 A. In Mr. Noack's testimony?

9 Q. Yes.

10 A. You have to ask Mr. Noack. What I saw him
11 set forth in his testimony was a pretty convincing case
12 that there are some rate elements that need to be taken a
13 fresh look at.

14 Q. Do you believe that the Missouri Public
15 Service Commission has failed to establish an accurate
16 rate base for Missouri Gas Energy?

17 A. I've made no independent analysis of that.

18 Q. Do you believe in the last three Southern
19 Union Company rate cases that the Missouri Public Service
20 Commission has failed to take into account the long-term
21 impact that its ratemaking decisions had on MGE and the
22 state?

23 A. I've made no independent analysis of that,
24 but again I remind you the purpose of my testimony is not
25 to go back and try to rehash what happened in the past but

1 to offer recommendations as to the future as to the way
2 rate case -- rates ought to be set in this case.

3 Q. You were a member of the Pennsylvania
4 Public Utility Commission from 1993 to 2001?

5 A. Yes, sir.

6 Q. How many contested natural gas rate cases
7 did you and your fellow commissioners decide in that time?

8 A. I don't recall.

9 Q. Well, let's bookend it. More than 20?

10 A. I honestly don't recall. During my tenure,
11 particularly when I was chairman, I encouraged as a matter
12 of public policy companies to settle with the litigants in
13 every instance possible because I thought that allowed for
14 a more reasoned and balanced result than the litigation of
15 rate cases, and lots of times that happened before it
16 reached to me. And there were occasions when we talked
17 about that afterwards and tried to get people together to
18 try to come to some reasonable understanding to get what
19 they needed rather than what they wanted.

20 Q. So you have no idea how many litigated
21 cases?

22 A. I'd have to go back and check. I don't
23 recall.

24 Q. Could you check?

25 A. Well, I don't -- I have none of those

1 records in my control. I mean, when I left, they all
2 stayed there. You could check as well as I could check.
3 I just don't recall. There was -- I mean, I voted on
4 roughly 2,000 cases a year. How many of those were
5 contested cases versus settled cases versus electric
6 versus telephone, I just don't have that recollection.
7 I'm sorry.

8 Q. When you were a commissioner, did the
9 Pennsylvania Commission express any preference in
10 methodology for determining a company's return on equity?

11 A. I don't recall. I honestly don't recall.
12 I'm not saying that we didn't in certain cases or not, and
13 I'm not saying whether I was in the majority of those
14 cases or not. I just don't recall.

15 Q. So in your -- most of your experience has
16 been in Pennsylvania; is that correct?

17 A. It's been all over the country. As a
18 regulator it's been in Pennsylvania.

19 Q. And as a -- as an attorney, you've tried
20 more cases in Pennsylvania than anywhere else, haven't
21 you?

22 A. No. If you're talking about experience in
23 the context of trying cases, yes, that's true.

24 Q. And you're not aware of whether or not the
25 State of Pennsylvania has -- that the Commission of

1 Pennsylvania has expressed a preference?

2 A. I'm not saying I'm unaware. I'm saying I
3 just don't recall.

4 Q. Don't remember today?

5 A. Don't remember today.

6 Q. When you were -- when you were a
7 commissioner, did the Pennsylvania Public Utilities
8 Commission express any preference with respect to the
9 years to be used for normalized weather?

10 A. I don't recall. I would think that there
11 would have been a preference stated. I don't recall what
12 that number was.

13 Q. But that would be in the cases?

14 A. It would be in the final order, I would
15 think.

16 Q. And if you disagreed with that preference,
17 you would have filed a dissent?

18 A. No, not necessarily.

19 Q. Okay. And why wouldn't you do that?

20 A. The process of being on a commission and
21 dealing with your colleagues on a whole host of issues, as
22 you know, the issues that go into a rate case are
23 numerous, very numerous, and there was not always the
24 desire by any party to take an exception with regard to a
25 specific issue.

1 I don't think there's any commissioner at
2 any time that agrees with the resolution of every issue
3 that comprises a final order in a rate case. There's just
4 too many and room for reasonable people to disagree.

5 Q. When you were a commissioner, did your
6 commission disallow any advertising expenses from rates?

7 A. I'm sure we did at one time for specific
8 occasions, but I couldn't recall what they are.

9 Q. When you were a commissioner, did your
10 commission disallow any dues and donations from rates?

11 A. I'm sure we did, but again I don't remember
12 the context. I don't think there was a general policy for
13 total disallowance all the time.

14 Q. When you were a commissioner, did your
15 commission disallow any lobbying expenses?

16 A. In terms of the expense level of them?

17 Q. Yes.

18 A. I'm sure there was always a question as to
19 what the appropriate level of expense level was. I don't
20 have specific recollection.

21 Q. When you were a staff attorney with PUC,
22 did you litigate any cases where you recommended
23 disallowance of certain ads?

24 A. You're going back to the early '80s. I'm
25 sorry. I just don't recall.

1 Q. When you were a staff attorney, did you
2 advocate disallowance of any dues and donations?

3 A. Again, I don't recall.

4 Q. When you were a staff attorney, way back
5 when, did you advocate recommending any disallowance of
6 any lobbying costs?

7 A. Again, I just don't recall.

8 Q. When you were a commissioner, did you and
9 your commission -- I mean when you were on the commission,
10 not just when you were chairman in all these questions --
11 did you reduce a company's return on equity for poor
12 service?

13 A. I believe we did.

14 Q. And can you name some of the companies?

15 A. I don't recall. But I also remember that
16 we, as we talked earlier, that we had the -- we had the
17 policy that if we were going to penalize, we were also
18 going to have to incent, and you can't incent without
19 penalizing. So the idea to incent a company to provide
20 good quality service and efficient management using rates
21 of return is part of that analysis.

22 Q. Give me some of the poor customer service
23 items you would look at in lowering a return on equity.

24 A. Safety, if there was serious safety
25 concerns, if there was water quality concerns, if there

1 was lack of compliance with commission regulations or
2 federal regulations, those type of things.

3 Q. What if a company misbilled hundreds of
4 thousands of customers?

5 A. I don't recall being presented with that
6 scenario.

7 Q. Is that a fact that you would consider?

8 A. It would depend. I'd have to know more
9 about the facts. Was it a computer glitch? Was it
10 intentional? Was it once? Was it for a year? I mean,
11 there's lots of facts that have to go into that.

