

1 STATE OF MISSOURI

2 PUBLIC SERVICE COMMISSION

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6 TRANSCRIPT OF PROCEEDINGS

7 Hearing

8 June 21, 2004

9 Jefferson City, Missouri

10 Volume 10

11

12 In the Matter of Missouri Gas)

13 Energy's Tariffs to Implement a)

14 General Rate Increase for Natural) Case No. GR-2004-0209

15 Gas Service)

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18 MORRIS L. WOODRUFF, Presiding,

19 SENIOR REGULATORY LAW JUDGE.

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23 STEVE GAW, Chairman,

24 CONNIE MURRAY,

25 ROBERT M. CLAYTON,

JEFF DAVIS,

LINWARD "LIN" APPLING,

COMMISSIONERS.

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1 P R O C E E D I N G S

2 JUDGE WOODRUFF: Good morning, everyone.

3 This is Case No. GR-2004-0209, which concerns Missouri Gas
4 Energy's tariffs to implement a general rate increase for
5 their natural gas service. It's now 8:30, and we're going
6 to go ahead and get started. We'll begin today by taking
7 entries of appearance, beginning with Staff.

8 MR. FRANSON: Robert Franson, Tim Schwarz,
9 Bob Berlin, Bruce Bates and Lera Shemwell, representing
10 the Staff of the Missouri Public Service Commission,
11 P.O. Box 360, Jefferson City, Missouri 65102.

12 JUDGE WOODRUFF: Thank you. And for the
13 company?

14 MR. HACK: Robert Hack, Eric Herschmann,
15 James Swearengen, Gary Duffy and Dean Cooper for Missouri
16 Gas Energy. Our addresses are already reflected in the
17 record. Thank you.

18 JUDGE WOODRUFF: Thank you. And for Public
19 Counsel?

20 MR. MICHEEL: Douglas E. Micheel appearing
21 on behalf of the Office of the Public Counsel and the
22 Public, P.O. Box 2230, Jefferson City, Missouri
23 65102-2230.

24 JUDGE WOODRUFF: For Midwest Gas Users
25 Association?

1 MR. CONRAD: If your Honor please,
2 Stuart W. Conrad, Finnegan, Conrad & Peterson,
3 1209 Penntower, 3100 Broadway, Kansas City, Missouri
4 64111, and I'm in the process of giving that to the
5 reporter. Should I --

6 JUDGE WOODRUFF: I'll call the next one,
7 then you can stand up again. UMKC, CMSU and Jackson
8 County?

9 MR. CONRAD: And, your Honor, by your
10 leave, Mr. Finnegan is delayed. He will be here, I'm
11 told, later on today. So I would like to enter the
12 appearance of Jeremiah D. Finnegan, same law firm,
13 Finnegan, Conrad & Peterson, oddly the same address, and
14 he is on behalf of the parties that you have mentioned,
15 and I'm filling out a doodad for the reporter.

16 JUDGE WOODRUFF: Thank you. For the
17 Federal Agencies?

18 MR. PAULSON: Major Craig Paulson,
19 AFLSA/ULT, 139 Barnes Drive, Suite 1, Tyndall Air Force
20 Base, Florida 32403.

21 JUDGE WOODRUFF: Thank you. And for the
22 City of Joplin? And I don't see anyone here for --
23 Mr. Ellinger or Mr. Deutsch here. We'll pass over them
24 and go to City of Kansas City.

25 MR. COMLEY: Good morning, Judge Woodruff.

1 Let the record reflect the entry of appearance of Mark W.
2 Comley, Newman, Comley & Ruth, 600 Monroe -- 601 Monroe,
3 excuse me, Suite 301, Jefferson City, Missouri 65101, for
4 the City of Kansas City.

5 JUDGE WOODRUFF: Thank you.

6 MR. HACK: Judge, if I may supplement my
7 list with two names, Michael Fay and Paul Boudreau, on
8 behalf of MGE.

9 JUDGE WOODRUFF: All right. And I'll
10 supplement by adding that we're now on the record. I
11 forgot to put us over the Internet. We were on the record
12 before but we were not on the Internet.

13 All right. We're going to proceed today
14 with opening statements in a moment, and at that time I'll
15 go up and get the Commissioners and bring them back down
16 for that. There are a couple of preliminary matters I
17 wanted to bring up as well.

18 First of all, there's the matter of the
19 true-up. Last week I issued an Order asking parties if
20 they had anything to add about the requested true-up that
21 was requested by Staff and MGE. Nobody responded, so I'm
22 assuming that there's no opposition to the true-up. I
23 don't know yet if there's going to need to be a hearing.
24 I'll expect the parties to tell me that by the end of the
25 hearing if they can.

1 Yes, sir?

2 MR. HACK: I'm not sure we'll be able to do
3 that, Judge. The true-up audit hasn't occurred, and I
4 think true-up testimony, according to the schedule, is due
5 sometime around mid July.

6 JUDGE WOODRUFF: That's correct.

7 MR. HACK: We will certainly endeavor to
8 tell you as soon as we can know, but I don't know that
9 we'll be able to know until sometime around mid July.

10 JUDGE WOODRUFF: All right.

11 MR. FRANSON: Your Honor, Staff is
12 relatively in the same position, and we are also wanting a
13 clear direction on whether we should actually proceed with
14 true-up, and I believe that is the question at hand.
15 There is aspects of that in the procedural schedule, but
16 before we start preparing things and doing testimony, we
17 need clear direction that there is, in fact, going to be
18 that need, and ultimately we will find out later whether a
19 true-up hearing is, in fact, needed, but starting point is
20 your order.

21 JUDGE WOODRUFF: Yes. When this first came
22 up back in December in the procedural schedule, the
23 true-up was scheduled provisionally as needed. Since no
24 one's opposing the true-up and I believe Staff and MGE
25 both indicate that it is required, at this point I will

1 order that a true-up be conducted, and I'll ask the
2 parties as soon as possible to let me know whether or not
3 that hearing date will actually be needed. Okay?

4 MR. FRANSON: Thank you, your Honor.

5 JUDGE WOODRUFF: There's a couple other
6 motions that were filed. First of all, there was a motion
7 filed by MGE a few weeks ago for leave to late file
8 schedules to John Dunn's rebuttal testimony. No one
9 opposed. That motion will be granted.

10 There was a couple other motions filed late
11 on Friday, motion to strike the testimony of Public
12 Counsel's witness Mr. Tuck, and also a motion to strike
13 the testimony of Public Counsel's witness Mr. Allen. I'm
14 going to not make a ruling on those motions at this time
15 pursuant to Section 536.070, subsection 7 of the Missouri
16 statutes, which indicates that evidence to which an
17 objection is sustained shall at the request of the party
18 seeking to introduce the same or at the instance of the
19 agency nevertheless be heard and preserved in the record
20 together with any cross-examination with respect thereto
21 and any rebuttal thereof, unless it is wholly irrelevant,
22 repetitious, privileged or unduly long.

23 What we're going to do is go ahead and hear
24 the evidence. The Commission will make a ruling at some
25 point after the hearing on those motions.

1 MR. MICHEEL: Your Honor, I assume that I'm
2 going to get an opportunity to respond to those motions,
3 and the rules provide that I get 10 days to respond to
4 both of those motions; is that correct?

5 JUDGE WOODRUFF: That is correct. And at
6 the close of the hearing we'll discuss how to proceed with
7 that, whether to have separate filings in response to
8 those or just respond to them in the Briefs, but we'll
9 discuss that again later in the process.

10 All right. I believe that takes care of
11 all the preliminary matters, unless there's something else
12 the parties want to bring up. Mr. Franson first.

13 MR. FRANSON: If you're cleaning up
14 motions, your Honor, there is also MGE's motion for
15 reconsideration of the Commission's order on David
16 Murray's testimony.

17 JUDGE WOODRUFF: Yes.

18 MR. FRANSON: I wondered what your
19 inclination was on that.

20 JUDGE WOODRUFF: I'm not going to rule on
21 that at this time either. We'll handle that similar to
22 how we've handled the motion to disqualify Mr. Tuck and
23 Mr. Allen.

24 Yes, Mr. Hack?

25 MR. HACK: There is one additional item.

1 There's a scheduling issue that Mr. Franson and I have
2 discussed. I wanted to -- it doesn't affect today or even
3 the next couple of days. But Mr. Warren, who is our
4 witness, MGE's witness on the alternative minimum tax
5 credit issue, which is, according to this schedule, shown
6 as being heard on Monday, the 28th, is only available on
7 Thursday afternoon, the 24th.

8 So what we would propose to do, and I
9 believe based on discussions with Mr. Franson it's
10 acceptable to the Staff, is to swap the bad debt, two sub
11 bad debt issues that are presently scheduled for the
12 afternoon of the 24th with the AMT issue that is, as shown
13 in this schedule, shown on the 28th. So we would -- if
14 we're -- if we hit our schedule dates, the AMT issue would
15 come up on June 24th in the afternoon, and the bad -- the
16 two bad debt subissues would come up on Monday, June 28th,
17 in the afternoon.

18 JUDGE WOODRUFF: All right.

19 MR. FRANSON: Your Honor, in that regard,
20 because there are several things in the schedule that are
21 rather fluid, including the possibility of witness
22 unavailability and other matters, if at some point toward
23 the end of each day we could actually view what is
24 expected the next day, that might help each of the
25 parties, and that would be Staff's suggestion.

1 JUDGE WOODRUFF: Certainly that would be
2 helpful to the Commission as well, and I'm certainly
3 willing to be flexible as needed.

4 There's one other thing I wanted to
5 mention, too. The parties had suggested the possibility
6 of doing mini opening before each issue. I think that's a
7 very good idea. I'm going to allow that. I believe
8 Staff's proposed order indicated that would be five
9 minutes per party per issue.

10 MR. FRANSON: Your Honor, not exactly.
11 That's true with the exception of rate of return/capital
12 structure. Staff recommended 10 minutes. MGE was
13 requesting 15. So that's where that stood. I think the
14 rest were five minutes across the board for each party,
15 with the hope that not every party will need it and not
16 everybody will use their full allotted time.

17 JUDGE WOODRUFF: I would expect that will
18 be the case.

19 Mr. Hack?

20 MR. HACK: And I just wanted to speak to
21 the 15-minute question very briefly and suggest that we
22 will not use all of our time if we don't feel like we need
23 it, but on that issue, which represents about 20-some-odd
24 million dollars of the difference between the parties in
25 the case, we feel like it's complicated enough,

1 significant enough that it calls for a little bit more
2 time. We will certainly not belabor the record in using
3 that time.

4 JUDGE WOODRUFF: I appreciate that, and I
5 will allow 15 minutes for that one issue.

6 MR. HACK: Thank you.

7 JUDGE WOODRUFF: Any other matters to bring
8 up before I go get the Commissioners?

9 MR. FRANSON: Briefly, your Honor. Do you
10 have a comprehensive list of the exhibits that perhaps
11 each of the parties could have?

12 JUDGE WOODRUFF: I do, if you would like.

13 MR. FRANSON: Yes, actually I would.

14 JUDGE WOODRUFF: All right. I'll hand
15 those out after we go off the record. Anything else
16 before we go off the record?

17 Hearing nothing, then we are all -- we'll
18 break until ten minutes to nine, and we'll come back for
19 opening statements.

20 (A BREAK WAS TAKEN.)

21 JUDGE WOODRUFF: All right. Welcome back.
22 We're ready to begin with opening statements. Let's go
23 ahead and start with opening statements. The order will
24 be the order that was listed by Staff, beginning with MGE.

25 MR. HACK: Good morning. May it please the

1 Commission and the Law Judge? Thank you for being here.
2 We will do our best to use your time wisely and to provide
3 you with as much good, useful and enlightening information
4 as possible to help you decide the issues in this rate
5 case.

6 My name is Rob Hack, and I'm here this
7 morning to talk to you this morning about the rate case
8 Missouri Gas Energy filed last November. Our as-filed
9 request was almost \$45 million. After settlement
10 discussions during the prehearing conference and
11 thereafter, MGE's revenue requirement stands at about
12 \$45 million.

13 As you can tell by looking at the list of
14 issues and the reconciliation, the differences between the
15 Staff and MGE are significant, both number and size.
16 Because the parties have agreed to open the trial of each
17 issue with what we're calling mini openings as a way to
18 apprise the Commissioners of the parties' takes on the
19 issues briefly at the time the issue is being tried, I
20 won't go into great detail on all of the issues during
21 this broader opening.

22 I will, however, try to explain why this
23 rate case is important, not just to MGE shareholders,
24 customers and employees, but to the foundation of the
25 utility ratemaking process in Missouri, and why the

1 impartial and balanced decision-making that this
2 Commission brings to the table is essential.

3 First, perhaps a little bit of history
4 about MGE is in order. MGE is a division, an operating
5 division of Southern Union Company. MGE came into
6 existence in 1994 upon Southern Union's acquisition of the
7 majority of the gas distribution property of Western
8 Resources. Prior to that time, Southern Union was
9 primarily a Texas-based distribution company.

10 MGE serves about a half million customers
11 in the western third of the state of Missouri. Our
12 service territory runs from north of St. Joe, down through
13 the Kansas City metro area, south of Joplin. MGE has
14 about 660 employees, 70 percent of whom are represented by
15 collective bargaining agreements. Since 1994, Southern
16 Union has acquired additional distribution properties in
17 Pennsylvania, Rhode Island and Massachusetts, sold its
18 Texas distribution property, and acquired an interstate
19 pipeline.

20 Since beginning operations in 1994, MGE has
21 completed three rate cases. So this is our fourth. The
22 three completed rate cases pretty much run the gamut in
23 terms of how they were resolved. The first rate case was
24 fully litigated with almost no issues being settled. The
25 second rate case was also fully litigated, with a few

1 issues settled, but a number of issues litigated. The
2 third rate case was resolved by a comprehensive
3 Stipulation & Agreement.

4 Nevertheless, although MGE has resorted to
5 the rate case process with regularity and has pursued the
6 ratemaking process both vigorously litigating its first
7 two cases and in a more conciliatory fashion settling its
8 third rate case, the results, the financial results have
9 been markedly similar.

10 The evidence will show that over the past
11 eight fiscal years MGE has never ever, not even once,
12 actually achieved its commission-authorized rate of
13 return. This graph, this chart which is drawn from the
14 surrebuttal testimony of Mr. Noack, Schedule MRN-5, shows
15 that during that eight-year period, MGE's cumulative
16 underearnings -- and this is the second line of numbers
17 from the bottom -- total nearly \$53 million. That's
18 approximately six and a half million dollars per year on
19 average of underearnings.

20 These significant underearnings exist even
21 in those years when MGE has implemented a
22 Commission-approved rate case. You can see that rate
23 increases took effect February 1, 1997, September 2, 1998,
24 and August 6th, 2001.

25 No party has disputed the assertion that

1 MGE has consistently underearned. In fact, Staff Witness
2 Oligschlaeger readily concedes this fact in his rebuttal
3 testimony.

4 Question: Having made these points
5 concerning MGE's earnings analysis, do you disagree that
6 MGE has had a tendency to underearn?

7 Answer, I quote: No. Given the fact that
8 MGE has added much plant in service to its rate base in
9 recent years and the nature of the ratemaking process in
10 Missouri, that phenomenon is exactly what would be
11 expected to happen.

12 Staff Witness Oligschlaeger reiterates this
13 concession, page 14 of his rebuttal testimony, question:
14 Does underearnings by utilities due to the addition of
15 plant in rate base point to the need for changes in the
16 regulatory process in Missouri?

17 Answer: No. This type of underearning
18 does not represent flaw or defect in Missouri's regulatory
19 process. It is exactly how the regulatory process is
20 intended to work.