12 Q. So the determination of whether to reduce a
13 company's return on equity for poor service is fact based?

14 A. It is based upon an analysis of the record
15 in determining whether the company is providing high
16 quality service or low quality service, whether there's
17 efficient management or inefficient management and what
18 the level of safety and reliability in the application of
19 that service is.

20 Q. And those were all facts that you would
21 expect to be developed by the parties to the case?

22 A. If there was a concern or an argument, yes.

23 Q. When you were a commissioner, did the
24 commission dismiss any rate cases for poor customer
25 service, outright dismiss them?

1 A. Not that I recall.

2 Q. When you were a commissioner, did the
3 commission increase the return on equity for companies for
4 management efficiency, good customer service?

5 A. I know we talked about it, and I know we
6 took it into consideration in picking a number within an
7 established rate of return supported by record evidence.

8 Q. Did you ever explicitly recognize that in
9 your reports and orders or your decision?

10 A. I honestly don't recall. You're asking me
11 to go back over a 20-year period and talk about specific
12 adjustments and specific cases and specific decisions, and
13 there was so many of them, I just don't have the
14 recollections that you're looking for.

15 Q. And those cases are all reported?

16 A. Some of them are. I don't think they all
17 are.

18 Q. Okay. When you were a commissioner, what
19 factors did you look at to determine whether the
20 management was efficient and deserved a bump in the ROE
21 up?

22 A. Cost controls, what was certainly a good
23 one to look at, reliability and quality of service,
24 whether the management was proactive in trying to be a
25 good corporate citizen and helping with the economic

1 development objectives of the commission and the
2 community, those kinds of elements.

3 Q. Did you look at whether they kept their
4 word on things they were going to do?

5 A. I expected every utility to keep their word
6 on what they said they were going to do.

7 Q. So if a utility came in and made a
8 representation, let's say a witness under oath, that we
9 were going -- we utility XYZ were going to do ABC, you
10 expected that utility to keep that commitment?

11 A. First I'd have to know whether that witness
12 had the authority to make that sort of commitment.

13 Q. Well, let's say that it was Mr. Oglesby,
14 the COO of the company, and they made the commitment that
15 the utility's going to do XYZ.

16 A. Okay.

17 Q. And we come down the road and they didn't
18 do it. Is that something you would take into account?

19 A. I think it would depend upon the gravity of
20 the situation. Was it a big item? Was it a little item?
21 Was it something that was made a commitment in terms of a
22 settlement? Was it something that was off the cuff?
23 There's a lot of considerations that would have to go into
24 a determination.

25 Q. Is it correct that Pennsylvania law is

1 clear that the Pennsylvania Public Utility Commission has
2 the discretion to withhold, limit or condition rate relief
3 on the quality of service?

4 A. Within certain parameters, I think that's
5 true.

6 Q. Would you agree with me that service is an
7 essential consideration of determining just and reasonable
8 rates?

9 A. The quality of service you mean, the
10 reliability of service?

11 Q. Just service.

12 A. I don't know that I can agree on just
13 service. I think quality of service and reliability of
14 service are statutory mandates that have to be followed.
15 I don't know what you mean by just service.

16 Q. Is the fair rate of return for a public
17 utility such as MGE a matter that should be determined by
18 application of a mathematical formula?

19 A. I think that is one part of the
20 consideration. I don't think it stops there.

21 Q. What else should you look at?

22 A. I think you look at the Hope and Bluefield
23 standard, and I think the application of good public
24 policy.

25 Q. And what is the Hope and Bluefield

1 standard?

2 A. They're set forth in my testimony. I can
3 read them to you again if you want.

4 Q. And that sets them all out, your testimony?
5 There aren't any others?

6 A. The Hope and Bluefield speaks for itself.
7 I pulled out what I thought were the most relevant
8 considerations for the testimony that I came here to give,
9 which is not anywhere close to what we're talking about
10 now, but that's the relevance of what I had in mind.

11 Q. Does the rate of return decision in a rate
12 case require the exercise of judgment based upon an
13 evaluation of the particular facts presented in each
14 proceeding?

15 A. Repeat the question, please.

16 Q. Does the rate of return decision in a rate
17 case require the exercise of judgment based upon an
18 evaluation of the particular facts presented in each
19 proceeding?

20 A. Yes, I think that's a fair statement. You
21 apply your judgment based upon the credibility and
22 rationale of the witnesses put forth. It's got to be
23 based on the evidence of record, and the exercise of your
24 judgment is limited to the evidence of record.

25 Q. Is there one precise answer to the question

1 as to what constitutes the proper rate of return for a
2 utility?

3 A. One precise answer?

4 Q. Yes, sir.

5 A. Obviously not. Otherwise there would be an
6 awful lot of people not offering testimony.

7 Q. Is there one precise answer as to what
8 constitutes the appropriate return on equity for a
9 utility?

10 A. I have to give the same answer.

11 Q. Is the discounted cash flow method of
12 determining the cost of common equity the most accepted
13 methodology for ratemaking purposes?

14 A. It is a highly accepted methodology. The
15 inputs that go into it I think are a matter of some
16 controversy, which I don't pretend to hold myself out as
17 an expert. Discounted cash flow is an accepted
18 methodology.

19 Q. And it's one that's been dealt with in peer
20 review articles?

21 A. It's been dealt with in lots of places, and
22 lots of commissions use it, but again, there's an awful
23 lot of -- two different rate of return experts can use the
24 same discounted cash flow methodology and by virtue of the
25 inputs they put in reach a different result.

1 Q. But that methodology is accepted expert
2 methodology for determining return on equity?

3 A. The methodology is, but my point is it's
4 the inputs and how that methodology is applied, as with
5 any methodology, is what becomes important.

6 MR. MICHEEL: Thanks a lot for your time,
7 Mr. Quain.

8 THE WITNESS: Thank you.

9 CROSS-EXAMINATION BY MR. CONRAD:

10 Q. Mr. Quain, my name is Stu Conrad. I'm here
11 representing a group of industrial customers.

12 A. Good afternoon.

13 Q. I just wanted to follow up on just frankly
14 just a couple of things here that I was kind of puzzled
15 at.

16 You've talked about the Hope Natural Gas
17 and Bluefield Waterworks cases on page 3 of your testimony
18 and then numerous times in your cross-examination here
19 this afternoon. Do you remember the facts of the Hope
20 Natural Gas case?