21 The Staff solution to MGE's consistent
22 underearnings problem, according to Staff Witness
23 Oligschlaeger, is simply to file rate cases more
24 frequently. Two significant and fatal problems are
25 presented by this solution. First, as a practical matter,

1 history has shown that repeatedly filing rate cases won't
2 solve the problem. As can be seen in surrebuttal schedule
3 MRN-5, underearnings exist even in those years when we
4 file and have approved rate cases.

5 Second, as a legal matter, rates which
6 consistently and, according to Staff Witness
7 Oligschlaeger, expectedly and intentionally produce
8 earnings lower than the Commission-authorized level
9 violate requirements established by the United States
10 Supreme Court more than 80 years ago.

11 As stated in Bluefield Waterworks, and I
12 quote, a public utility is entitled to such rates as will
13 permit it to earn a return on the value of the property
14 which it employs for the convenience of the public equal
15 to that generally being made at the same time in the same
16 general part of the country on investments and other
17 business undertakings which are attended by corresponding
18 risks and uncertainties.

19 MGE's Commission-authorized returns must be
20 presumed to have been equal to that of other comparable
21 companies, otherwise the Commission orders authorizing
22 those returns would violate the comparability requirements
23 of Bluefield.

24 Rates that consistently produce actual
25 earnings levels lower than the Commission-authorized

1 return violate the United States Supreme Court requirement
2 that authorized rates for a public utility such as MGE
3 will permit it to earn a return equal to that being made
4 by other comparable businesses.

5 The Staff would apparently have the
6 Commission simply ignore the Supreme Court requirements
7 and go about setting MGE's rates using methodologies
8 similar to those which have been used in the past that
9 have consistently produced inadequate earnings.

10 The evidence will show that a few prominent
11 examples of this Staff refusal to acknowledge reality
12 include the Staff's use of a 30-year measure for normal
13 weather despite the fact that a 30-year measure has
14 consistently resulted in an overstatement of average use
15 per residential customer in the ratemaking calculation in
16 comparison to average use per residential customer
17 actually experienced on MGE's system.

18 And the Staff's opposition to a low
19 attrition adjustment, despite the fact that customer usage
20 has been consistently declining due to increased appliance
21 efficiency, better home building practices and recent
22 significant increases in the price of natural gas
23 commodity, among other things, and the Staff's opposition
24 to any meaningful form of weather mitigation rate design
25 to moderate the significant weather variability on MGE's

1 revenue streams despite the fact that the combination of
2 weather and volumetric rate design has been shown to be a
3 significant driver of MGE's consistent underearnings, and
4 the fact that this form of rate design was recently
5 implemented for Laclede Gas Company, and -- and I won't go
6 too long here -- the Staff's use of Panhandle Eastern's
7 indebtedness to calculate the cost of debt for MGE,
8 despite the fact that not one dollar of the proceeds of
9 any Panhandle Eastern debt offerings have ever been used
10 to support MGE operations or fund MGE capital
11 improvements, and the Staff's attribution of a capital
12 structure to MGE which includes the impact of Panhandle
13 Eastern, despite the fact that, pursuant to Commission
14 order, Southern Union may not infuse equity, cash or
15 financial guarantees into Panhandle without Commission
16 approval.

17 And two, all of the Panhandle Eastern debt
18 is nonrecourse to Southern Union, and the Staff's
19 calculation of bad debt expense based on a five-year
20 average which includes two years of extremely low volume
21 sales and low gas prices despite the fact that sales and
22 gas price levels are expected to be considerably higher
23 than that during the future period when rates from this
24 case will take effect.

25 But attempting to ignore the realities,

1 these and other realities of MGE's operation while
2 pretending they don't exist won't make them go away.
3 Although it goes without saying that the Commission has a
4 significant amount of discretion in setting rates, that
5 discretion does have bounds, and the U.S. Supreme Court
6 has provided significant guidance in that regard. The
7 rate levels approved by the Commission must provide the
8 company with a reasonable opportunity to achieve the
9 authorized earnings level.

10 The evidence will also show that MGE and
11 Southern Union run a very tight ship when it comes to cost
12 control, yet consistent earning shortfalls have still
13 ensued. One example demonstrates this focus on cost
14 control very clearly. As shown in Schedule G-1 of
15 Mr. Noack's direct testimony, Missouri Gas Energy's
16 operating and maintenance expense per customer over a
17 five-year period, '98 through 2002, was consistently and
18 significantly lower than the average O&M expense per
19 customer of peer companies. The numbers are striking.
20 1998, MGE average O&M expense almost \$117. Compare that
21 to almost 166, 167, 185. Come to 2002, MGE average O&M
22 cost per customer, right about \$117. The other companies,
23 193, 274, 252.

24 This analysis, which no party has disputed,
25 clearly establishes that MGE is exceedingly vigilant in

1 terms of cost control. So it cannot credibly be argued
2 that MGE's earnings shortfalls have resulted from an
3 unwillingness or an inability to manage costs. Nor can it
4 be said that MGE has not upheld its end of the regulatory
5 compact.

6 Throughout this period of consistent
7 earning shortfalls, MGE has continued to provide safe and
8 reliable service to its customers, and has continued to
9 employ capital for the benefit of its customers.
10 Significantly, MGE expended approximately \$123 million on
11 its safety line replacement program from July 1 of 1995
12 through June 30 of 2003, in compliance with the
13 Commission's gas safety rules.

14 All that MGE is asking here is that the
15 assumptions used by the Commission in establishing the
16 cost of service elements for calculating rates must bear
17 some reasonable resemblance to MGE's operating reality.
18 Fairness requires it, the law requires it, good public
19 policy considerations require it. The regulatory
20 ratemaking process must reasonably reflect MGE's operating
21 reality if MGE is to have any realistic chance of actually
22 achieving its Commission-authorized earnings level.

23 Up to this point my remarks have focused
24 on -- almost exclusively on the requirement that rate
25 levels permit MGE a fair opportunity to achieve its

1 Commission-authorized earnings, and while this is an
2 extremely important part of the Commission's
3 responsibilities in this case, it is only a part of those
4 responsibilities.

5 The Commission must also decide in this
6 case what MGE's authorized return is to be. This, too, is
7 an extremely important part of the Commission's
8 responsibilities and bears significantly on the overall
9 reasonableness of the rates resulting from this case.

10 In making this determination, the
11 Commission should keep in mind guidance from the Missouri
12 courts, and I quote, it is not methodology or theory, but
13 the impact of the rate order which counts in determining
14 whether rates are just, reasonable, lawful and
15 nondiscriminating.

16 Although rate of return analysis can seem
17 intimidating due to its apparently technical nature, it
18 can be approached, especially on the basis of the record
19 in this case, from a common sense, nontechnical,
20 policy-level perspective.

21 In another seminal opinion addressing
22 utility regulation and the reasonableness of rates and
23 return levels, the United States Supreme Court has said,
24 and I quote, the fixing of just and reasonable rates
25 involves a balancing of investor and consumer interests.

1 And the Supreme Court also said, the return to the equity
2 owner should be commensurate with returns on investments
3 in other enterprises having corresponding risks.

4 Setting the technical arguments to the side
5 for a moment, the evidence in this case will show
6 unequivocally that the return recommendations being made
7 by Staff and Public Counsel fail this fundamental
8 comparability requirement.

9 The following table compares the Staff and
10 Public ROE recommendations to equity returns being
11 authorized by other regulators around this period of time.
12 What we see is a Staff ROE recommendation of about 8.5 to
13 9.5, a Public Counsel recommendation of about 9 to 9.3.
14 What other regulators have done for natural gas
15 distributors in the first quarter of calendar '04 is 11.1
16 percent. That's an average. Calendar year 2003, the
17 average of other jurisdictions across the country was just
18 shy of 11 percent.

19 The large difference between the Staff and
20 Public Counsel ROE recommendations and ROEs being
21 concurrently authorized by other regulatory authorities
22 demonstrates the unreasonableness of the Staff and Public
23 Counsel positions. Clearly in terms of the Supreme Court
24 requirement set out in Hope, these Staff and Public
25 Counsel ROE recommendations are not commensurate with

1 returns on investments and other enterprises having
2 corresponding risks.

3 Moreover, the Staff and Public Counsel ROE
4 recommendations are so low in comparison to equity returns
5 currently being authorized by other regulators that the
6 Staff and Public Counsel positions would result in a rate
7 order of substantial negative impact to MGE in violation
8 of the standard announced in Associated Natural Gas.

9 The evidence will also show that neither
10 the Staff nor Public Counsel has made any credible attempt
11 to show that MGE and/or Southern Union is significantly
12 less risky than industry peers to explain how their very
13 low ROE recommendations comport with Bluefield and Hope
14 comparability requirements.

15 The absence of any such explanation
16 demonstrates that the Staff and Public Counsel have
17 developed their ROE positions without any meaningful
18 attempt at a balancing of investor and consumer interests
19 in violation of Hope.

20 This failure to balance investor and
21 consumer interests is particularly alarming as it applies
22 to the Staff, which acts with the authority of the
23 Commission under Section 386.240, RSMo, and would
24 therefore reasonably be expected to advocate positions
25 consistent with the legal principles applicable to the

1 Commission itself, including the balancing of investor and
2 consumer interests.

3 The evidence will show, however, that this
4 is not a principle which the staff appears willing to
5 embrace. Surrebuttal Schedule JCD-7, of which this is a
6 copy, portrays a comparison of historical Staff ROE
7 recommendations, they're shown in the magenta squares,
8 two ROE determinations being made by other regulatory
9 authorities, which is represented by the diamond and the
10 thin line. OPC is also on there with the triangles.

11 A quick look at the graph -- this is from
12 '93 through the current. A quick look at the graph shows
13 that from 1993 through 1997 the Staff ROE recommendations
14 trended fairly close to what other regulatory authorities
15 were authorizing on average. Beginning in about 1998,
16 however, the change began to occur, and from 2001 to the
17 present the Staff ROE recommendations have been
18 consistently lower and significantly lower than the
19 average equity returns being authorized by other
20 regulators across the country.

21 MGE does not know why this change occurred.
22 We've seen no Commission policy statement that would
23 justify this change or explain this change. Nevertheless,
24 we think it's something that the Commission -- something
25 for the Commission to address, and this case presents the

1 opportunity to do so.

2 In brief conclusion, MGE would simply ask
3 that the Commission do two things: One, set MGE's rates
4 with a return comparable to other local natural gas
5 distributors, and two, use the individual cost of service
6 elements that bear some reasonable resemblance to MGE's
7 operating reality. This is the only way to truly ensure
8 that MGE has a fairly opportunity to actually achieve its
9 Commission-authorized earnings level.

10 Thank you very much.

11 JUDGE WOODRUFF: Thank you, Mr. Hack.
12 For Staff?

13 MR. FRANSON: Mr. Hack, don't forget your
14 exhibit back there. That is, in fact, yours.

15 MR. HACK: Yes.

16 MR. FRANSON: Your Honor, if I may
17 approach. I do have a handout for the judge, the
18 Commissioners and then the other parties.

19 JUDGE WOODRUFF: Very well.

20 MR. FRANSON: May it please the Commission.
21 If I may proceed, your Honor?

22 JUDGE WOODRUFF: You may proceed.

23 MR. FRANSON: Thank you. Why we're here.
24 We're here because MGE has filed a rate case seeking a
25 \$45 million rate increase. Staff's role in this case has

1 been questioned by MGE. What is Staff's role? Well,
2 we've had data requests on that subject. Staff's role is
3 to provide independent audit and review of the company's
4 books. Staff's role in a case is to provide an
5 independent view that balances the interests of the
6 company and of the ratepayers.

7 By definition, that means Staff will not
8 always agree with the company. There is nothing bad about
9 that. There's not necessarily anything good about that.
10 It is reality. When there's a balance that you are
11 drawing as your job, you do not always agree with one
12 party. That is the theme of Mr. Hack's opening statement,
13 Staff is wrong on everything because we don't agree with
14 MGE.

15 That is as wrong as wrong can be. Staff
16 wants MGE to be a viable economic entity in the state of
17 Missouri, providing services to its customers in a safe
18 and reliable manner and having the opportunity, not a
19 guarantee as MGE seems to be seeking here today, but the
20 opportunity to provide a reasonable return to its
21 shareholders.

22 But at the same time MGE must be an
23 efficient, effective operation. An efficient, effective
24 operation is not necessarily correct and not necessarily
25 reasonably rated by simply pointing to things at other --

1 other commissions do this on ROE, other -- our O&M
2 expenses are lower. Listen to the evidence. That in and
3 of itself does not establish anything other than a nice
4 statistic. When you're considering the evidence in this
5 case, what did MGE leave out, that is what the evidence
6 will show.

7 There are similarities to the prior rate
8 case. Mr. Hack gave an interesting history of rate cases.
9 MGE has -- I believe he said this is their fourth rate
10 case. You don't always get what you ask for. That
11 doesn't mean that this Commission made wrong decisions.
12 It just means MGE didn't get everything they asked for.

13 In their last case, it was settled by
14 Unanimous Stipulation & Agreement. MGE agreed to the
15 rates set therein. MGE alone controls when it comes in
16 for a rate case. In the last three years, many sectors of
17 the Missouri economy have undergone an economic downturn.
18 The utilities in this state have not. If MGE is earning
19 below its return, then it needs to be in here for a rate
20 case, especially since it agreed to the last one.

21 Now, what I handed out is what Staff filed
22 on June 18, 2004, the revenue reconciliation. It breaks
23 down several of the issues in this case that you will be
24 hearing evidence about.

25 Staff's independent audit shows a need for

1 a \$4.871 million increase, and MGE seeks an increase of
2 45.3 million, and Public Counsel's information would show
3 that a \$9.15 million rate increase would be appropriate.

4 This type of difference is not
5 unprecedented. In the last MGE rate case, GR-2001-292,
6 which resulted in the Unanimous Stipulation & Agreement
7 with rates being effective in August 2001, there was
8 initially a similar situation. There was a -- at the time
9 the Staff filed its direct, there was an approximate
10 \$39.8 million difference between the parties at that point
11 in time.

12 Keeping in mind that Staff's direct in that
13 case initially showed no increase being needed or being
14 justified, the case settled at 9.9 million. As is often
15 the case, Staff negotiated, Staff considered things, and
16 after a prehearing and after all the things that went into
17 it, there was an increase that was justified. Staff's
18 number is quite often near the actual settled amount or
19 the litigation result.

20 So where are we here now? Well, we have
21 all of the parties that have done any types of audits and
22 all the ones that have evidence on almost everything, that
23 being Staff, MGE and OPC saying, we need a rate increase.
24 The question is how much and how is it decided and how is
25 it constituted among the issues, most of which appear in

1 the reconciliation which I've handed out to you.

2 The primary issues in this case in terms of
3 money are rate of return, capital structure and
4 depreciation. Other important issues are revenues and low
5 income programs. MGE did not mention low-income programs.
6 You will hear evidence regarding that, and the Staff would
7 point out that, in addition to the monetary issues, those
8 are equally important.

9 However, given events in this case, Staff's
10 opening statement will focus primarily on rate of return
11 and capital structure. Why are we really here? Well,
12 first of all is money. MGE has filed for a rate increase,
13 and as we've already discussed, that's appropriate.
14 However, MGE is seeking a much higher than appropriate
15 increase.

16 The second reason is the ISRS. This is the
17 infrastructure replacement surcharge. Now, MGE is
18 obligated under the ISRS law to be in here for a rate
19 increase and for a rate case. They need certain things
20 determined. They need a rate of return determined. They
21 need depreciation rates determined.