21 A. I have read them. I don't know that I have
22 specific recollection with regard to that.

23 Q. Do you remember who won?

24 A. I don't recall who won. I look at it for
25 the propositions that are set forth in my testimony.

1 Q. When you were in law school, did you ever
2 have a prof that asked you to brief a case and just give
3 him the propositions of the case and not the facts?

4 A. I don't recall. I don't -- look, the Hope
5 and Bluefield standards are set forth not --- and are
6 important in this context not for the facts of that
7 particular case or for who won or who lost in this case.
8 The propositions are well-accepted seminal cases as to
9 what the Commission should look at in establishing the
10 appropriate rate of return.

11 Q. Do you remember the facts of the Bluefield
12 Waterworks case?

13 A. No, I don't.

14 Q. Do you remember who won that one?

15 A. No, I don't.

16 Q. Do you remember when it was decided?

17 A. It was decided in the '20s.

18 Q. When was the Hope case decided?

19 A. Early to mid '40s.

20 Q. How many people were on the Supreme Court
21 in 1923?

22 A. I don't know.

23 Q. Would you agree with me, if you like
24 subject to check, there were seven?

25 A. That's fine.

1 Q. Do you remember a president by the name of
2 Franklin Roosevelt?

3 A. Sure do.

4 Q. Do you remember anything about disputes
5 that he might have had with some people about packing the
6 court?

7 A. Yes, I have a vague recollection of that.

8 Q. Do you remember what the basis of that
9 dispute was?

10 A. No, I don't.

11 Q. Do you recall what the Supreme Court with
12 Justice Butler and all did with the initial element of
13 Franklin Roosevelt's new deal?

14 A. No, sir, I don't.

15 Q. And you have indicated, though, that the
16 application of the Hope Natural Gas case, even though you
17 don't recall the facts of it, and the Bluefield Waterworks
18 case, even though you don't recall the facts of that, are
19 factually dependent; isn't that correct?

20 A. The holdings of the Hope and Bluefield
21 courts are well-established and accepted principles. I
22 have read the cases. I have read them before I came here
23 today, but I just don't have specific recollections of
24 those facts. If you would like me to review them again
25 and discuss the facts with you, I can.

1 I remember, though, both appeals were out
2 of West Virginia and they were both concerned with the
3 return on equity. The factual application of the Supreme
4 Court holding is important for the disposition of that
5 case, but what the Supreme Court holdings is used for is
6 whether it's applicable in other cases, and clearly Hope
7 and Bluefield is well-accepted applicable case law with
8 regard to the setting of return on capital. That's the
9 important aspects of it, not who won, not what year.

10 Q. But you would agree with me that in both
11 those cases the court was looking backward?

12 A. Say that again, please.

13 Q. You would agree with me that in both of
14 those cases the Supreme Court was looking backward at the
15 state of facts?

16 A. There was no dispute that the Supreme Court
17 would have been relying on record evidence in terms of
18 making its decision.

19 Q. And so their opinion as written would have
20 been based on that state of facts, would it not?

21 A. The opinion in Hope and Bluefield were
22 based upon record evidence in those cases, but the
23 importance of those cases --

24 Q. Now --

25 A. Can I finish my answer?

1 Q. No. You finished it.

2 A. No..

3 Q. You indicated, sir, that you had not served
4 as a Congressman, so you could not testify regarding
5 Congress' public policy. Do you recall that answer?

6 A. Let me finish my other answer first because
7 I think that's only fair. You were quizzing me on the
8 facts of a case.

9 Q. Sir, you more than -- you more than
10 justified Hope and Bluefield.

11 MR. HACK: I would ask that the witness be
12 allowed to answer.

13 MR. CONRAD: This is my deposition. It's
14 his deposition. It's not yours. When you want to take
15 one, you take it.

16 MR. HACK: You may be permitted to state
17 your objection and he is permitted to answer the question.

18 MR. CONRAD: Do you have an objection?

19 MR. HACK: Yes, I do. I would ask the
20 witness to answer the question.

21 MR. CONRAD: It's denied. Let's move on.

22 THE WITNESS: I would simply say the Hope
23 and Bluefield standards have been in just about every rate
24 proceeding that I've come in contact with and every other
25 rate order dealing with rate of return since their --

1 since the seminal cases were decided in those time
2 periods. They're well accepted.

3 BY MR. CONRAD:

4 Q. Have you completed your answer?

5 A. I've not com--

6 Q. Have you completed your answer?

7 A. Thank you, sir.

8 Q. Have you completed your answer?

9 A. I'm trying to tell you that I completed my
10 answer. You keep interrupting me. Yes, sir, I have
11 completed that answer.

12 Q. That's about the first time that we've
13 gotten a yes out of you.

14 Now, you indicated that you have not served
15 as a Congressman and, therefore, you could not opine as to
16 congressional public policy; is that correct?

17 A. I think I said it broader than that.

18 Q. What did you say, sir?

19 A. I said I did not hold myself out as an
20 expert on the application of the congressional process and
21 how they resolve and establish laws. I've not
22 participated in those discussions in any level of detail
23 either as a staff person or a lobbyist, except on very
24 specific instances, and as a result didn't believe that I
25 could opine on whether a specific law passed by Congress

1 was applicable to resolving, I think the question was in
2 the context of bad debt in the state of Missouri. I think
3 that was my answer.

4 Q. Have you served as a member of the Missouri
5 Public Service Commission?

6 A. No, I have not.

7 Q. Have you served as a member of the Missouri
8 Public Service Commission Staff?

9 A. No, sir, I have not.

10 Q. Have you served as a member of the Missouri
11 Legislature, or what we call here technically the General
12 Assembly?

13 A. No, sir, I have not.

14 Q. In a discussion with, I believe, Staff
15 counsel, you talked about the question of contributions.
16 I think it was in the context of charitable contributions.
17 Do you recall that discussion?

18 A. I recall the questions generally, yes.

19 Q. And then later someone, I believe it was
20 Staff counsel, asked you about the CAP program that you
21 opined as to in Pennsylvania. Do you recall that?

22 A. I recall that.

23 Q. And you recall that you indicated as long
24 as the contributions were voluntary, that that was okay?

25 A. I think I said more than that. I think

1 that was part of my answer.

2 Q. Do you recall the word voluntary being
3 used?

4 A. I recall saying that I was of the opinion
5 that CAP programs were appropriate if they were
6 voluntarily administered by the utility, but I had
7 difficulty with the requirement of the CAP program because
8 of discrimination of rates issue.