22 Staff suggests to this Commission you need
23 to consider all of this as you're making your decisions,
24 because once those decisions are made, then they're set
25 when MGE comes in for another ISRS. So this has

1 ramifications outside of what's been brought up by
2 Mr. Hack in his opening statement, and outside of what's
3 been brought up by MGE in all of their filed testimony.

4 In fact, in Mr. Oglesby's deposition, which
5 will be offered and admitted into evidence, he stated
6 that's not any part of the driver for this case. Well,
7 it's certainly an important factor, and if it wasn't, then
8 it still plays an important part herein.

9 The major issues of this case, rate of
10 return and depreciation, make up approximately 26 million
11 of the company's attempt to and desire to have a rate
12 increase of \$45 million. These are -- these issues do not
13 represent past costs that MGE incurred to serve its
14 customers that were not already covered by existing rates.
15 These are new increases that the company is wanting for
16 either costs that do not exist or are not needed.

17 The biggest difference in this case from
18 the last case is the lack of stability and the uncivil
19 tone introduced into this case by MGE. This began
20 specifically with the direct filed testimony of MGE
21 president Jim Oglesby. And he talks about a variety of
22 the things Mr. Hack talked about, but essentially he
23 blames any woes of MGE, at least to a large extent, on
24 this Commission. Staff doesn't believe that's
25 appropriate.

1 To say it more succinctly and accurately,
2 why is the company here? Well, we've been here before.
3 You haven't set our rates as high as we want, so let's try
4 it again and let's get it right this time, Commission.
5 Mr. Oglesby specifically says that this company has not
6 fixed rate design to protect MGE from weather volatility,
7 that you haven't -- you've set per customer usage too
8 high, you've set bad debt expense too low, what he deems
9 to be necessary expenses that are disallowed by the
10 Commission, the primary one of those being lobbying,
11 punishment for inappropriate conduct, and all of this
12 means the Commission should get all of these issues right
13 this time by deciding them in favor of MGE.

14 This is virtually identical to the claims
15 made by MGE's then president Steve Catron in the last rate
16 case. In fact, it was made in virtually identical
17 testimony with some very interesting edits, which will
18 come out in the course of the testimony. When Mr. Oglesby
19 is up here on the stand, he needs to explain all of these
20 matters and answer some questions. Everybody will be
21 asking him questions, and you need to consider any
22 questions that are asked to him. Consider him just like
23 any other witness. His idea that the Commission is to
24 blame for MGE's woes is groundless.

25 Now, with that being said, Mr. Oglesby does

1 say one thing that is correct, and that is the Commission
2 should perhaps reconsider things. This Commission should
3 always be considering things as matters evolve. For
4 instance, in the area of capital structure and return on
5 equity, interest rates go up and down, costs go up and
6 down. Things change.

7 There's also one other thing that
8 Mr. Oglesby asked for, and that is what I'm calling the
9 adder. He wants an additional bump of 25 basis points in
10 the rate of return due to alleged management efficiency by
11 MGE. Well, what's he talking about? We need to ask him
12 that because it's not in his testimony. Other than
13 alleged lower costs which Mr. Hack used in his opening
14 statement, there's nothing else. MGE pulls out a very
15 select document and says, we're the lowest.

16 Well, Staff's evidence shows that if they
17 get this full rate increase, they won't be the lowest,
18 even using all of their data to the effect that they want
19 to use. Staff's evidence will show that MGE hasn't even
20 come close to meeting its stipulated targets for customer
21 service standards.

22 And one thing notably left out of
23 Mr. Hack's opening statement, the implied threat in
24 Mr. Oglesby's rebuttal testimony. He states that if this
25 Commission should have -- decide that it's appropriate to

1 adopt OPC or Staff's return on equity or overall rate of
2 return, then it's highly unlikely that Southern Union will
3 make any discretionary investments in this state.

4 Now, there is also an unusual aspect of
5 this case. That is, MGE simply wants to control every
6 single aspect of this case. Example, we took at -- we
7 look at a motion to strike proposed by Staff and OPC
8 regarding low-income programs and customer service
9 reporting. Those were overruled. Those are issues that
10 are appropriate in a rate case. Those are issues that
11 have substantial merit on their own.

12 MGE's customer service, for instance, has
13 had over the history of MGE substantial problems. It
14 continues to have problems. Customer service reporting is
15 a very desirable thing. It gives this Commission valuable
16 information.

17 Then we saw other disturbing aspects of
18 MGE's attempt to control this case unilaterally. That was
19 a Data Request that sought to get into the very minds of
20 the Commissioners. That was a Data Request that said, we
21 want to know, outside the context of a rate case, has
22 there ever been any communications between Commissioners
23 and Staff regarding, of all surprise surprise, rate of
24 return, return on equity and depreciation. Well, that was
25 properly overruled.

1 Then we have the most intriguing of all.
2 If you don't like another party's evidence and you don't
3 want to face it on the merits and maybe you can't, what
4 you do is you attack the messenger, the attack on David
5 Murray. Well, that is just totally unprecedented. You've
6 got a \$24 million issue. You've got an expert witness.
7 Let's attack him. Let's get it out of there. And it
8 continues. Every single witness that would have anything
9 to say contrary to MGE apparently, under MGE's opinion, is
10 incompetent, period. That is wrong.

11 This Commission is apparently going to take
12 it with the case. Well, there are proper ways to do
13 things like this, and it's now being done. It's called
14 evidence. What we heard as these things, oral
15 arguments were being done was simply the opinions of MGE's
16 attorneys. You didn't hear any evidence. There hasn't
17 been any evidence as of this moment in time. There wasn't
18 then. There hasn't been yet. There will be, but there
19 hasn't been yet.

20 All you had was MGE's view of the evidence
21 that they expect to introduce, specifically Mr. Dunn and
22 Roger Morin. However, it just isn't there. What this is
23 akin to is a motion to suppress in a criminal case, but
24 see there's a difference. In a criminal case what you do
25 is you bring in the evidence, the finder of fact hears the

1 evidence and makes a decision. I've litigated a good
2 number of those motions. It works quite well. That's
3 what needs to be done here.

4 Now, what MGE did was they used a
5 preemptory -- in essence, a preemptory strike to put all
6 of this, all of their opinions -- and that's absolutely
7 all it is is their opinions -- before this Commission, and
8 what they've done is tried to taint David Murray.

9 Well, there's been talk, Staff hasn't
10 responded. Well, Staff has responded appropriately.
11 Well, now is the time Staff will respond. Mr. Murray will
12 sit in that seat right over there. Mr. Murray will be
13 asked questions, not only by all the parties but by this
14 Commission.

15 Mr. Murray, David Murray is qualified by
16 knowledge, skill, experience, training and education to be
17 an expert witness. His methodologies are of a type
18 reasonably relied on by experts in the field in forming
19 opinions or inferences upon the subject and are reasonably
20 reliable.

21 David Murray has testified before this
22 Commission before. David Murray has been properly
23 challenged before. That is, if someone didn't like his
24 testimony, they went to the weight of it and questioned
25 him about it. That's what needs to be done here with all

1 of the witnesses that testify and have been attacked.

2 Now, when David Murray sits there, that's
3 the time for all of the questions to be put to him and for
4 his testimony to be admitted into evidence. That is the
5 proper way to do it.

6 Now, there's a couple more aspects here
7 that need to be considered. Is there support for David
8 Murray in the record? Yes, there is. We start with David
9 Murray's testimony. Then we look at MGE's testimony, the
10 mere falsity of the fact of their attack on David Murray
11 is, we feel, in their own testimony. Take a look at MGE
12 Witness John Dunn's surrebuttal testimony. He spends 26
13 pages responding to David Murray's criticisms. If David
14 Murray is not an expert, that wouldn't be necessary.

15 What is troubling is that MGE's return on
16 equity and rate of return, if they want to say Staff's too
17 low, you know, there's another measure here, and that is
18 you can go too farther the other way. MGE has done that.

19 Now, one final thing here. MGE is saying,
20 Commission, look at what other jurisdictions are doing.
21 Look at the Regulatory Research Associates. What are they
22 doing? Well, look at the evidence that you hear. There
23 is not going to be a witness from the Regulatory Research
24 Associates. MGE has not filed any testimony in that
25 regard. They haven't identified any witnesses that are

1 going to come in and say that this mere average done --
2 it's a survey, is what it is, by the Regulatory Research
3 Associates. Well, just give us that and we can all go
4 home.

5 No. What you've got to do is hear the
6 evidence. That's how this Commission works. You hear the
7 evidence, then you make a decision. The mere fact that
8 some agency does a survey doesn't tell you anything other
9 than some agency does a survey and comes up with a number.
10 Consider all relevant factors.

11 Now, MGE says Staff's ROE is too low;
12 therefore, its unreasonable. One of the reasons is --
13 it's unreasonable is look at the numbers. It was right
14 around 11 percent that Regulatory Research Associates
15 tells us, well, look at MGE. They were almost 100 basis
16 points above that, and that is their minimally acceptable
17 ROE. Not just any range, it's their minimally acceptable.

18 Listen to the evidence. Staff's position
19 is much stronger than MGE admits, and the magnitude of
20 MGE's attack reflects this. When this is all said and
21 done, this Commission will hear evidence. You've also
22 heard, unfortunately, bombast and venom, and I'm hoping
23 that civility reigns from is this point on. But when it's
24 all said and done, all Staff asks you to do is listen to
25 the evidence, consider the evidence and make a decision in

1 this case on the merits.

2 Thank you.

3 JUDGE WOODRUFF: Thank you, sir. Public

4 Counsel?

5 MR. MICHEEL: May it please the Commission?

6 My name is Doug Micheel. I am the Deputy Public Counsel

7 with the Office of the Public Counsel, and for those of

8 you who don't know, I represent the customers of MGE,

9 generally the residential customers, small general service

10 customers.

11 And I've talked to some of my clients and

12 customers of MGE regarding the rate case. I've discussed

13 this rate case on the phone with them, I've received

14 letters from customers, I've received e-mails from

15 customers, and I've heard from customers at local public

16 hearings. Every single one of my clients that I heard

17 from believes that the proposed \$45 million rate increase

18 by MGE is simply, to use their words, outrageous. A few

19 of them used a few more flowery words that I cannot use in

20 a setting like this.

21 And you know what, we audited the

22 company's books and records, and our audit clearly

23 substantiates my clients' beliefs that the \$45 million

24 proposed rate increase is well beyond the bounds of

25 reasonableness.

1 Public Counsel, as the reconciliation
2 indicates, is recommending an approximate \$9.1 million
3 increase. Now, due to the new structure of openings that
4 we're giving, these mini openings, I'm not going to go
5 into all of the ins and outs of our positions here today.
6 I'm going to do that at the mini openings. But I do want
7 to tell you that we're going to be presenting five
8 witnesses in this proceeding. Four of them are from our
9 office: Travis Allen, a public utility financial analyst;
10 Kim Bolin, a public utility accountant; James Busch, a
11 public utility economist; and Barbara Meisenheimer, the
12 chief public utility economist.

13 We're also presenting one outside
14 consultant and a former OPC alumnus, Mr. John Tuck. He's
15 the investment manager for the Public School Retirement
16 Fund. He manages over \$23 billion worth of equity on
17 behalf of the retirement fund. He's going to be in here
18 talking to you about rate of return, and I'll talk a
19 little bit more in my mini opening.

20 There are numerous issues, and I just want
21 to highlight here kind of at the 10,000 foot level the
22 issues that Public Counsel has testimony on. One is
23 capital structure. Two is the return on equity, the
24 appropriate return on equity, and as everyone's indicated,
25 we're recommending 9.01 to 9.34. We think at the close of

1 the evidence you'll find that to be a reasonable return to
2 be given. We're also providing testimony on capacity
3 release/off-system sales issue, the environmental response
4 fund, lobbying and legislative costs and incentive
5 compensation.

6 We're also going to be providing extensive
7 testimony on rate design, specifically the issues of class
8 revenue responsibility, fixed monthly rate elements,
9 volumetric rate elements, and the weather normalization
10 clause and miscellaneous service charges.

11 Finally we'll be presenting expert
12 testimony with respect to the low-income issues of
13 weatherization, the experimental low-income rate, and the
14 experimental Pay as You Save program. Now, I will give
15 you a bigger version when I have my 10 minutes with all of
16 these issues. I just wanted to apprise the Commission
17 that's what the Office of the Public Counsel is going to
18 be talking about.

19 You know, there's a lot that I agree with
20 in Mr. Hack's opening, surprisingly, and when I say that,
21 I say I certainly agree with the legal precedence that he
22 cites in his openings. But what I disagree with, and I
23 vehemently disagree with, is his conclusions and his
24 applications of the facts to this case to those
25 conclusions, and I think that the evidence is going to

1 show something completely different.

2 First of all, the evidence will show, and
3 it's no secret, Mr. Hack talked about to it, MGE has had
4 three -- two fully litigated rate cases before this
5 Commission. This Commission determined that the decisions
6 that they made in those cases based on the record
7 evidence, as you're required to do, that those rates
8 resulted in just and reasonable rates and gave MGE the
9 opportunity, and when it comes down to it, Commissioners,
10 the law is they get an opportunity to earn their rate of
11 return, an opportunity. And based on the evidence in
12 those cases -- and I litigated all of these cases. I've
13 had the unfortunate goodness of litigating every single
14 MGE rate case, even their merger case, and, you know, it's
15 all the same.

16 I can tell you this about GR-96-285, the
17 company didn't appeal. I can tell you this about
18 GR-98-140, the company -- or no. On GR-96-285 the company
19 appealed certain aspects of the Commission's decision.
20 The court found what this Commission did was just and
21 reasonable. Same thing with GR-98-140.

22 With respect to the third case,
23 GR-2000-292, that was a settled case. I assume,
24 apparently incorrectly, that when somebody settles they're
25 satisfied that they're going to be getting the opportunity

1 to earn that return. Well, now they come and they say,
2 look at all the evidence. You know, we had litigated
3 cases. The Commission authorized us to do this, gave us
4 this opportunity to earn. We didn't earn. It's your
5 fault, Commission. You've done something wrong. You need
6 to change certain things, and Mr. Hack went through a
7 laundry list of those things.

8 What I ask you to do today and throughout
9 this two weeks of hearing is I ask you to listen to the
10 evidence on these issues about whether it's appropriate to
11 use the 30-year normal, for example, for weather. I think
12 after you've heard the evidence, you've heard the
13 testimony, you'll come to the conclusion that that is the
14 appropriate measure to use, for example, for weather. I
15 think after you hear the evidence, you will come to the
16 conclusion that the rate design offered by the Office of
17 the Public Counsel is the appropriate rate design.

18 Remember, what we do at regulation, what
19 your job is, and I agree with Mr. Hack, it is to balance
20 the interests of the consumers and the company, but this
21 is a regulated monopoly. This Commission sits to
22 guarantee or to ensure that there's some competitive
23 nature going on here. This Commission should not make any
24 decisions that guarantee the company a return.

25 In the real world, in a real competitive

1 setting where we have real competition, the car dealer
2 down the street isn't guaranteed a return. They could
3 lose it all. The little barbershop isn't guaranteed a
4 return. The mom and pop grocery store, they're not
5 guaranteed a return. They're given an opportunity.

6 And your job is to balance those interests
7 and give them that opportunity. To the extent that that
8 opportunity doesn't materialize is not contrary to the
9 law, does not violate any Missouri Supreme Court cases.
10 You give them that opportunity. There is no guarantee. I
11 like to think about it as a fishing license, and I like to
12 fish. I buy my fishing license. That does not guarantee
13 that I'm going to catch any fish. It just says,
14 Mr. Micheel, you have an opportunity to dip your hook in
15 the water.

16 That's the same decision that this
17 Commission is making. You say, we're going to give you an
18 opportunity to earn this return. We think it's
19 reasonable. We're not guaranteeing that. And at the
20 close of the evidence, that's what you will do, and I
21 think at the close of the evidence, you will come to the
22 conclusion that MGE needs no more than \$9.1 million.

23 JUDGE WOODRUFF: Thank you, Mr. Micheel.
24 For Midwest Gas?

25 MR. CONRAD: If your Honors please, I think

1 both Staff and Public Counsel have done a wonderful job of
2 presenting their positions, which we generally share.
3 We're not going to get into that debate with you here this
4 morning.

5 I did want simply to note that the
6 principal issue that my client is going to be active on
7 involves the class cost of service and rate design. I
8 will hopefully have more to say about that. I don't want
9 to take any significant amount of time here this morning,
10 save to make one brief comment about that, and it kind of
11 asks you to close down the ROE stuff for just a second.

12 In October of 1985, that's close to
13 20 years ago, the FERC put out an Order that we call
14 Order 436, and that instructed the interstate pipelines
15 that they had to give open access, they had to become,
16 although they didn't like the term, probably de facto
17 pretty close to common carriers for not only the gas that
18 LDCs purchased, but the gas that my clients began to
19 purchase on their own.

20 When that decision rippled down to the
21 state level and this particular Commission, we initiated a
22 case that was called GO-85-264, and as its number implies,
23 that was almost 20 years ago, too. The upshot of that
24 case, which was resolved, and the Commission approved it,
25 was that we simply took the existing sales rates and we

1 extracted from them the cost of the natural gas that was
2 embedded in those rates, and what was left over in the
3 particular classes of at that time what was called large
4 commercial and large industrial customers, once you
5 withdrew that cost of gas from those rates, what was left
6 in those rates was what was called the margin. One could
7 argue about whether that was entirely accurate, but
8 basically it was the non-gas margin.

9 For 20 years that margin has really never
10 been looked at. Our clients buy their own gas. They
11 don't buy gas from MGE. And while we are not in this case
12 advocating a massive restructuring of how that's done, we
13 are going to ask you to take a look at a couple, three
14 things that I will develop in greater detail, but
15 basically some expenses and some activities that MGE or
16 for that matter any LDC, be it Laclede, be it MoPub, does
17 not do for transportation customers, and including in this
18 particular case a number of years ago by tariff and by
19 agreement, it was actually in, I believe, the last KPL
20 case which preceded the merger case where Southern Union
21 acquired what was then the Missouri, primarily the
22 Missouri assets of KPL, we agreed that our customers would
23 install at their own expense the electronic gas metering
24 equipment that not only permitted them to better control
25 their gas, but also permitted the LDC and the pipeline to

1 have access to that information so they could better
2 operate and better run their systems.

3 We're simply asking that those types of
4 things be taken into account. We were willing to do that
5 then. We're not unwilling to do that now. That's
6 enshrined in a tariff actually as a condition of doing
7 transportation. But while I won't speak for Mr. Finnegan,
8 it does have impacts when you have an institution such as
9 CMSU that has 14 of these installations that cost up to
10 \$5,000 apiece at that time.

11 And we're going to ask you to look at some
12 of those issues as to some of the expenses that the LDC
13 really does not incur when it does transportation. We
14 will offer the single witness, Don Johnstone, and we're
15 sharing him, Midwest Gas Users are sharing him along with
16 UMKC, CMSU and County of Jackson, and we'll offer that --
17 I think that's almost a week or perhaps more out per the
18 schedule.

19 And so with that, I will conserve the rest
20 of my time to hopefully better orient you at that point in
21 time when things will be fresh. We appreciate your
22 attention this morning. Thank you.

23 JUDGE WOODRUFF: Thank you, sir. Next on
24 the list is Jackson County, UMKC, CMSU, and I see
25 Mr. Finnegan is not here yet. So we'll pass over him and

1 go to the Federal Agencies.

2 MR. PAULSON: Good morning. I'm Major
3 Craig Paulson. I represent the Federal Executive
4 Agencies. We appreciate the efforts of the Staff and the
5 Public Counsel to protect our interests as customers here
6 in the state of Missouri. We will be presenting testimony
7 also on the cost of service. That will be next week on
8 Thursday.

9 The major customers of MGE here in Missouri
10 are Whiteman Air Force Base and the Department of Energy
11 facility in Kansas City. Both of those customers are
12 large volume service transportation customers. They don't
13 purchase gas. Whiteman Air Force Base is a large general
14 service customer as well. The military family housing
15 area on the base is served under that tariff.

16 Next Thursday we'll be presenting Mr. Gary
17 Price as a witness. He'll testify on a cost of service
18 study that will show that the current revenue percentages
19 assigned to the LGS and LVS classes are too high. The LGS
20 class, according to our study, is 60 percent too high, and
21 the LVS is 18 percent too high.

22 The reasons for this include, as indicated
23 by Mr. Conrad, the fact that costs associated with gas
24 purchases are included in the rates paid by the LVS
25 transportation only customers. Other reasons include a

1 mathematical error in the calculation of weighted meter
2 installation.

3 With regard to the cost of service, the
4 Federal Executive Agencies propose that the large general
5 service class receive 75 percent of any new revenue above
6 current rates. With regard to the other rate classes, we
7 propose any increase be assigned based on the current
8 system averages, except those classes should
9 proportionately share any LGS shortfall. For example, if
10 you approved a 5 percent increase, then under our proposal
11 the large general service class would receive a
12 3.75 percent increase and, according to our calculations,
13 the other classes would receive approximately a
14 5.05 percent increase.

15 Thank you.

16 JUDGE WOODRUFF: Thank you, sir. City of
17 Kansas City?

18 MR. COMLEY: May it please the Commission?
19 My name is Mark Comley, and I represent the City of Kansas
20 City in this matter. And the City has appeared for a
21 discrete issue concerning the low-income weatherization
22 program that's funded by MGE and administered by the City.

23 As a consequence of that, I think it's
24 probably a better use of the Commission's time and the
25 parties' time if I can just simply reserve my remarks for

1 the mini openings that have been scheduled for this issue
2 on July 2nd. We intend to present the testimony of one
3 witness, Robert T. Jackson. I think he is acquainted with
4 the Commission already, some would know him, and we will
5 be discussing the needs of the city-administered program
6 at that time.

7 And as a housekeeping matter, your Honor,
8 since that is the only issue that the City is appearing
9 for and it is scheduled for some time in the future, I was
10 going to ask if the attorney for the City could be excused
11 from this hearing until such time as that issue is heard.

12 JUDGE WOODRUFF: Certainly. That's up to
13 you.

14 MR. COMLEY: Thank you very much.

15 JUDGE WOODRUFF: I don't see anyone here
16 for City of Joplin, so we'll pass over them.

17 Commissioner Clayton indicated he had a
18 question concerning the handout that Staff used in their
19 opening.

20 COMMISSIONER CLAYTON: Judge, thank you
21 very much. Before we get started on the evidence, Staff
22 presented a document which has not been marked as an
23 exhibit but apparently was submitted as part of the
24 pleadings, and it is a summary of the parties' positions
25 identifying each issue and the value of each issue.

1 I wanted to see if all the parties have
2 received a copy of that document, and I don't know if it's
3 going to be offered as an exhibit or not, but we got it.
4 So I wanted to see if they accurately reflect the dollar
5 amounts and the positions of each of the parties, or if
6 you don't know right now, then perhaps we can come back,
7 but if it is accurate, it may be a helpful guide.

8 JUDGE WOODRUFF: Mr. Franson?

9 MR. FRANSON: Your Honor, Commissioner
10 Clayton, actually, that was filed. It was a required part
11 of the procedural schedule, and it is Staff's belief that
12 it is accurate. So at this time I will offer it into
13 evidence, and I will offer it, I believe, as Staff's
14 Exhibit 842.

15 MR. HACK: I would just say in response
16 that we have generally looked at it. The Staff has been
17 in contact with this on the reconciliation since the
18 prehearing. And we did just get it Friday. I think we're
19 generally comfortable with it, but I think at this point
20 we would prefer to reserve any admission of it as an
21 exhibit, let us take perhaps a little closer look at it.

22 JUDGE WOODRUFF: Mr. Micheel?

23 MR. MICHEEL: Yes, Commissioner. We have
24 looked at that, and that accurately represents our
25 positions. I think one of our -- I think our public

1 utility accountant, Kim Bolin, worked with
2 Mr. Oligschlaeger to make sure that those positions
3 accurately reflect Public Counsel's position.

4 COMMISSIONER CLAYTON: Just for
5 clarification, for Public Counsel's positions, basically
6 you-all would agree with Staff on any issue that is not
7 listed or basically added back in your disagreement
8 section down at the bottom?

9 MR. MICHEEL: I think that's correct.

10 COMMISSIONER CLAYTON: Is that accurate?
11 Certainly if any party has a problem with the numbers,
12 they can attack those later on. Thank you, Judge.

13 MR. FRANSON: Your Honor, are you still
14 taking comments from anyone?

15 JUDGE WOODRUFF: If you have something to
16 add.

17 MR. FRANSON: Just, Judge, it has been
18 shared, it has been offered into evidence, so I guess I
19 would renew that motion.

20 JUDGE WOODRUFF: I'll go ahead and mark it
21 as 842. I'm not going to rule on it at this time to give
22 the parties more time to look at it. We'll deal with it
23 again later in the hearing.

24 All right. I believe that concludes the
25 opening statements. We'll go ahead and take a short break

1 now and come back at, let's say, 10 minutes after 10 and
2 we'll begin with mini openings on the first issue.

3 (A BREAK WAS TAKEN.)

4 JUDGE WOODRUFF: We're on the record again.
5 We're going to start with the mini openings on the rate of
6 return issues, I believe. Mr. Hack, it looks like you're
7 going to be using the ELMO.

8 MR. HACK: I'm going to try, your Honor.

9 JUDGE WOODRUFF: I can actually change the
10 camera. Are you going to start at the podium?

11 MR. HACK: Mr. Herschmann -- I'm the
12 spokesmodel, and I will be putting exhibits here.

13 JUDGE WOODRUFF: I can go ahead and put the
14 camera over to ELMO so it will be recording on that. Are
15 you going to be using the exhibits throughout the
16 presentation?

17 MR. HERSCHMANN: On and off.

18 JUDGE WOODRUFF: We'll go ahead and start
19 with the camera there. When you start using the exhibits,
20 let me know and I'll try and switch the camera.

21 MR. HACK: Thank you.

22 JUDGE WOODRUFF: All right. You may
23 proceed.

24 MR. HERSCHMANN: May it please the
25 Commission, Judge Woodruff? My name is Eric Herschmann,

1 and I will be addressing the mini opening dealing with
2 rate of return.

3 To begin, as to some of the comments made
4 by both Mr. Franson and Mr. Micheel, first dealing with
5 Mr. Franson and the claim that since MGE is actually
6 exercising its statutory rights and ask the Commission
7 that witnesses that come before it comply with McDonagh
8 standard and the statutory standards, I believe there's
9 nothing improper in that process. I think as we discussed
10 during the motion to exclude Mr. Murray's testimony, it's
11 the basis for which, at least since McDonagh, the standard
12 applies.

13 Ironically, in listening to Mr. Franson
14 dealing with issues of criminal law, a matter for which I
15 spent much of my career, I never heard and I don't know of
16 any court that's ever said that in a criminal case the
17 trier of fact gets to hear all the evidence. In fact,
18 criminal law is premised on just the opposite.

19 You look no further than Miranda warnings.
20 The warnings are not given, it's a custodial
21 interrogation, then the statements are suppressed. The
22 jury doesn't hear it and then they decide. If it's an
23 illegal search and there was no search warrant authorized
24 by a court which was subsequently challenged and ruled
25 upon by the court, then the evidence doesn't come in.

1 I've never heard of a case, and I'm certain
2 that Mr. Franson can't cite to any cases that say in
3 criminal proceedings you get to hear all of the evidence
4 and then you decide what do you want to do. Ironically,
5 when I was a prosecutor, I probably would have liked that
6 process, but that's just not how it works. And in the
7 admission of testimony, expert testimony in this case, it
8 likewise doesn't work that way.

9 As far as Mr. Micheel's comments dealing
10 with real competition and the opportunity to earn an
11 authorized rate of return, there are some substantial
12 differences between regulated entities and obviously
13 non-regulated industries. If MGE was a non-regulated
14 industry, we all wouldn't be here right now.

15 The mom and pop example, sure, there's the
16 possibility that it will fail. It also has no limit on
17 its earning capacities. That is a distinction that's
18 important. In the mom and pop operation, if a customer
19 couldn't pay its bills, then the company has the
20 discretion whether or not it wants to cut them off, not
21 cut them off or go forward. That discretion doesn't lie
22 with MGE in this proceeding, and the analogies, with all
23 due respect, aren't applicable here.

24 In this proceeding, this Commission will
25 have the opportunity to hear by what almost everyone

1 agrees is the leading authoritative figure in this country
2 dealing with rate of return, return on equity and utility
3 finance, Dr. -- or Professor Morin. He's written numerous
4 books. He gives many lectures. His testimony in his
5 deposition discloses that he's testified all over the
6 world dealing with these issues. He has a Ph.D.

7 And I invite the Commission, without all
8 the rhetoric of Mr. Murray or Mr. Allen or Mr. Dunn, to
9 take this opportunity and to find out from the leading
10 authority when he's here in this room what is it that he
11 says is the appropriate method, what is the appropriate
12 procedure, and why is it that the Staff and the OPC
13 witnesses have not complied.

14 Mr. Hack has given you an overview of the
15 issues this Commission will hear in the next few weeks.
16 What I really want to focus on and where there's really a
17 significant majority of dispute are what is the rate of
18 return. As this Commission is well aware, the rate of
19 return calculation is made up of two separate
20 examinations. The first is determining the appropriate
21 capital structure to use for MGE, what amounts of debt and
22 what amounts of equity to assign to MGE. The second is
23 determining the weight request to be given to each
24 component.

25 Within the second analysis, assigning debt

1 is relatively easy. It's the interest that's paid on the
2 bonds. But assigning a cost or weight to the equity
3 component is a more difficult task. This is where
4 expertise and subjective judgment comes into play, to
5 determine the cost of equity, also known as return on
6 equity, expected by investors or the ROE.

7 The ROE calculation is typically using some
8 form of the discounted cash flow or the DCF model that
9 we've heard so much about, and it involves a lot of
10 subjective expertise, including selecting comparable proxy
11 group companies with similar risk to evaluate and compare,
12 selecting appropriate growth data sets based on relevant
13 historical parameters, and ultimately making a
14 determination as to what investors will do in the future.
15 It is no easy task. It cannot be done in a mechanistic or
16 robotic way. Then once a capital structure and cost of
17 capital components are assigned, a rate of return can be
18 calculated.

19 The focus, as Mr. Hack pointed out, is the
20 reasonableness of the overall result, and the
21 reasonableness has to be based on an opportunity to earn
22 equal to that generally being made at the same time and in
23 the same general part of the country on investments in
24 other business undertakings which are attended by
25 corresponding risk and uncertainties. That's directly out

1 of the Supreme Court case of Bluefield.

2 One of the things that Staff has criticized
3 is the idea of looking at what other regulatory agencies
4 have done. If Staff were so confident in its
5 recommendations and in its analysis, then where's the harm
6 in determining it, especially after somebody has
7 challenged your qualifications? And had Staff bothered to
8 look at the Regulatory Research Associates listing of
9 returns on equity, it would have seen the sharp
10 disparities that exist between their recommendations
11 during the same relevant time period and what has actually
12 been authorized.