9 Q. And then you, I believe, went on to make
10 some comment about if other classes were involved, that
11 became more problematic. And I wrote down the quote more
12 problematic. Do you recall that?

13 A. I recall that.

14 Q. What was more problematic about that?

15 A. Well, as you well know, there's always
16 issues --

17 Q. I don't, sir, well know. Just make --

18 A. Sir, I don't interrupt your questions.

19 Q. Don't make assumptions about what I know or
20 not.

21 MR. HACK: May the witness answer the
22 question?

23 MR. CONRAD: The witness can answer the
24 question, but he doesn't need to make assumptions about
25 what I know or don't know.

1 MR. HACK: He is free to answer the
2 question.

3 THE WITNESS: I am free to answer the
4 questions the way I see fit. If you don't like it, I'm
5 sorry that you don't like it. I'm not trying to be
6 antagonistic. Obviously you are. I don't see a need for
7 that.

8 The question was what do I find as
9 problematic with regard to a cross-subsidization issue. I
10 think the rate setting process endeavors to try to set
11 rates with the costs incurred per rate class being paid by
12 that rate class. That is not always achievable in all
13 instances, but that certainly is the goal.

14 And when you have a program that is
15 designed to assist a customer class, the costs associated
16 with that program ought to be recovered, in my opinion,
17 from that customer class, not subsidized by another
18 customer class.

19 BY MR. CONRAD:

20 Q. Now, you approached that on the basis of
21 discrimination, correct?

22 A. No. That's not -- that's not my comment.
23 My comment was on discrimination that you cannot require a
24 utility to offer a discounted rate program to certain
25 members of a customer class and not to all members of a

1 customer class. That is intraclass discrimination, rate
2 discrimination.

3 Q. I'm still not understanding, though, what
4 it is that's problematic about going out of that class to
5 finance. Can you help me there?

6 A. I'll try to repeat what I said, because I
7 thought it was clear, that I think the rate setting
8 process has as an objective that costs incurred by a
9 customer class ought to be recovered from that customer
10 class. That is a goal and an objective. It is not always
11 achievable in every instance. When you begin to seek
12 recovery of costs outside a customer class that does not
13 benefit from the program, that is cross-subsidization. I
14 think that is problematic.

15 Q. Now let's roll back a moment, back to your
16 comments about the CAP program being acceptable because it
17 was voluntary. You indicated some reliance, I believe, in
18 your testimony on the Hope and Bluefield cases, Supreme
19 Court decisions, right?

20 A. Yes, sir.

21 Q. Are you familiar with another one called
22 the Buckley case?

23 A. Not by that name, no, sir.

24 Q. Let me just ask you if you believe that
25 ratepayers of the public utility are entitled with respect

1 to political or charitable contributions made by the
2 public utility, are they entitled to less or more
3 protection than members of the trade or other labor union?

4 A. I'm sorry. I don't understand the
5 question.

6 Q. That's fine. Since you don't understand
7 the case, I can understand.

8 Okay. I think just one last area. Early
9 on you talked about the relationship of a utility's
10 management to its shareholders, and I believe you used the
11 term fiduciary. Do you recall that --

12 A. Yes, sir.

13 Q. -- line of questions?

14 A. I recall that question, yes.

15 Q. What does it mean to be a fiduciary?

16 A. In the context that we were talking about,
17 it means that the utility management has the obligation to
18 protect the property interest of the shareholders that
19 have invested in that particular enterprise.

20 Q. And the standard by which a fiduciary is
21 typically judged is what standard, sir?

22 A. In the context which I meant it, it's a
23 standard of making sure that the management operates
24 its -- discharges its obligation with the interest of its
25 shareholders in mind. In the context of a rate case, or I

1 guess I should say a regulated utility, if a fiduciary
2 duty extends to the ratepayers as well to make sure
3 there's appropriate balances, the quality of service,
4 safety and reliability of that service, and management has
5 an obligation to make sure that they fulfill that
6 obligation in a way that promotes the interests of its
7 ratepayers as well as its shareholders.

8 Q. Now, how would the shareholders go --
9 excuse me.

10 How would the ratepayers go about firing
11 management?

12 A. I think ratepayers go about firing
13 management in terms of making their dissatisfaction known
14 to the owners of the company that the level of management
15 and the activities of those in management is not
16 fulfilling the obligation, the statutory obligations that
17 the public utility has in the fulfillment of public
18 utility service.

19 Q. Have you of heard of a stockholder
20 derivative suit?

21 A. I have.

22 Q. Have you ever heard of ratepayers
23 derivative suit?

24 A. I don't -- I don't know that that is
25 relevant to anything.

1 Q. Have you ever heard of one?

2 A. I've never heard of any, but I don't see
3 how that's relevant to anything.

4 Q. You ever hear the statement that no man can
5 serve two masters?

6 A. I've heard the statement.

7 Q. Do you know who made it?

8 A. No, I do not.

9 Q. Try Matthew 6:24. Do you know who made it
10 now?

11 A. I know who you just told me made it, but
12 again, I really am having --

13 Q. Have you --

14 A. Can I finish my answer, please?

15 Q. Sure. Go ahead.

16 A. I don't know that I see the relevance to
17 that at all or how that relates to anything that we're
18 talking about here.

19 Q. Do you think that statement is right or
20 wrong?

21 A. I think that statement has no relevance to
22 what we're talking about.

23 Q. That's not what I asked you. Do you think
24 the statement's right or wrong?

25 A. I stand on my answer.

1 Q. Are you refusing to answer the question?

2 A. I see no relevance to that. You would have
3 to be able to give me the context in which that statement
4 was made.

5 Q. You indicated, sir, that your counsel and
6 you had in preparation for this deposition made an
7 investigation of the Missouri statutory law. Let me --
8 let me talk to you about what that says. 536.707, in any
9 contested case, which this is, each party shall have the
10 right to call and examine witnesses, to introduce
11 exhibits, to cross-examine opposing witnesses on any
12 matter relevant to the issues even though that matter was
13 not the subject of the direct examination to impeach any
14 witness, regardless of which party first called him to
15 testify and to rebut the evidence against him.

16 You're familiar with the purpose of a
17 deposition, aren't you?

18 A. Sure am.

19 Q. So you either believe or disbelieve that a
20 utility executive as a fiduciary can serve two masters,
21 the stockholders and ratepayers?