13 In our motions to exclude the testimony of
14 Mr. Murray, Mr. Allen and Mr. Tuck, MGE is attacking these
15 witnesses for two reasons, their inadequate qualifications
16 to determine an appropriate capital structure/return on
17 equity and the improper methodologies used to calculate
18 these results.

19 OPC's witness Mr. Tuck also addresses the
20 fact that his surrebuttal testimony is simply an
21 additional to the direct testimony of Mr. Allen. And it's
22 not surprising that you're seeing Mr. Tuck's testimony in
23 his surrebuttal, because Mr. Allen, who prior to being
24 hired, quote/unquote, as an expert by the OPC, previously
25 worked loading docks at FedEx.

1 He was told during his interview, you are
2 going to be hired with the explicit designation of being
3 an expert in this case. He didn't even know what the
4 standards were. He had never read any of the cases. He
5 never inquired what the statutes required to be an expert.
6 Within two weeks, he had already started drafting his
7 testimony in this case that he says you should rely upon.

8 Let me focus now on capital structures.
9 The issue with the capital structures boils down to, in
10 essence, what is the appropriate amount of debt and equity
11 assigned to MGE. All parties agree that Panhandle,
12 Southern Union's interstate pipeline, is a separate and
13 distinct business. This Commission is aware that there
14 was testimony filed by both the Staff and the OPC in
15 relationship to Southern Union's desire to acquire
16 Panhandle's pipeline.

17 Mr. Murray submitted testimony in that
18 proceeding that demanded that MGE be insulated from
19 Panhandle business, and there were certain parameters that
20 were imposed. And the Commission eventually issued an
21 Order designed to insulate Panhandle from MGE. For that
22 reason and that reason alone, since Panhandle's debt is
23 nonrecourse, it's not related to MGE, the debt that it
24 issued could not conceivably be related to MGE because it
25 was issued before Southern Union acquired the pipeline,

1 Panhandle's debt and equity should be removed from the
2 balance sheet.

3 What this Commission is here to do is
4 balance the customers' interests and the shareholders'
5 interests as it relates solely to MGE.

6 Mr. Murray in his testimony in the
7 Panhandle case said he's presented a condition intended to
8 eliminate the detrimental impact on Southern Union's
9 proposal. The condition is designed to achieve insulation
10 of the regulated utility from the business and financial
11 risk of Southern Union's other operations and thereby
12 protect Missouri ratepayers. That is exactly what he got
13 in the stipulation and order that required the
14 segregation.

15 Ironically, Murray has testified himself
16 before this Commission that there are times when it would
17 be appropriate to remove from the parent company a
18 division or subsidiary. This is his testimony in March of
19 this year in the Aquila case. Well, what information
20 would show you or convince you that the divisional capital
21 structures of in that case MPS and L&P were closer
22 estimates of the actual capital used to serve these
23 customers than the capital structure of the parent
24 Aquilla? His answer, spin them off as a subsidiary and
25 have them issue their own debt.

1 That is exactly what happened in this case
2 dealing with Panhandle. And yet what does the Staff and
3 OPC say to do now? We should take the Panhandle debt and
4 reinsert it into the MGE or use the Southern Union
5 consolidated balance sheet.

6 After asking that there be insulation from
7 MGE by segregating Panhandle and demanding certain
8 parameters that guarantee that not only directly but
9 indirectly there be protection, due process requires that
10 now in the balancing of what is appropriate capital
11 structure, that the Staff and OPC not be allowed to go
12 ahead and put the Panhandle debt back into the balance
13 sheet.

14 This Commission has already ruled -- this
15 is taken from Case No. ER-93-41, the St. Joe Light & Power
16 Company -- that the question dealing with capital
17 structure is a zone of reasonableness. The Commission in
18 other cases has utilized the actual capital structure
19 whenever the debt equity ratio has not been shown to be
20 outside the zone of reasonableness.

21 However, when, as in this case, the actual
22 capital structure is so entirely out of line with what the
23 Commission considers to be a reasonable range, a
24 hypothetical capital structure must be adopted to balance
25 properly the interests of the shareholder and ratepayer.

1 It's not an option. This Commission has already ruled, it
2 must be adopted.

3 And in this case, there is no doubt that
4 the equity that is -- the debt to equity ratio that's
5 being proposed by the Staff and the OPC, which includes
6 and puts back in Panhandle, is outside the zone of
7 reasonableness.

8 JUDGE WOODRUFF: I'm going to give you
9 about a five-minute warning.

10 MR. HERSCHMANN: Thank you.

11 There seems to now be uniform agreement
12 amongst all the witnesses in this case that Mr. Murray
13 doesn't know and didn't know what he was talking about in
14 removing panhandle's debt and equity from Southern Union's
15 consolidated financials. Of course, that didn't stop
16 Mr. Murray from testifying that he was assured, he was as
17 certain as how he backed out Panhandle from the
18 consolidated balance sheet as he was in providing the rest
19 of the testimony in this case, including ROE and ROR.

20 MGE is not alone in criticizing
21 Mr. Allen -- I'm sorry -- Mr. Murray. Allen does this as
22 well. In fact, Staff Witness Mr. Oligschlaeger says that
23 the way that Mr. Murray calculated and tried to remove
24 Panhandle from Southern Union's balance sheet was
25 incorrect. That's on page 5, line 20 of

1 Mr. Oligschlaeger's prepared testimony.

2 Tragically for the Staff, even

3 Mr. Oligschlaeger didn't get it right. We'll show you

4 during the course of the testimony that if you use

5 Mr. Oligschlaeger's calculations, then over \$300 million

6 in equity has just vanished from Southern Union's balance

7 sheets.

8 Interestingly enough, both Mr. Allen and

9 Mr. Murray try to use consolidated -- I'm sorry -- try to

10 use hypothetical capital structures in this matter,

11 similar to what Southern Union or MGE is suggesting.

12 Mr. Allen argues initially that the

13 comparable groups used by Staff Witness -- I'm sorry --

14 MGE Witness Dunn was not comparable, and yet in analyzing

15 the hypothetical capital structure, he goes back to those

16 exact companies instead of actually using the companies

17 that he said was comparable and analyzing and using them

18 for hypothetical capital structure. Had he done that, the

19 hypothetical capital structure as it applied to MGE would

20 have been 40 percent.

21 Both the Supreme Court in Bluefield and in

22 Hope, the seminal cases here, discuss that the fixing of

23 just and reasonable rates involves the balancing of

24 investor and consumer interests. The return of equity

25 owner should be commensurate with returns on investments

1 in other enterprises having corresponding risks.

2 This Commission needs to look at the other

3 companies to make that determination and see if the

4 recommendations that are coming from the Staff and OPC are

5 within the zone of reasonableness. If they're not and the

6 capital structure proposed is not within the zone of

7 reasonableness, then this Commission has already decided

8 in the St. Joe Light & Power Company case that you must

9 use a hypothetical capital structure. The only question

10 is, do you use it appropriately or not?

11 Thank you.

12 JUDGE WOODRUFF: Thank you. All right.

13 For Staff? Mr. Berlin, don't put that up for just a

14 second. I need to change some settings here. All right.

15 MR. BERLIN: May it please the Commission,

16 Judge Woodruff? I'm Bob Berlin, and I'm the Staff

17 attorney assigned the issue of capital structure and rate

18 of return in this proceeding.

19 As you can see, I'm using a decidedly

20 low-tech method of demonstrating what I believe to be the

21 central point of my opening statements, and it's embodied

22 on this flip chart. Robert Franson will pass out copies

23 to those in the room who are unable to see this flip

24 chart.

25 This is a \$20 million issue. Certainly it

1 is of great concern to Staff and to MGE. Earlier you
2 heard Robert Franson lay out Staff's concerns over MGE's
3 unrelenting drive to keep you, the finders of fact, from
4 considering Staff's recommendation and its rationale, and
5 much has been said on this matter, and I'm not going to
6 take you through that again at this time. However, I do
7 want to describe for you what has been a major downward
8 trend in the equity and the financial markets, a big
9 downward trend since MGE last appeared here in 1995-'96.

10 Now, to explain this downward market trend
11 movement in the cost of capital, I draw your attention to
12 the color bar graph chart that I place here before you.

13 MR. HACK: I'm sorry. I realize these are
14 opening statements, but I do have a question. I've never
15 seen any of this stuff before and I'm trying to understand
16 if it's actually in the record and it relates to evidence
17 that has actually been shown to be in the record.

18 JUDGE WOODRUFF: Can you respond to that,
19 Mr. Berlin?

20 MR. BERLIN: Yes, it is in the record.
21 This is merely capsulization of, reflection of exactly
22 what's been going on in the market and is embodied in
23 Staff's recommendation.

24 JUDGE WOODRUFF: Can you give us more
25 detail on which witnesses and which testimonies this is

1 in?

2 MR. BERLIN: Well, you will hear more about
3 this from Staff Witness David Murray and in great detail
4 in his direct, rebuttal and surrebuttal testimony.

5 MR. HACK: And again, I'm not trying to be
6 difficult, but I think that opening statements are
7 supposed to reflect what the evidence either has or will
8 show. Just as an example, perhaps two examples, the first
9 line, second line, first bullet point on the sheet of the
10 explanation contains the 96-285 cost of common equity
11 recommendation by MGE and the percent of common equity. I
12 don't know where that is in this record. I've never seen
13 it.

14 MR. BERLIN: Let me be more specific. It's
15 page 45 of David Murray's surrebuttal testimony.

16 MR. HACK: Thank you.

17 JUDGE WOODRUFF: All right. Thank you.
18 You can go ahead and proceed. While we're in a break here
19 anyway, do you wish to mark this as an exhibit?

20 MR. BERLIN: Not at this time, your Honor.
21 We'll do that when Staff Witness Murray is presented.

22 JUDGE WOODRUFF: Well, since you're
23 referring to it in the record, we really need to have a
24 number on it. Let's go ahead and --

25 MR. FRANSON: Your Honor, if I may, that

1 would be Staff Exhibit 843.

2 JUDGE WOODRUFF: Exactly. 843. All right.

3 You may proceed.

4 MR. BERLIN: All right. Now, this color

5 bar chart that you see before you shows the changes in the

6 equity and the financial markets and that there has been a

7 downward movement in the equity cost of capital from when

8 MGE last appeared here in 1995-'96 to 2004. And if you

9 look at the blue bar, and that blue bar may actually

10 appear to be lavender, but it's somewhat blue to me, you

11 will see -- and I just pointed to the blue bar -- you will

12 see the change in the Southern Union return on equity

13 recommendation from eight years ago.

14 Now, look closely at that particular bar,

15 if you will, because Southern Union's return on equity

16 recommendation from eight years ago has barely changed. A

17 drop of 25 basis points is what the blue bar actually

18 shows. Eight years ago Southern Union had recommended a

19 12.25 percent cost of common equity. Today Southern Union

20 recommends a minimum 12.0 cost of common equity.

21 Now, if you look at the red bar, you'll see

22 Staff's downward change in its return on equity

23 recommendation. The red bar is the largest bar on this

24 graph. Eight years ago the Staff recommended a return on

25 equity of 11.8 percent. Today the Staff's midpoint return

1 on equity recommendation, and I say again, the midpoint
2 return on equity recommendation is 9.02 percent. This is
3 a downward movement of 278 basis points.

4 Yes, Staff has moved its return on equity
5 recommendation downward significantly. Why is that?
6 Well, take a look how much the cost of preferred stock has
7 dropped. You can see how preferred stock cost has dropped
8 by looking at the yellow bar. There's some things you
9 should know about that yellow bar. In May 1995 Southern
10 Union's coupon on its trust originated preferred
11 securities was 9.48 percent, and for the sake of brevity
12 and clarity I will call these securities TOPrs.

13 Today Southern Union's stated dividend on
14 its non-cumulative preferred stock that it issued in
15 October of 2003 was 7.55 percent, and as of June 8th of
16 2004 this preferred stock was yielding 7.1 percent. The
17 total downward change shown by the yellow bar is 238 basis
18 points.

19 But there's something more that you need to
20 know about the yellow bar. The TOPrs in May 1995 had a
21 rate of 9.48 percent, carries less risk than the preferred
22 stock issued by Southern Union in October of 2003. TOPrs
23 carry less risk because they have some characteristics of
24 debt. TOPrs offer a preferred dividend that is backed by
25 a coupon on debt issued by Southern Union. Therefore,

1 TOPrs carry less risk than non-cumulative preferred stock.

2 What does that mean? Means that the change
3 in the cost of capital between these two types of
4 preferred securities is a bit understated, meaning the
5 yellow bar would be somewhat bigger than what you see here
6 on the chart.

7 Now, if you look at the green bar, you will
8 see the downward change in BBB utility bond yield. In May
9 1995 the BBB bond yield was 8.03 percent according to the
10 merchant bond record. In April 2004, the BBB bond yield
11 was 6.46 percent. BBB utility bond yield moved down 184
12 basis points.

13 I also want to point out that the size of
14 the red bar would actually be smaller and closer, more
15 proximate in size to that of the yellow bar, if Staff used
16 its high end ROE recommendation of 9.52 percent.

17 And with regard to capital structure, MGE
18 counsel talked about an Order of the Commission, and an
19 Order that says something, therefore it is. Now, if that
20 were the reality of the world today, all we would need is
21 government officials and tribunals to issue orders and
22 reality would be a whole lot different than what we have
23 today, but that isn't reality.

24 And what the evidence from Staff will show
25 with regard to capital structure and the rationale for

1 using a consolidated capital structure of Southern Union
2 that includes the Panhandle acquisition is that Staff
3 believes that that is the best capital structure to use;
4 whereas, MGE on the other hand pulled out the long-term
5 debt. And it is true that long-term debt of Panhandle is
6 nonrecourse debt to Southern Union, but that long-term
7 debt that's nonrecourse to Southern Union is not
8 nonrecourse to Panhandle. That debt is recourse to
9 Panhandle and the assets that back that up.

10 Now, before I close, I'm kind of reminded
11 of a quote that was made famous by President Harry Truman
12 when he was being challenged by some of his adversaries,
13 and Truman said, quote, I never did give anybody hell. I
14 just told the truth and they thought it was hell.

15 Now, Staff is in much the same position
16 today as Truman was. MGE simply does not like the truth
17 of how today's equity and financial markets have changed.
18 They no longer reflect the good old days of 1995-'96. MGE
19 wants you to approve a 12.0 percent minimum ROE, only
20 25 points off of what it recommended eight years ago, when
21 equity prices have gone through the roof.

22 From its pleadings MGE would have you
23 believe that this Staff, indeed this Commission is driving
24 the equity market with its recommended ROE of a range of
25 8.52 to 9.52 percent. This Commission is not driving the

1 market. This Commission is in step with the market. And
2 that is the reality.

3 That completes my comments. Thank you.

4 JUDGE WOODRUFF: Would you remove your
5 chart, please? Thank you.

6 All right. For Public Counsel?

7 MR. MICHEEL: Hello again. This is issue
8 rate of return and capital structure, and I think I agree
9 with Mr. Herschmann, there are two issues here, the
10 capital structure and the appropriate return on equity.

11 With respect to the capital structure, we
12 presented the testimony of Mr. Allen, and Public Counsel's
13 recommending that the Commission utilize Southern Union's
14 consolidated capital structure and associated embedded
15 debt cost of preferred stock, long-term debt less the
16 embedded cost of Panhandle Eastern's long-term debt and
17 short-term debt.

18 So contrary to Mr. Herschmann's openings,
19 Public Counsel has made some adjustments to its capital
20 structure with respect to Panhandle.

21 Why are we recommending that the Commission
22 utilize the consolidated capital structure of Southern
23 Union Company? The evidence will show several reasons.
24 First, the investment community recognizes the
25 consolidated capital structure of Southern Union including

1 Panhandle Eastern's debt, and the reason we're here, the
2 court cases say, is to do what the investment community
3 looks at, what they want.

4 Secondly, equity investors can only make
5 investments in the consolidated entity, not the contrived
6 entity Witness Dunn offers up.

7 Third, Southern Union's acquisitive
8 strategy that Mr. Hack discussed in his opening is the
9 reason the equity levels in Southern Union Company's
10 capital structure are so low. In the past 10 years,
11 Southern Union Company has acquired Pennsylvania
12 Enterprises, Fall River Gas, Providence Energy, Valley
13 Resources and Panhandle Eastern Pipeline Company.

14 Ladies and gentlemen of the Commission,
15 those are management decisions. My clients weren't asked,
16 and they shouldn't have been asked. I'm not suggesting
17 that. The evidence will demonstrate that the reason
18 Southern Union Company has a 26 percent equity ratio is
19 because it took on 1.2 billion, with a B, dollars worth of
20 debt to purchase Panhandle Eastern Company.

21 And if you go back and look at Southern
22 Union's equity structure, it's been an issue, the low
23 equity has been an issue since it first came to this state
24 in 1994, and they've been hovering around between the 25
25 to the 40 percent. Why? The evidence will show it's

1 their acquisitive nature.

2 The evidence will show that Southern Union
3 and MGE are attempting to transfer the risk related to
4 these acquisitions and the increased cost from that risk
5 from shareholders to ratepayers. An increase in risk, the
6 evidence will show, or an increase in the cost associated
7 with risk that directly stems from decisions by management
8 to increase the overall company risk profile for the
9 explicit purpose of increasing the opportunity for and
10 magnitude of financial rewards for shareholders and in a
11 lot of cases the management of the company itself should
12 not be passed on to ratepayers through the regulatory
13 ratemaking process.

14 Your job is to balance that, not to accept
15 every single management decision and say, well, management
16 did this. We're stuck. We have to give them some new
17 hypothetical capital structure or adjust this or that.

18 And ironically, the Office of the Public
19 Counsel is not the only party that shares this concern.
20 So does the company. Attached to Mr. Tuck's surrebuttal
21 testimony as Schedule JT-2 is an e-mail from the company,
22 and it states this: Essentially the concern is one we
23 discussed in great detail during our meetings. Why should
24 the Commission increase the recommended rate of return to
25 reflect the greater risk associated with higher debt when

1 the company created that problem? As Mike puts it, why
2 should MGE benefit from its failure to optimize its own
3 capital structure?

4 I'm not making this stuff up. This is an
5 e-mail between company attorneys and Mr. Dunn. It's
6 attached as JT-2.

7 The Office of the Public Counsel's also
8 offered an alternative on capital structure, a
9 hypothetical capital structure that would be reasonable
10 for use in this proceeding, and it's based on the
11 methodology adopted by the Commission in the St. Joseph
12 case that Mr. Herschmann discussed, and we think that's
13 reasonable. We don't think you must do it, as
14 Mr. Herschmann suggests.

15 But in doing that and if you decide to
16 accept that, you need to go to the lower end of that
17 reasonable range of capital structure because the evidence
18 will show that's the reasonable range given the management
19 decisions that Southern Union Company has made.

20 After you've heard all of the evidence on
21 the capital structure issue and when you're determining
22 what to do with the capital structure issue, I ask each
23 and every one of you Commissioners to ask yourself two
24 questions: Why should the Commission increase the
25 recommended rate of return to reflect the greater risks

1 associated with higher debt when MGE caused that problem?

2 Second question I want you to ask yourself
3 when you're deciding on capital structure is, why should
4 MGE benefit from its failure to optimize its own capital
5 structure? My clients shouldn't have to pay for those
6 decisions.

7 Now on to the ever-interesting issue of
8 return on equity. First of all, the Office of the Public
9 Counsel has recommended a return on equity of 9.01 to
10 9.34 percent. And you've heard a lot of attacks on
11 witness Allen. I guess you probably haven't seen them yet
12 because the company didn't file those attacks until 5:30
13 on Friday, and I'm going to get my response in. But
14 you've heard discussions about how he's not qualified and
15 he hasn't had enough time.

16 And I was watching last week with the
17 passing of President Reagan. One of the debates between
18 President Reagan and former Vice President Mondale where
19 President Reagan said, you know, I'm not going to talk
20 about my opponent's young age and lack of experience. I
21 want to talk about the issues.

22 And in this proceeding, I'm not going to
23 talk about the fact that Mr. Dunn, the company's witness,
24 has been a company hack for the past 25 years and only
25 recommended high rates of return. I don't need to do

1 that. I'm going to talk about the issues and the analysis
2 and why his analysis is wrong.

3 Now, let's talk about the analysis.

4 Mr. Allen, the evidence will show, has offered up a DCF
5 analysis and a capital asset pricing analysis, something
6 Witness Dunn has not done. And that analysis, both of
7 those analyses are generally accepted in the field
8 traditionally what is done.

9 Now, I agree with another thing that
10 Mr. Herschmann said. There are some outliers here with
11 respect to the return on equity, but it's not the Staff
12 witness' testimony that's an outlier with respect to
13 return on equity. It's not Public Counsel witness'
14 testimony that's an outlier. It's Witness Dunn's
15 12 percent recommendation, and that's what the evidence is
16 going to show.

17 Even using their stilted RRA
18 recommendation, RRA is at 11 percent. He's 100 basis
19 points higher than that. Even if you accept that premise,
20 which I don't, and we've got testimony about that, he's
21 above that.

22 But both Mr. Allen and Mr. Murray are in
23 the same range. Why is that? This is what the evidence
24 is going to show, that Mr. Dunn, Witness Dunn has done
25 numerous inappropriate add-ons to his cost of capital or

1 his cost of equity recommendation that have the --
2 increase it.

3 First of all, he's done floatation costs,
4 and the evidence will show that a floatation cost
5 adjustment is necessary because of their acquisition of
6 Panhandle Eastern Pipeline. Well, that's an increased
7 cost due to the acquisition of Panhandle, something the
8 company agreed it wouldn't do in the Stipulation &
9 Agreement.

10 Secondly, he makes an inappropriate risk
11 adjustment. Again, why is MGE more risky than the other
12 companies? Because of a management decision.

13 Third, he says he makes a small company
14 risk adjustment. And I ask you to look at the testimony
15 of Ms. Barbara Meisenheimer who looked at the statistical
16 soundness of that adjustment. It just is not consistent
17 with basic statistical theory, and Mr. Dunn doesn't
18 dispute that.

19 When you wipe away all these unnecessary
20 adjustments, Witness Dunn's bare bones, as he puts it in
21 his testimony, DCF analysis is 10.9 percent. Now we're at
22 9.34 and 10.9 percent.

23 But the evidence will show when you use the
24 appropriate growth rate in his DCF analysis, not the
25 unsupported 7 percent that he uses, but a more reasonable

1 4.9 percent that is consistent with Mr. Allen's testimony
2 or the consensus analysis of the Thompson Investment
3 Institute contained in Mr. Dunn's own direct testimony,
4 that Mr. Dunn's DCF analysis is 9.5 percent, and Mr. Allen
5 explains this in his rebuttal testimony.

6 Then we have three testimonies all in that
7 same range. It's not Mr. Murray or Mr. Allen who are the
8 outliers. It's Mr. Dunn. That's what the evidence will
9 show.

10 Finally, I just need to respond just a
11 little bit. As I told you, 5:30 on Friday they filed some
12 motions to strike some of our testimony, and we will
13 answer that at the appropriate time.

14 But Mr. Herschmann characterized Mr. Allen
15 as somebody who's never done this. First of all, he's had
16 six years experience learning, six years of training
17 through his undergraduate and graduate education. He's
18 reviewed numerous testimonies. He read the book The Cost
19 of Equity Capital by Dr. Myron Gordon. And with all due
20 respect to Dr. Morin, Dr. Gordon is the father of the DCF
21 model. He's somebody that Dr. Morin looked up to, and
22 that is, in my estimation, the seminal book on cost of
23 capital for a public utility.

24 And Dr. Myron Gordon's book uses the BR
25 plus SV method to determine the G component or the growth

1 rate component for the DCF. That's what witness Allen has
2 done. But you'll get your chance to hear his
3 cross-examination and look. I think when you give a fair
4 and independent reading to his testimony, you'll find it
5 persuasive.

6 Additionally, we've offered the testimony
7 of John Tuck. He's an outside expert. He manages
8 \$23 billion worth of funds for the Public School Teacher
9 Retirement Fund, and he's provided extensive surrebuttal
10 testimony. The company has tried to paint it as
11 additional direct testimony, but the evidence will show
12 that is not true.

13 Witness Dunn claimed in his rebuttal
14 testimony that the actions taken by -- the calculations
15 and methods used Mr. Allen were mechanistic, contrived and
16 a few other loaded words. Well, how do you respond to
17 that claim that those are mechanistic, contrived without
18 looking at what Mr. Allen did in his testimony?

19 And that's what Mr. Tuck has done in his
20 surrebuttal testimony, and I urge you to talk to Mr. Tuck
21 because he's not an academic. He's not a witness on the
22 Staff or the Public Counsel or somebody like Mr. Dunn, who
23 only does this. He's out in the real world dealing with
24 real equity investors.

25 I think when all the evidence is in, you'll

1 come to the conclusion that the return on equity
2 recommendation and the capital structure recommendation
3 made by Public Counsel witness Allen is the most
4 appropriate one to use in this proceeding.

5 JUDGE WOODRUFF: Thank you. Does Midwest
6 Gas wish to make an opening on this issue?

7 MR. CONRAD: No, sir. As I indicated
8 earlier, we'll reserve for our time on the mini 'til that
9 issue is reached.

10 JUDGE WOODRUFF: Very good. Federal
11 Agencies?

12 MR. PAULSON: No, sir.

13 JUDGE WOODRUFF: City of Kansas City, I
14 believe, has already left. Still no within here from
15 Joplin. All right. Then it's time to go to our first
16 witness, which I believe is Mr. Dunn.

17 Welcome, Mr. Dunn. If you'd please raise
18 your right hand.

19 (Witness sworn.)

20 JUDGE WOODRUFF: You may be seated, and you
21 may inquire when you're ready.

22 MR. HERSCHMANN: Thank you.

23 MR. FRANSON: Your Honor, I'm sorry to
24 interrupt. Before we proceed, are we going to mark
25 Mr. Dunn's testimony? Has that been done, or where does

1 that stand?

2 JUDGE WOODRUFF: It's already been assigned
3 a number. It will be Nos. 1, 2 and 3 for his direct
4 rebuttal and surrebuttal.

5 As far as how the court reporter wants to
6 do it, is that what your question is?

7 MR. FRANSON: Yes. Actually, my question
8 is procedure. How are we going to do this on each
9 witness? Are we going to offer the testimony of each
10 witness as we go through, I mean, actual copies for the
11 court reporter? Are we going to offer it all at some
12 point? I'm not quite sure.

13 JUDGE WOODRUFF: Let's do it as we go
14 through for each witness. And I know witnesses are going
15 to be testifying at various points.

16 I would suggest we go ahead and mark or
17 offer each exhibit at that time. If there's a reason not
18 to admit it at that time, then we can wait until their
19 last testimony to actually admit it.

20 JOHN C. DUNN testified as follows:

21 DIRECT EXAMINATION BY MR. HERSCHMANN:

22 Q. Can you please -- I'm sorry. Can you
23 please state your name for the record?

24 A. It's John C. Dunn, D-u-n-n.

25 Q. Mr. Dunn, did you cause to be filed

1 prepared direct, rebuttal and surrebuttal testimony that
2 we have premarked for identification purposes as Exhibits
3 No. 1, 2 and 3?

4 A. Yes, sir, I did.

5 Q. Are there any changes that you need to make
6 to that testimony at this time?

7 A. Yes, sir, there are.

8 Q. What changes do you need to make?

9 A. With respect to the direct testimony, which
10 is marked as Exhibit 1, on page 3, line 17.

11 JUDGE WOODRUFF: What were those page
12 numbers again, please?

13 THE WITNESS: I'm sorry. It's page 27,
14 line 10, the third from the end of the line, third word
15 from the end of the line says "account." It should be
16 "count." Strike the two letters A-C.

17 BY MR. HERSCHMANN:

18 Q. Mr. Dunn --

19 A. Page 44.

20 Q. -- could you do that on the original
21 exhibits, please?

22 A. That would be these (indicating)?

23 Q. Yes.

24 A. Page 44 -- 45, I'm sorry. Line 10, it
25 currently reads JCD-5; should be JCD-7.

1 Q. And can you please make that change on the
2 original Exhibit 1?

3 A. (Witness complied.)

4 And in Appendix 1 -- or A, page 1, line 15,
5 it currently reads "20 years"; that should be changed to
6 "30 years."

7 Q. I'm sorry. Where was that again?

8 A. It was on page 1 of Appendix A, line 15,
9 currently reads "I have been an economic consultant for
10 over 20 years"; should be changed to 30 years.

11 Page 3, line 17, after the word "yes,"
12 insert the words "I have been a member of."

13 Those are all the changes that I'm aware of
14 in Exhibit No. 1. I do, however, have changes to Exhibit
15 No. 2.

16 Q. Is Exhibit No. 2 your rebuttal testimony in
17 this matter?

18 A. Yes, sir, it is.

19 Q. Can you tell us what changes you have to
20 Exhibit No. 2?

21 A. Page 5, line 8, under the column equity
22 ratio, it currently reads 49.03; it should read 49.93.
23 And on line 9, it currently reads 45.51; it should read
24 45.61. That change has been the subject of Data
25 Request 2050, and has been provided to the parties

1 previously.

2 On page 14, line 9, at the end of the

3 sentence, three dots should be inserted to indicate a

4 break in the quote.

5 Q. You mean after the word "that"?

6 A. Correct. And on line 12, brackets should

7 be put around the word "moreover."

8 COMMISSIONER DAVIS: I'm sorry. Where was

9 that moreover at?

10 MR. HERSCHMANN: I believe it was the first

11 words on line 12.

12 THE WITNESS: Line 12.

13 Page 34, line 5, last number on the line,

14 4.16 percent should be 3.31 percent. Line 9, the number

15 6.07 percent should be 4.91 percent. And line 11, the

16 number 11.09 should be 11.17 percent.

17 And that's all the changes I have to

18 Exhibit 2.

19 I do, however, have changes to Exhibit 3.

20 BY MR. HERSCHMANN:

21 Q. Can you identify those for us, please?

22 A. After the word 9.02 --

23 Q. What page are you on?

24 A. Excuse me. On page 25, line 20. After the

25 word -- or the number 9.02 percent, on line 20, should be

1 inserted "and 10.05 percent."
2 Those are all the changes that I'm aware
3 of.
4 Q. And did you make on Exhibit 1, 2 and 3 all
5 the changes that you just described?
6 A. Yes, sir, I did.
7 Q. If I were to ask you today the questions
8 posed in that testimony, with the changes that you just
9 made, would your answers be the same as are shown in
10 Exhibits 1, 2 and 3?
11 A. Yes, sir, they would.
12 Q. And are the answers true and correct to the
13 best of your information, knowledge and belief?
14 A. They are.
15 MR. HERSCHMANN: At this time I'd move for
16 admission of Exhibits 1, 2 and 3 into evidence and tender
17 the witness for cross-examination.
18 JUDGE WOODRUFF: Exhibits 1, 2 and 3 --
19 MR. MICHEEL: Your Honor, I have an
20 objection to the admission of Exhibit 1 I would like to
21 speak to before it's admitted.
22 JUDGE WOODRUFF: All right. Go ahead.
23 MR. MICHEEL: Public Counsel objects to the
24 inclusion of portions of direct testimony and opinions of
25 John C. Dunn regarding a calculated rate of return for MGE

1 because it's impermissible pursuant to Section 490.065(3).
2 Subsection 3 of 490.065 states, the facts or data in a
3 particular case upon which an expert bases his opinion or
4 inferences may be those perceived by or made known to him
5 at or before the hearing and must be the types reasonably
6 relied upon by experts in the field in forming opinions or
7 inferences upon the subject and must otherwise be
8 reasonably reliable.