22 A. That's not what you asked me. That
23 question I can answer.

24 Q. So you dispute the statement?

25 A. No. Wait a minute.

1 Q. That one man can't serve two masters?

2 MR. HACK: Would you please let him answer,
3 Mr. Conrad?

4 THE WITNESS: I believe the management of
5 the utility has an obligation to both its customers and to
6 its shareholders, yes, I do.

7 BY MR. CONRAD:

8 Q. And those obligations differ?

9 A. Yes.

10 Q. But the obligations to a fiduciary are
11 between the company management and the shareholders,
12 aren't they?

13 A. Yeah.

14 Q. Is there a fiduciary relationship in your
15 view between the ratepayers and the management of the
16 utility?

17 A. I think there's an obligation. Whether you
18 call it fiduciary or not, I won't quibble with you on, but
19 certainly the management of a public utility because of
20 the nature of the fact it is a public utility has absolute
21 obligation to its ratepayers to provide safe, reliable and
22 adequate service at reasonable rates.

23 Q. But you have trouble characterizing a
24 fiduciary relationship?

25 A. I used fiduciary in the sense of having a

1 legal obligation. If you want to talk about the fiduciary
2 relationships in the context of something outside what I
3 was talking about, then I'm sorry, I can't agree with you.
4 But I think that there is an absolute statutory obligation
5 for management to protect the interests of its
6 shareholders and to provide safe and adequate and reliable
7 service. That's the law.

8 Q. But you had no qualms in characterizing the
9 relationship between the shareholders and the management
10 as fiduciary; is that correct?

11 A. I think I've answered that question two or
12 three times now, yes.

13 Q. Well, answer it again for me.

14 MR. HACK: I'll object, state that he's
15 answered the question.

16 MR. CONRAD: Unless you want to direct him
17 not to --

18 THE WITNESS: I just answered it, yes. You
19 weren't listening. You were talking over me again.

20 BY MR. CONRAD:

21 Q. You, though, are reluctant again to
22 characterize the relationship between a ratepayer and
23 utility management as fiduciary?

24 A. I think --

25 Q. Is that correct?

1 A. I think there were different legal
2 obligations that flow from the management, one set of
3 obligations to the shareholders, one set of obligations to
4 the ratepayers, and I think the utility management has
5 obligations to both. Whether you care to characterize
6 them as fiduciary doesn't matter to me. The obligations
7 are the statutory obligations.

8 Q. Now, you've indicated that you were not
9 looking backward, but rather trying to put forward some
10 kind of a forward-looking approach; is that fair?

11 A. I think I said that my recommendations are
12 designed to try to provide some assistance in setting
13 rates prospectively and evaluating the -- in that context,
14 evaluating the fact that for eight years in a row the
15 authorized return was much higher than the realized rate
16 of return, and I think my testimony went on to say that,
17 in my opinion, that's an issue that the Commission has a
18 legitimate right to look at in a prospective basis.

19 Q. And yet at page 4, you're citing to the
20 Regulatory Research Associates report, the first two
21 quarters of 2003, that's looking backward, isn't it?

22 A. Yes.

23 Q. And, in fact, it compares 11.03 in 2002,
24 and that's also looking backward, right?

25 A. And the intent is on rebuttal testimony to

1 update that for the current information to give the
2 Commission the best information. That's what was
3 available at the time counsel for the consumer counsel
4 asked for it. When we have the additional information, we
5 will provide it.

6 Q. Is that looking backward?

7 A. At that time it was not looking backward.
8 It was the best information available at the time to make
9 a recommendation prospectively. There's a mismatch in
10 time obviously between when the testimony was prepared and
11 when the ultimate decision is going to be made. So we'll
12 update it consistent with the rules.

13 Q. But 2002 is not looking backward?

14 A. I didn't say it wasn't looking backwards.
15 I didn't say it wasn't looking backwards rather. My point
16 is, we tried to provide the Commission additional
17 information that was current at the time, and it will be
18 continually updated up until the point in time that the
19 Commission makes a decision consistent with the rules, the
20 local rules of being able to update information. There is
21 no intent to hide the ball here or to pick and choose
22 specific statistics.

23 Q. Well, I'll tell you, Mr. Quain, I come away
24 still confused.

25 A. I can't tell you how disappointed I am.

1 Q. Maybe you can help me. Why is it you're
2 here?

3 A. To provide the expert testimony that you
4 received as prepared direct testimony as a party in this
5 proceeding.

6 Q. For what purpose?

7 A. Purpose like any other witness, to provide
8 advice to the Commission in terms of the very difficult
9 job they have in terms of balancing the very competing
10 interests that are sitting around this table, as well as
11 many other interests that are going to be taken into
12 consideration in the prospective setting of rates.

13 It is ia difficult job. I know it is a
14 very difficult one. I've sat there. I've always -- when
15 I sat there, I welcomed the opportunity to talk to others
16 and relied on testimony of others and relied on
17 colleagues, formal and otherwise, in the context of trying
18 to make the very best decision I could make.

19 My goal here today is to provide that
20 service to the extent the Commission cares to listen to
21 it, to help them make a very difficult decision that is
22 coming before them. It's very important to the
23 shareholders and ratepayers of this company.

24 Q. Why do you think, Mr. Quain, that it is
25 worth \$320 an hour to the ratepayers of this public

1 utility to have you come out here from Pennsylvania and
2 endure this? Do you feel you have some piece of
3 information that the Missouri Commission is not aware of?
4 You've told me that you're not a member of the Missouri
5 Legislature, you've never been, haven't served here on
6 Staff, you're not a member of the Missouri Bar, never sat
7 on the Commission. Why is it you feel that your opinion
8 here is worth \$320 an hour to ratepayers of this utility?

9 A. First, whether the Missouri ratepayers pay
10 all or a portion of my fee is not the issue that I'm
11 appointed to. That's a separate issue. That's a rate
12 case expense issue.

13 In terms of why I think it's valuable,
14 because unless you, sir, have served in these very
15 difficult positions, it is easy to sit here and take pot
16 shots and take one particular point of view to represent
17 the interests of your set of clients. That's your job.
18 That is not the Commission's job.

19 The Commission has a very different point
20 of view, a different obligation, and those that have sat
21 there have some opportunity from their experience to offer
22 some insight as to how others have done it and what they
23 thought was valuable and important in the public policy
24 goals that are to be achieved. It's in that context I'm
25 offering this testimony.

1 Q. Then what is it, sir, that you think
2 they're doing wrong?

3 A. I didn't say that they're doing anything
4 wrong. I'm saying that they have before them a very
5 important case. The stakes are very high for all parties
6 involved, your client, the Staff, the OPC clients,
7 Missouri Gas Energy, the shareholders as well, and it is a
8 very difficult decision.

9 And if I can provide some insight, some
10 assistance, some recommendation, I don't see why you
11 wouldn't want that. I don't see why that's so problematic
12 to you that you wouldn't want your Commission to make the
13 very best decision they could.

14 Q. Why do you think they're not?

15 A. Because the decision hasn't been made yet.
16 I don't know what they're going to do.

17 Q. Why are you here, then, if you're not
18 worried about that?

19 A. I think I've answered that.

20 Q. Are you not the least bit concerned about
21 the decision that's going to be made?

22 A. I'm not even sure where that question came
23 from. I've offered my reason why I'm here. If you don't
24 accept it, that's your prerogative. That doesn't make it
25 any less important for the reason I'm here. You're free

1 to disagree with the fact that I'm here. Frankly, I don't
2 care. My job is not to convince you that I'm right. My
3 job is to convince the Commissioners that there's a very
4 important decision to be made here and I have had
5 experience in that position and know how difficult a job
6 it is and try to provide some assistance to that, like
7 every other witness.

8 Q. Your job is to convince them that they have
9 a very important decision; is that right?

10 A. My job is to convince them that the
11 application of Hope and Bluefield is an important part of
12 the process as well as the promotion of public policy
13 objectives.

14 Q. Why do you think they don't know that?

15 A. I didn't say that they don't know.

16 MR. CONRAD: Okay. That's enough. Thank
17 you.

18 MR. HACK: I have simply one question.

19 CROSS-EXAMINATION BY MR. HACK:

20 Q. In reference, Mr. Quain, to the two masters
21 discussion relative to a utility management's obligations,
22 can you perhaps explain your understanding of the masters
23 that the Public Service Commission serves in undertaking
24 its responsibilities?

25 A. I think the Public Service Commissioners

1 have an obligation to the investors and to the ratepayers,
2 and within the context of ratepayers they have obligations
3 to the different classes of ratepayers. And it is a very
4 difficult balance to handle, but yet is extraordinarily
5 important.

6 MR. HACK: That's all I have. I think
7 we're done.

8 (PRESENTMENT WAIVED; SIGNATURE REQUESTED.)
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CERTIFICATE OF REPORTER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, KELLENE K. FEDDERSEN, RPR, CSR, CCR, and
Notary Public within and for the State of Missouri, do
hereby certify that the witness whose testimony appears in
the foregoing deposition was duly sworn by me; that the
testimony of said witness was taken by me to the best of
my ability and thereafter reduced to typewriting under my
direction; that I am neither counsel for, related to, nor
employed by any of the parties to the action to which this
deposition was taken, and further that I am not a relative
or employee of any attorney or counsel employed by the
parties thereto, nor financially or otherwise interested
in the outcome of the action.

KELLENE K. FEDDERSEN, RPR, CCR
Notary Public, State of Missouri
(Commissioned in Cole County)
My commission expires 3/28/05.

SIGNATURE PAGE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, John Quain, do hereby certify:

That I have read the foregoing deposition;

That I have made such changes in form and/or
substance to the deposition as might be necessary to
render the same true and correct;

That having made such changes thereon, I hereby
subscribe my name to the deposition.

I declare under penalty of perjury that the
foregoing is true and correct.

Executed the ____ day of _____, 2004, at
_____.

JOHN QUAIN

Notary Public:

My commission expires:

KF/John Quain

Re: MGE/Tariffs - GR-2004-0209

ERRATA SHEET

Witness: John Quain
In Re: MGE - GR-2004-0209

Upon reading the deposition and before subscribing thereto, the deponent indicated the following changes should be made:

Page Line Should read:
Reason assigned for change:
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Reporter: Kellene K. Feddersen, RPR, CSR, CCR

Midwest Litigation Services
714 West High Street
P.O. Box 1308
Jefferson City, MO 65102

Phone (573) 636-7551 * Fax (573) 636-9055

May 7, 2004

James Swearengen
Brydon, Swearengen & England
312 East Capitol Avenue
P.O. Box 456
Jefferson City, MO 65102-0456

In Re: MGE - GR-2004-0209

Dear Mr. Swearengen:

Please find enclosed your copy of the deposition of John Quain taken on May 5, 2004, in the above-referenced case. Also enclosed is the original signature page and errata sheet.

Please have the witness read your copy of the transcript, indicate any changes and/or corrections desired on the errata sheet and sign the signature page before a notary public.

Please return the errata sheet and notarized signature page to Mr. Berlin for filing prior to trial date.

Thank you for your attention to this matter.

Sincerely,

Kellene K. Feddersen, RPR, CSR, CCR

Enclosure

cc: Robert Berlin
Douglas Micheel

Exhibit No.: _____
Issues: Policy
Witness: John M. Quain
Sponsoring Party: Missouri Gas Energy
Case No.:

MISSOURI PUBLIC SERVICE COMMISSION

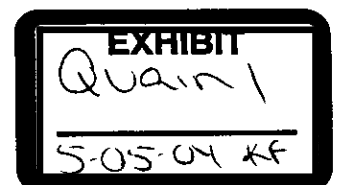
MISSOURI GAS ENERGY

DIRECT TESTIMONY OF

JOHN M. QUAIN

Jefferson City, Missouri

November 2003



DIRECT TESTIMONY OF

JOHN M. QUAIN

NOVEMBER 2003

1 **I. INTRODUCTION**

2

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

4 A. My name is John M. Quain, and my business address is Klett Rooney Lieber &
5 Schorling, P.C., 240 North Third Street, Suite 700, Harrisburg, Pennsylvania,
6 17101.