9 Witness Dunn's sole reliance on the
10 discounted cash flow method to determine his return on
11 equity recommendation is not the type of information
12 reasonably relied on by experts in the field, and his sole
13 reliance on the discounted cash flow model renders his
14 opinions unreliable, and thus contrary to statute.

15 According to Dr. Roger A. Morin in his book
16 Regulatory Finance Utilities Cost of Capital, at page 238,
17 quote, when measuring equity cost, which essentially deal
18 with the measurement of investor's expectations, no single
19 methodology provides a foolproof panacea. If the cost of
20 equity estimation process is limited to one methodology,
21 such as DCF, it may severely bias the results. One major
22 problem that results from using only one methodology is
23 the lack of corroborating evidence. There is simply no
24 objective cross check on the result. All the market data
25 and financial theory available at the time should be used

1 in making an estimate.

2 Dr. Morin went on in his deposition to
3 further express his opinions. I asked him this question:
4 So if a cost of capital expert only proffers a DCF
5 analysis, in your mind, they haven't met the requirements
6 of Hope? Answer: I think they subject themselves to very
7 serious measurement error and the potential lack of
8 reliability or recommendation. In other words, the DCF
9 model on its own is fragile, just like the CAPM on its own
10 would be fragile or the risk premium method on its own
11 would be fragile. Again, you don't want to fly on one
12 instrument. You want to fly on a variety of gauges and
13 meters and signals and indicators and get an error-free
14 estimate of cost of capital.

15 Question: Does sole reliance on the DCF
16 method meet the Bluefield requirement that allowed returns
17 to be sufficient to assure a utility's financial
18 soundness? Answer: No.

19 And why not? Answer: Because it's highly
20 subject to measurement error. You've got to measure those
21 returns accurately. In strict reliance on the DCF, you
22 run the danger that you will not do that.

23 Moreover, in his surrebuttal testimony --
24 this is, again, Dr. Morin, the company witness. At
25 page 9 -- Dr. Morin states, the exclusive reliance on the

1 DCF method is, quote, an approach at odds with recognized
2 standards for cost of capital analysis, close quote. Both
3 witnesses Murray and Mr. Allen relied on more than one
4 method; for example, the cost of capital asset pricing
5 method, the CAPM method, the risk premium method, in
6 recommending their return on equity.

7 As Public Counsel utility financial analyst
8 Allen noted in his deposition at pages 50 and 51,
9 question: How did you know to do a CAPM, capital asset
10 pricing model calculation? Answer: Through my education.
11 It is well understood that any respectable analyst would
12 provide a check on his DCF, and the capital asset pricing
13 method is a good way to check it. Any analyst who doesn't
14 perform a check on their DCF analysis really lends --
15 really undermines reliability of the analysis.

16 Question: And where did you learn that?
17 In my education at school.

18 Question: Specifically. Answer:
19 That's -- what do you mean specifically? Through my
20 understanding and experience with the DCF model and those
21 courses that I referred to earlier.

22 Question: And where did you understand
23 that you needed to address the topic in your direct
24 testimony? Answer: Any time you're dealing with the DCF
25 method, you need to perform a check to do the reliabil--

1 due to reliability to determine how reliable your analysis
2 is. Any analyst who doesn't do so is really flying solo
3 and really subjects themselves to a lot of error.

4 Simply put, Witness Dunn's sole reliance on
5 the discounted cash flow method to determine an
6 appropriate return on equity is unreasonably unreliable
7 and not the type of analysis reasonably relied upon --
8 relied upon by experts in the field. This explains why
9 and how Witness Dunn arrived at his outrageously high 12
10 percent for return on equity, because he failed to
11 completely do any check, analysis or study to determine if
12 his results are correct.

13 Therefore, Public Counsel requests portions
14 of Witness Dunn's direct testimony and his return on
15 equity recommendation fail to meet subsection 3 of 490.065
16 and his opinion and testimony regarding return on equity
17 should be excluded from this proceeding, specifically his
18 direct testimony, pages 3 through 61, and the attendant
19 schedules.

20 JUDGE WOODRUFF: All right. Your motion to
21 strike is now part of the record. As I did earlier with
22 the motion to strike that was filed by the company against
23 Public Counsel's witnesses, I'm not going to make a ruling
24 on it at this point. The Commission will take it up after
25 hearing the evidence, as is consistent with Missouri

1 statute.

2 MR. HERSCHMANN: Once again, I renew my
3 offer of Exhibits 1, 2 and 3 into evidence at this time.

4 MR. FRANSON: Your Honor, on Exhibit 3, I
5 believe, is the only one that I have concern. This raises
6 an issue of how depositions -- and there were a number of
7 them done in this case -- how those come into evidence.
8 They're allowed by the rules in for any purpose, so I'm
9 not objecting to them.

10 The problem is, we haven't heard any
11 testimony from Mr. Dunn, nor have we heard any
12 representations by MGE's attorneys that the transcripts of
13 certain things in here, specifically I believe it's the
14 deposition of Roger Morin and specifically the deposition
15 of David Murray. Then there is also transcripts from a
16 hearing that is labeled as 3-11-2004. I could guess what
17 those are, but Exhibit No. 3, at this point in time, has
18 an improper foundation.

19 I would not have any problem with
20 representations from MGE's counsel that the transcripts of
21 the depositions are full and complete and accurate, but --
22 and also I'd just like to know what this hearing is and
23 that at least the part they put in, that that's fair and
24 true and accurate. And if they assert that, Judge, I
25 would have no objection.

1 JUDGE WOODRUFF: Response?

2 MR. HERSCHMANN: These are fair and

3 accurate transcriptions. There is an error that counsel

4 is aware of. I'd be more than happy to address that, but

5 as far as we understand, this is a fair and accurate

6 transcription or photocopy of the actual deposition.

7 MR. FRANSON: Judge, I'm not in any way

8 suggesting that these have been tampered with or anything.

9 It's just I was looking and expecting originals, but if

10 they're saying they're accurate, that's fine.

11 JUDGE WOODRUFF: If you're satisfied,

12 that's fine with the Commission. If you would like to

13 voir dire the witness to get more details on that, you

14 certainly can do that as well.

15 MR. FRANSON: No, I really don't think that

16 would be necessary, because I think all we've learned from

17 Mr. Dunn is these are photocopies. And since

18 Mr. Herschmann has represented he believes they are fair

19 and accurate and complete, then I have no objections on

20 that basis.

21 JUDGE WOODRUFF: All right. Exhibit 1 will

22 be received into evidence, subject to the objection that

23 was raised by Public Counsel, which will be addressed at a

24 later time. For the moment it's received into evidence.

25 Exhibits 2 and 3 will be received into evidence.

1 (EXHIBIT NOS. 1, 2 AND 3 WERE RECEIVED INTO
2 EVIDENCE.)

3 JUDGE WOODRUFF: All right.

4 MR. HERSCHMANN: Pass the witness.

5 JUDGE WOODRUFF: Thank you. Then for
6 cross, we can begin with the City of Kansas City, which is
7 not here. City of Joplin is not here.

8 Federal Agencies, do you wish to cross?

9 MR. PAULSON: No, sir.

10 JUDGE WOODRUFF: Midwest Gas?

11 MR. CONRAD: No, sir.

12 JUDGE WOODRUFF: Public Counsel?

13 MR. MICHEEL: Of course.

14 CROSS-EXAMINATION BY MR. MICHEEL:

15 Q. Mr. Dunn, do you consider Dr. Myron Gordon
16 to be an expert in the field of regulatory finance?

17 A. I believe he was, yes.

18 Q. You consider him to be an expert now?

19 A. He's an academician who, my understanding,
20 was working for FERC or FPC at that time, when he produced
21 the book that you referred to several times on the
22 discounted cash flow, and I think his academic interests
23 have broadened since then.

24 Q. Do you know if Witness Morin considers
25 Dr. Gordon to be an expert in the field of regulatory

1 finance?

2 A. I believe he does.

3 Q. Do you disagree with Dr. Morin?

4 A. No.

5 Q. Do you consider Dr. Myron Gordon's book,
6 The Cost of Equity Capital to a Public Utility, published
7 by Michigan State University in 1974, to be an
8 authoritative text?

9 A. I think it's authoritative but dated.

10 Q. Do you agree with Dr. Morin that that is an
11 authoritative text?

12 A. As I indicated, I consider it authoritative
13 but dated.

14 Q. Would you agree with me that estimating the
15 growth component of the discounted cash flow method is the
16 most difficult and controversial step in implementing the
17 DCF since it is a quantity that lies buried in the minds
18 of investors?

19 A. It is in the minds of investors. It is
20 difficult. I think all the steps of the discounted cash
21 flow are difficult. But if you want to rank them, it is
22 possibly the most difficult.

23 Q. Well, is it the most difficult or is it not
24 the most difficult?

25 A. I think it depends on the circumstances.

1 In some cases it's possible that it would be extremely
2 difficult to find a yield. In some cases it's very
3 difficult to find a target company, a comparable group.
4 In this particular case, it's probably the most difficult
5 for this particular analysis.

6 Q. Would you agree with Dr. Morin's statement
7 in his book that it is the most difficult analysis?

8 A. I would have to see the context, if you
9 could.

10 MR. MICHEEL: May I approach the witness,
11 your Honor?

12 JUDGE WOODRUFF: You may.

13 BY MR. MICHEEL:

14 Q. I'm showing him page 140 of Dr. Morin's
15 book, where it says, and I quote, estimating the growth
16 component is the most difficult and controversial step in
17 implementing DCF, since it is a quantity that lies --
18 excuse me -- that lies buried in the minds of investors.

19 Is that what Dr. Morin says there --

20 A. I see that quote.

21 Q. -- on page 140?

22 JUDGE WOODRUFF: Mr. Micheel, could you
23 have him read the title of that book?

24 MR. MICHEEL: Sure.

25 BY MR. MICHEEL:

1 Q. Could you read the title of the book into
2 the record?

3 A. The title of the book is Regulatory
4 Finance, with a subtitle Utilities Cost of Capital, and
5 it's by Roger A. Morin, published by Public Utilities
6 Reports, Incorporated, 1994.

7 Q. And that's the same Roger A. Morin, is it
8 not, that MGE has engaged in this proceeding to provide
9 testimony?

10 A. Yes.

11 Q. And that is indeed what Dr. Morin says in
12 his book?

13 A. It is.

14 Q. Do you agree with that statement, sir?

15 A. As I indicated to you, it is in most cases
16 the most difficult, but in some cases other matters are
17 more difficult.

18 Q. Would you agree with me that in his book,
19 Dr. Morin believes it's the most difficult?

20 A. I would.

21 Q. Is it correct that there are three general
22 approaches to estimating the expected growth that can be
23 used in the DCF; the historical growth rates, analyst
24 growth rates and sustainable growth rates?

25 A. I would agree with that.

1 Q. And is that consistent with what Dr. Morin
2 says in his book?

3 A. I don't know about that.

4 MR. MICHEEL: May I approach the witness
5 again?

6 JUDGE WOODRUFF: You may.

7 BY MR. MICHEEL:

8 Q. Showing you the same book on the same page,
9 could you read into the record right there, starting with,
10 there are three general approaches to estimating?

11 A. It states, three general approaches to
12 estimating expected growth can be used; historical growth
13 rate, analyst forecasts, sustainable growth rates.

14 Q. And is it correct that the sustainable
15 growth rate is -- the BR plus SV is the primary method
16 that Dr. Gordon recommends to determine growth in his
17 seminal book, The Cost of Capital to a Public Utility?

18 A. In 1974, yes, sir.

19 Q. And at page 31 of your surrebuttal
20 testimony, lines 8 and 9, you state that the BR plus SV
21 method contains a circularity so fundamental that the
22 calculation is absolutely worthless in this context as a
23 methodology to estimate the cost of common equity; is that
24 correct?

25 A. Could you refer me to -- more specifically

1 the surrebuttal testimony?

2 Q. Yes, sir.

3 A. On what page?

4 Q. Page 31 at lines 9 and 8.

5 A. Yes, I have that, and that was an accurate

6 reading of those lines.

7 Q. Is it correct that that assertion is in

8 direct conflict with Dr. Gordon?

9 A. I don't know that it's in direct conflict

10 with Dr. Gordon. I would say that it certainly is

11 different than what Dr. Gordon said in 1974 and what he

12 used in 1974. His views today may be entirely different.

13 Q. In his seminal book, did he suggest that

14 it's appropriate to use the BR plus SV growth rate --

15 A. He did.

16 Q. -- in determining the cost of capital for a

17 public utility?

18 A. He did.

19 Q. Is it correct that the use of the BR plus

20 SV or the retention growth rate has been endorsed by

21 several financial textbooks?

22 A. Frankly, I'm not aware of any major

23 textbooks that endorse it.

24 MR. MICHEEL: May I approach the witness,

25 your Honor?

1 JUDGE WOODRUFF: You may.

2 BY MR. MICHEEL:

3 Q. I'm handing you The Cost of Capital, a
4 Practitioner's Guide, by David Parcell, and I'm asking you
5 to look at page 8-31.

6 Let me ask a preparatory question. Is it
7 correct that you cite to Mr. Parcell's Cost of Capital
8 Practitioner's Guide 1997 edition on page 36 of your
9 rebuttal testimony at lines 3 through 7?

10 A. I'll accept that. I did cite to the book,
11 yes.

12 Q. And you attached a schedule from that book,
13 JCD-2, did you not?

14 A. I did.

15 Q. So you're aware of this book, are you not?

16 A. I am.

17 MR. MICHEEL: May I now approach the
18 witness, your Honor?

19 JUDGE WOODRUFF: You may.

20 BY MR. MICHEEL:

21 Q. If you could, sir, would you look at
22 page 8-29 and confirm for me there it's talking about
23 retention growth.

24 A. I confirm for you there is a subtitle on a
25 section that says retention growth rate, but the predicate

1 to your original question was, are there major textbooks
2 which, in fact, endorse the use of the retention growth
3 rate.

4 Q. And I'd like to lay that foundation.

5 A. Can I finish, sir, or do you want to go
6 ahead?

7 Q. Go ahead.

8 A. This particular book is a compendium of
9 virtually every methodology and every approach to
10 regulatory calculations. It is a part of the certified
11 financial analyst -- or the certified rate of return
12 analyst program, and it is designed to provide students
13 with the breadth of possibilities, as opposed to endorsing
14 particular things, and it is not a major textbook.

15 Q. Let me ask you this: Is the retention
16 growth rate the same thing as the BR plus SV growth rate?
17 Isn't that correct?