7

8 **Q. PLEASE STATE YOUR BACKGROUND AND QUALIFICATIONS.**

9 A. I am currently a shareholder and chair of the Energy & Utility Law Practice
10 Group with the law firm of Klett Rooney Lieber & Schorling in Harrisburg,
11 Pennsylvania. Prior to my current position, I was the Chairman of the
12 Pennsylvania Public Utility Commission (the "Pennsylvania Commission").
13 Before I served on the Pennsylvania Commission, I practiced public utility law on
14 the state and regional levels. As a result, I have extensive experience in
15 considering the central role of public policy in public utility ratemaking.
16 Additionally, while I was Chairman, I had primary responsibility for the creation
17 and implementation of the Pennsylvania Electricity Generation Customer Choice
18 and Competition Act and the Pennsylvania Natural Gas Competition Act. In this
19 capacity I dealt directly with the statutory policy considerations underlying the

1 Pennsylvania Public Utility Code. Further detail regarding my background and
2 qualifications is contained in my curriculum vitae, attached hereto as Schedule
3 JMQ-1.

4
5 **Q. PLEASE STATE THE PURPOSE OF YOUR TESTIMONY.**

6 A. I am presenting this testimony on behalf of Missouri Gas Energy ("MGE") with
7 respect to the general public policy implications of MGE's pending rate case and
8 the relevance of public policy considerations to the issue of MGE's rate of return.

9
10 **II. DISCUSSION**

11
12 **Q. PLEASE EXPLAIN WHY PUBLIC POLICY OBJECTIVES ARE**
13 **INTEGRAL TO THE RATEMAKING PROCESS.**

14 A. A utility's rate of return should be established in the context of achieving broad
15 public policy objectives. Utility rate cases do not merely establish new rates.
16 They also affect perceptions in the investment community and thus investment in
17 public utility infrastructure, which is an integral part of a state's economy. If
18 investors perceive the "return of and return on" utility investment dollars to be
19 inadequate, they will invest their money in a different business sector, possibly in
20 another state. In setting a rate of return, regulators should be mindful of the
21 impact their actions have on a utility's ability to attract adequate investment.
22 Hence, one of the ratemaking process' principal goals should be establishing rates

1 at a sufficient level to attract the capital essential to secure a sound infrastructure
2 and to maintain or enhance the utility's creditworthiness.

3
4 **Q SHOULD THE RATEMAKING PROCESS ALLOW A FAIR**
5 **OPPORTUNITY TO ACHIEVE A FAIR RATE OF RETURN?**

6 A. Yes.

7
8 **Q DOES THAT CONCLUSION HAVE A LEGAL AS WELL AS A PUBLIC**
9 **POLICY BASIS?**

10 A. Yes, it does. It should come as no surprise that in reaching my conclusion I have
11 in mind the *Hope Natural Gas*¹ and *Bluefield Waterworks*² cases. In summary,
12 these cases form the legal underpinning to accepted principles on the "fair return"
13 standard. *Hope* and *Bluefield* stand for the proposition that, "... a public utility
14 is entitled to such rates as will permit it to earn a return on the value of the
15 property which it employs for the convenience of the public equal to that
16 generally being made at the same time and in the same general part of the country
17 on investments in other business undertakings which are attended by
18 corresponding risks and uncertainties;"³ and, the return should be reasonably
19 sufficient to assure confidence in the financial soundness of the utility and should
20 be adequate, under efficient and economical management, to maintain and support
21 its credit and enable it to raise the money necessary for the proper discharge of its
22 public duties.

¹ *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)

² *Bluefield Waterworks & Improvement Co. v. Public Serv Comm'n*, 262 U.S. 679 (1923)

³ *Id.* at 692

1
2 Stated more succinctly, a utility needs both a fair rate of return and a fair
3 opportunity to realize that rate of return as a matter of law as well as a matter of
4 sound public policy.
5

6 **Q. SHOULD A UTILITY'S RATE OF RETURN BE COMPARABLE TO**
7 **THOSE OF SIMILARLY SITUATED COMPANIES?**

8 A. Yes. Regulators generally have a broad sense of what similarly-situated utilities
9 are authorized to earn and whether they are achieving those rates of return. In the
10 case of natural gas utilities, a recent study by Regulatory Research Associates,
11 Inc., concluded that the average gas equity return authorization for the first two
12 quarters of 2003 (based on nine major rate cases) was 11.37%, up from 11.03% in
13 2002.⁴ As a matter of public policy, one important regulatory goal is to ensure
14 that utilities receive evenhanded treatment with respect to rate of return as well as
15 their ability to realize that return. Absent extraordinary circumstances, there
16 should not be a significant discrepancy among similarly-situated companies.
17

18 **Q. HAVE YOU HAD AN OPPORTUNITY TO REVIEW ANY OF THE**
19 **OTHER TESTIMONY PRE-FILED IN THIS CASE?**

20 A. Yes, I have reviewed the direct testimony of James Oglesby, the President and
21 Chief Operating Officer of MGE, in addition to the direct testimony of MGE
22 witness Michael R. Noack.

⁴ See "Major Rate Case Decisions: January-June 2003," Regulatory Research Associates, Inc. (July 7, 2003).

1
2 Q. WHAT CONCLUSION DO YOU DRAW FROM THE FACT, AS
3 PRESENTED IN THE TESTIMONY OF MR. NOACK, THAT MGE'S
4 RATES HAVE NOT PERMITTED MGE TO ACHIEVE ITS
5 AUTHORIZED RATE OF RETURN?

6 A. From both a rate-setting and policy perspective, this is a significant problem
7 which strongly indicates that the regulatory process of setting rates as it has
8 applied to MGE has not achieved one of its fundamental objectives. Because this
9 problem, as shown in Mr. Noack's testimony, recurs year after year—even in
10 fiscal years 1998, 1999 and 2002 during which, or immediately before, rate
11 increases were approved—I do not believe it can reasonably be ignored as an
12 unusual or isolated occurrence. Absent some material change in the way MGE's
13 future rates are set, it is not reasonable to expect that MGE will have any higher
14 likelihood of achieving its authorized rate of return in the future.

15
16 Q. IF A COMPANY CONSISTENTLY FAILS TO ACHIEVE ITS
17 AUTHORIZED RATE OF RETURN, WOULD THAT BE A PROBLEM
18 FROM A PUBLIC POLICY PERSPECTIVE?

19 A. Yes, it would. Again, a broad public policy view takes into account both a fair
20 rate of return and a fair chance to realize that rate of return. If the regulatory
21 process of setting rates consistently produces earnings for a company that fall
22 short of its authorized rate of return, regulation may inadvertently harm the
23 consumers it is trying to protect. That inadvertent harm occurs because the

1 immediate, short-term effect of such a process is a shortfall in the company's
2 earnings in comparison to the expected rate of return. The subsequent, longer-
3 term effect is to make the company look unattractive to investors and to drive up
4 the cost of capital (which will ultimately be factored into future rates).
5 Establishing a fair rate of return and a reasonable opportunity to achieve that rate
6 of return allows a utility to attract adequate capital in competitive financial
7 markets, and that is a vital public policy objective.

8
9 **Q CAN AUTHORIZING AN INADEQUATE RATE OF RETURN, OR**
10 **SETTING RATES WHICH CONSISTENTLY PRODUCE EARNINGS**
11 **SHORT OF THE AUTHORIZED RATE OF RETURN, HAVE ANY**
12 **OTHER NEGATIVE EFFECTS ON THE PUBLIC?**

13 **A.** Certainly, and at several levels. First, a utility needs to have a fair rate of return in
14 order to invest capital into discretionary projects that can enhance service levels
15 and bring greater efficiency to the enterprise, such as technological advances like
16 the roughly \$25 million automated meter reading system MGE deployed in the
17 1997-1998 time frame. Secondly, and related to the need for investment capital, it
18 must be understood that investors have a choice as to where to put their money. If
19 investors redirect funds to out-of-state utilities, in-state utilities' financial health
20 will suffer. Likewise, if investment dollars flow to another state or region, then
21 new businesses, jobs and tax revenues will soon follow. In addition, a state with
22 an inadequately funded utility infrastructure may discourage businesses from
23 either entering the state or expanding their existing in-state operations.

1
2 **Q. IS CREDITWORTHINESS AFFECTED BY THE PERCEPTIONS OF THE**
3 **INVESTMENT COMMUNITY?**

4 A. Of course. I think you need only look at the downgrades in the energy sector
5 generally, to demonstrate this.
6

7 **Q. WHY IS A UTILITY'S CREDITWORTHINESS AN IMPORTANT**
8 **PUBLIC POLICY OBJECTIVE?**

9 A. Creditworthiness is the key to attracting investment capital, which in turn is
10 essential to sound utility infrastructure. Utilities need a fair rate of return and a
11 fair chance to realize that return if they are going to attract and invest capital into
12 discretionary projects. Infrastructure is vital to every state and to every utility, as
13 evidenced by the reliability mandates integral to state public utility codes. Indeed,
14 the quality of utility infrastructure is a critical element of a community's overall
15 financial health.
16

17 **Q. SHOULD REGULATORS USE RATE OF RETURN DETERMINATIONS**
18 **TO ASSURE A UTILITY'S FINANCIAL HEALTH?**

19 A. No, I am not suggesting that financial health be guaranteed. Once again, what I
20 am advocating is an appropriate balance of interests. That balance is impacted by
21 broader public policy concerns than just the interests of individual utilities and
22 customers. As a general proposition, regulators must guard against keeping rates
23 artificially low, even though that may seem a popular decision in the short term.

1 A broader perspective is important because how investors perceive a utility and its
2 earning ability affects the cost of capital. Rate base/rate of return regulation is not
3 about simply limiting rate increases. Sound rate making requires consideration of
4 the full financial implications of regulatory decisions, including how those
5 decisions affect the long-term economic vitality of the utility and the state in
6 general. Rate setting should not take place solely with the short term in mind.
7 Generally, regulators should balance an interest in reasonable customer rates with
8 consideration of the financial health of utilities.

9
10 **Q. CAN YOU ELABORATE ON YOUR POLICY GOAL OF**
11 **ENCOURAGING "HEALTHY" UTILITIES?**

12 **A.** Yes. A financially healthy and robust utility is an asset not just to shareholders,
13 but to a state's economy. Customers also benefit. Effective public policy
14 requires that we view public utility service to customers on both a short-term and
15 long-term basis. That is to say, if rates are not set artificially low, then a utility
16 should be able to attract adequate capital at reasonable rates, preventing customers
17 from being harmed over the long term. The lack of a fair rate of return or the lack
18 of a fair chance to realize that rate of return would have negative long-term effects
19 for the utility's customers and shareholders alike. By establishing an accurate rate
20 base, a fair rate of return, and the opportunity to earn that rate of return, effective
21 regulation achieves the proper balance between the short-term objective of
22 reasonable rates and the long-term objective of financial health for the utility.

1 Q. AS CHAIRMAN OF THE PENNSYLVANIA PUBLIC UTILITY
2 COMMISSION, DID YOU CONSIDER THE LONG TERM IMPACT
3 THAT RATEMAKING DECISIONS HAD ON UTILITIES AND THE
4 STATE?

5 A. Yes. When I served as Chairman of the Pennsylvania Commission, the
6 Governor's economic development team frequently inquired as to the overall
7 quality of public utility infrastructure. We knew that we were in competition with
8 other states to attract businesses to Pennsylvania, so it was important to convey a
9 correct perception that our utility infrastructure was not only adequate but was
10 robust and could support the expansion of business in our state. Clearly,
11 companies are interested in cost considerations, but cost considerations must also
12 be balanced with infrastructure support and development.

13
14 III. SUMMARY OF TESTIMONY

15
16 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

17 A. Sound public policy in ratemaking requires a careful balancing of the interests of
18 shareholders and utility customers in both the short and long terms. While it is
19 tempting to approve low rates, rates must be set in a realistic fashion. Every
20 utility should have an appropriate rate of return and the fair chance to realize that
21 rate of return. This is a legal requirement as well as sound public policy.

1 The natural gas industry is capital intensive. The supply of capital is limited, and
2 investors can choose where they will put their dollars. If one jurisdiction is
3 consistently less attractive than another in terms of profitability, healthy utilities
4 and sound infrastructure, investors will naturally place their capital with the more
5 attractive option. A flight of capital can have negative long-term implications for
6 the existing customer base and for the state's economy, including its ability to
7 attract new businesses.

8
9 An inadequate authorized rate of return, or rate levels that consistently produce
10 earnings that fall short of authorized earnings levels, is not sound public policy.

11 An inadequate rate of return raises the cost of capital. Conversely, an adequate
12 rate of return attracts capital at reasonable rates.

13
14 In sum, designing and setting rates at proper levels, and giving utilities a fair
15 opportunity to realize their authorized rates of return, will benefit all concerned.

16
17 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

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

Select Document

Testimony(Parent)

jmj.doc (Public)

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