18 A. As we're talking about it in this case,
19 yes.

20 Q. Could you read for me the sentence -- the
21 full paragraph starting "in addition to its adoption by
22 FERC"?

23 A. In its addition to its adoption by FERC,
24 the retention growth rate has received endorsement in
25 several finance texts: Riley 1985; Cohen, Zinbarg and

1 Zinkel 1982; Sharp, 1985; Howe and Rasmussen 1982; Breeley
2 and Meyers 1984.

3 Q. Could you read the next paragraph into the
4 record?

5 A. It is sometimes maintained that the
6 retention growth rate is circular, since the expected
7 return on equity is a factor in determining the costs of
8 equity. However, the expected return helps quantify the
9 growth rate that investors expect, because the actual
10 return on equity has great influence on the obtained level
11 of future cash flows. This difference from the cost of
12 equity which reflects the return investors expect to
13 receive on their market price movement, the return
14 investors actually receive takes into consideration the
15 future cash flows consistent with the achieved return on
16 equity (R). If the market price is above book value,
17 K will be less than R , whereas if the market price is
18 below book value, K will be higher than R .

19 Q. Does Mr. Parcell's book, at least, indicate
20 numerous textbooks that approve of use of the retention
21 growth rate method?

22 A. It does, all quite old.

23 Q. Is it true that Mr. Sharp, one of the
24 authors of the textbooks that is cited, is the individual
25 who created the capital asset pricing method?

1 A. He is one of the people, yes.

2 Q. Is it correct, sir, that the Federal Energy
3 Regulatory Commission mandated the use of BR plus SV
4 growth calculations for rate cases regarding interstate
5 natural gas pipelines?

6 A. It's my recollection that the FPC used the
7 Gordon book initially and that FERC evolved through to a
8 direct use of the discounted cash flow model as it's being
9 used in this case without the retention growth rate.

10 Q. And when did the FERC decide to get rid of
11 the retention growth rate, if you know?

12 A. Frankly, I don't know.

13 Q. Was it 1992?

14 A. I don't know.

15 Q. So you don't know if the Commission did it
16 in its Order No. 538 final rule issued on January 2nd,
17 1992?

18 A. No, I don't.

19 Q. Do you know why the FERC did away with it?

20 A. No, I don't.

21 Q. But it's correct up until 1992, the FERC
22 utilized the BR plus SV growth rate; isn't that correct?

23 A. If that's what you're stating. I mean, if
24 you're stating to me that that particular order is the
25 order that eliminated the use of the retention growth rate

1 and that is the particular order that says that up until
2 that time that was the primary method, I'll certainly
3 accept what you're saying, subject to check.

4 Q. Is it correct that you provided testimony
5 before the FERC where you yourself used the BR plus SV
6 growth calculation?

7 A. I have testified before FERC, and if it was
8 mandated, I'm sure I did.

9 Q. Is it your sworn -- so you have utilized
10 the BR plus SV growth rate; is that correct?

11 A. I said that if it was mandated, I did. I
12 have provided testimony before FERC. It's not my practice
13 right now to -- and has not been for many years to use the
14 retention growth rate. If a specific jurisdiction
15 requires that a specific calculation be made, it's
16 customary, I believe, to make that calculation, or at
17 least I comply to the extent of making that calculation.

18 Q. So you would agree with Dr. Morin, then, in
19 his book where he says that the sustainable growth rate
20 method is one of the three appropriate ways to determine
21 growth; isn't that correct?

22 A. I don't believe that's what he said in his
23 book. If you could pass that to me again, I'd appreciate
24 it.

25 Q. Well, I'll get to it here, but isn't it

1 correct that you read into the record for me from page 140
2 three general approaches to estimating expected growth can
3 be used; historical growth rates, analyst forecast and
4 sustainable growth rates?

5 A. I think that's a little different than what
6 you embodied in your question, which said that it was one
7 of the acceptable ways.

8 Q. Isn't it -- now, isn't it correct that the
9 alleged circularity problem with respect to use of the BR
10 plus SV growth rate is dampened by the self-correcting
11 nature of the DCF model?

12 A. You'll have to explain that to me. I have
13 no idea what you're talking about.

14 Q. Well, is it correct that you've alleged in
15 your -- both your rebuttal and surrebuttal testimony that
16 use of BR plus SV method is circular?

17 A. I agree that it is circular.

18 MR. MICHEEL: May I approach the witness,
19 your Honor?

20 JUDGE WOODRUFF: You may.

21 BY MR. MICHEEL:

22 Q. I'm handing you a copy of Regulatory
23 Finance, again, by Dr. Roger A. Morin, on page 161, and
24 I'd ask that you read the paragraph into the record on
25 circularity, starting right there.

1 A. The circularity problem is somewhat
2 dampened by the self-correcting nature of the DCF model.
3 If a high return on equity is granted, the stock price
4 will increase in response to the unanticipated favorable
5 return allowance, lowering the dividend yield component of
6 the market return in compensation for the high G induced
7 by the high allowed return. At the next regulatory
8 hearing, more conservative forecasts of R would prevail.
9 The impact of the dual components of the DCF formula yield
10 and growth are at least partially offsetting.

11 Q. Could I get you to read into the record
12 from page 161 of Dr. Morin's book, the first sentence of
13 the first full paragraph on page 162?

14 A. In summary, of the three proxies for the
15 expected growth component of the DCF model, historical
16 growth rates, analyst forecasts and the sustainable growth
17 method, the latter is the least desirable. Criteria
18 choosing --

19 Q. That's all you need to read. Thank you.

20 So does Dr. Morin in his book indicate that
21 it's appropriate -- he believes it's the least desirable,
22 but he believes it's appropriate to use the sustainable
23 growth model, doesn't he?

24 A. The word "appropriate" is what I'm
25 stumbling over here. I think that Dr. Morin has said,

1 here are three ways you can do it, and then he says, there
2 are some problems here and there, and he specifically
3 points to some problems with respect to the sustainable
4 method and says you can use it. Now, I don't know that
5 he's endorsing it in any way or recommending it in any
6 way.

7 Q. Is it correct that there are no academic
8 studies that indicate the alleged circularity of the use
9 of the sustainable growth rate method?

10 A. I'm not sure that it would warrant a
11 specific study. It is so obvious on its face that it
12 doesn't appear to me to be needing a study.

13 Q. Do you know if I asked that question to
14 Dr. Morin in his deposition?

15 A. No, I don't.

16 MR. MICHEEL: May I approach the witness,
17 your Honor?

18 JUDGE WOODRUFF: You may.

19 BY MR. MICHEEL:

20 Q. You have his deposition, do you not,
21 attached to your surrebuttal testimony?

22 A. I do.

23 Q. Could you go to that, and turn to page 91
24 of his deposition, sir. Let me know when you're there.
25 It's JCD-3 is your schedule, if you're lost in your myriad

1 of schedules.

2 A. I have that.

3 Q. Could you read into the record for me lines
4 21 through 25 on page 91?

5 A. My question to you is, are there any
6 academic studies that indicate the alleged circularity of
7 use of the sustainable growth method? Answer: I haven't
8 seen that, except in my own publications.

9 Q. And isn't it correct that Dr. Morin, in his
10 book, has a mere three paragraphs on the issue, and one of
11 them debunks his claim?

12 A. Frankly, I don't remember one debunking
13 his claim. If you're referring to his statement that
14 there is some offset for the errors created by the
15 problem, I don't -- I would not consider that to be
16 debunking the claim.

17 Q. There's only three paragraphs in his book;
18 is that correct?

19 A. I have not counted the paragraphs.

20 Q. Would you agree with me that there are many
21 dimensions and factors that determine a utility's
22 financial integrity?

23 A. There are.

24 Q. Is it correct that an equity investor
25 cannot make an investment in Southern Union Company less

1 Panhandle Eastern?

2 A. That's correct.

3 Q. Is it correct an equity investor must make
4 an investment in Panhandle Eastern if they invest in
5 Southern Union Company?

6 A. That's correct.

7 Q. Is it correct that Southern Union's
8 consolidated capital -- it is Southern Union's
9 consolidated capital structure that the equity investor
10 looks at when analyzing Southern Union Company?

11 A. I would suggest that it depends on the
12 sophistication of the investor.

13 Q. Is it correct that the investment community
14 recognizes the consolidated capital structure of Southern
15 Union Company, including Panhandle debt?

16 A. Again, it depends on the sophistication of
17 the investor, and a recent survey suggests that in
18 analyzing companies such as Southern Union, most analysts
19 review independently independent divisions and
20 subsidiaries of the company and then add them back
21 together. That appears to be the methodology employed by
22 Standard & Poor's and Moody's.

23 Q. Have you reviewed Mr. -- witness Tuck's
24 testimony in this case?

25 A. I have.

1 Q. Do you have a copy of it there with you?

2 A. I don't know. Yes, I do.

3 Q. Could you turn to page 66 of that

4 testimony?

5 MR. HERSCHMANN: Judge Woodruff, just for

6 the record, I would object to use of Mr. Tuck's testimony

7 in light of the motion we have pending. I understand the

8 Commission's going to reserve the ruling on that. For the

9 record, I would object to it.

10 JUDGE WOODRUFF: It's noted for the record,

11 but it is overruled at this time.

12 MR. FRANSON: Your Honor, perhaps I can

13 offer something in that regard. Can we just have an

14 agreement here among all the parties that certain things,

15 that being Mr. Tuck's testimony, all of it, Mr. Allen's

16 testimony, Mr. Murray's testimony, are going to be

17 referred to at different times, and that we just assume

18 any party objects that deems appropriate, so we don't have

19 that coming up throughout the proceeding and everyone has

20 a continuing objection?

21 JUDGE WOODRUFF: I don't think that will be

22 appropriate. It's really not a problem for the parties to

23 make specific objections at the time they come up, and

24 I'll deal with them summarily.

25 BY MR. MICHEEL:

1 Q. Does Mr. Tuck indicate on lines 5 through
2 10 there that A.G. Edwards states, unlike other gas
3 utilities that maintain an equity level nearly equal to
4 debt, SUG or Southern Union Company has a highly leveraged
5 balance sheet. Following its recent acquisition as of
6 December 31st, 2003, common equity represented only
7 26 percent of total capitalization?

8 A. I believe that's an accurate reading of
9 what's in Mr. Tuck's testimony.

10 Q. And is A.G. Edwards, is that a respected,
11 reputable investment house?

12 A. A.G. Edwards is a regional investment
13 house.

14 Q. So you don't think they're a nationwide
15 investment house?

16 A. They are not an investment house that would
17 be ranked on the order of a Goldman Sachs or companies of
18 that nature.

19 MR. MICHEEL: If I could just have a
20 moment?

21 JUDGE WOODRUFF: That's fine.

22 MR. MICHEEL: Thanks, Mr. Dunn, for your
23 time.

24 JUDGE WOODRUFF: Thank you. Move on then
25 to cross from Staff.

1 MR. FRANSON: Your Honor, Staff's
2 cross-examination will be done by Mr. Berlin, but if I
3 could have just a moment, we would like to at this time
4 offer the deposition of Mr. Dunn into evidence.

5 JUDGE WOODRUFF: Never a good sign when
6 attorneys come forward with boxes.

7 MR. FRANSON: I have to ask your
8 indulgence, also. What number are we up to?

9 JUDGE WOODRUFF: This will be 844.

10 MR. FRANSON: 844. Thank you. I'll hand
11 one to the court reporter and --

12 (EXHIBIT NO. 844 WAS MARKED FOR
13 IDENTIFICATION BY THE REPORTER.)

14 MR. FRANSON: Your Honor, if I may, this
15 has been presented to all of the parties. This is an
16 accurate copy of Mr. Dunn's deposition, and the original
17 signature page of Mr. Dunn, with his errata sheet, is
18 attached to the one that the court reporter has.

19 At this time, I'll offer it into evidence.

20 JUDGE WOODRUFF: Do you have copies for the
21 Bench?

22 MR. FRANSON: Your Honor, I apologize. I
23 may not have enough for that. I can provide those.

24 MR. CONRAD: I will offer up a copy.

25 MR. FRANSON: That'll work. Yes, Judge,

1 due to good circumstances I do.

2 JUDGE WOODRUFF: Okay. We will need copies
3 for all the Commissioners as well.

4 MR. FRANSON: I understand.

5 MR. CONRAD: Judge Woodruff, just a
6 question, certainly not an objection, but do you know if
7 that -- or if counsel could indicate whether that in any
8 way, shape or form is available electronically.

9 MR. FRANSON: Actually, if it's not, it
10 soon will be.

11 MR. CONRAD: I'd be happy to have it in
12 that form, if it would be of help to counsel.

13 MR. FRANSON: It would be of great
14 assistance. Thank you. Your Honor, how many am I short?

15 JUDGE WOODRUFF: Two.

16 MR. FRANSON: And, your Honor, I will ask
17 that the witness be allowed to use the copy given to the
18 court reporter for purposes of testimony, because, quite
19 frankly, I'm short. I didn't count right, but I know how
20 many I need now, your Honor. Thank you.

21 JUDGE WOODRUFF: Okay. I believe you've
22 offered this Exhibit 844 into evidence at this time.

23 MR. FRANSON: I have, your Honor, and I
24 would renew that request.

25 JUDGE WOODRUFF: Is there any objections to

1 its being received into evidence?

2 MR. HERSCHMANN: No objection.

3 MR. CONRAD: No objection.

4 MR. PAULSON: No objection.

5 JUDGE WOODRUFF: It will be received into

6 evidence.

7 (EXHIBIT NO. 844 WAS RECEIVED INTO

8 EVIDENCE.)

9 JUDGE WOODRUFF: Mr. Berlin, you may

10 proceed.

11 MR. BERLIN: Thank you, your Honor.

12 CROSS-EXAMINATION BY MR. BERLIN:

13 Q. Good morning, Mr. Dunn.

14 A. Mr. Berlin, how are you this morning?

15 Q. I'm doing great.

16 Mr. Dunn, do you have a copy of your

17 surrebuttal testimony before you?

18 A. Yes, sir, I do.

19 Q. Would you please refer to Schedule 2 of

20 your surrebuttal testimony, that's JCD-2?

21 A. Yes, sir, I have that.

22 Q. Could you please identify that document?

23 A. It's a Moody's Investor Service analysis of

24 Southern Union Company dated February 2004.

25 Q. Would you be so kind as to read the first

1 sentence under the header Rating Rationale, then the
2 sentence begins with the words "Southern Union"?
3 A. You want the entire paragraph or --
4 Q. No. Just the first sentence, please.
5 A. Southern Union Company's (SUG, B AA-3
6 rating) (senior uninsured, senior negative outlook)
7 reflects its low business risk with little diversification
8 outside its regulated gas distribution and transmission
9 businesses (52 percent and 48 percent of assets
10 respectively) as of December 31st, 2003.
11 Q. On what operations does Moody's base its
12 credit assessment of Southern Union?
13 A. The Southern Union rating is based on the
14 entire Southern Union consolidated operation. The
15 Panhandle rating is based on Panhandle's operation.
16 Q. Is the transmission business Panhandle
17 pipeline operations?
18 A. It is.
19 Q. So you would agree that Moody's bases its
20 credit assessment of Southern Union on all of the company
21 operations?
22 A. It does.
23 Q. Does Southern Union have its own bond
24 rating?
25 A. It does.

1 Q. What operations are covered by this bond
2 rating?

3 A. The entire consolidated operation of the
4 company.

5 Q. Please refer to page 3 of Schedule 2 of
6 your surrebuttal testimony.

7 A. Yes, sir, I have that.

8 Q. Under the header of continued expansion --
9 do you see it, the header?

10 A. Yes, sir, I do.

11 Q. Would you please read the last two
12 sentences, and I believe the last two sentences begin with
13 the word "Trunkline"?

14 A. Trunkline LNG currently has approximately
15 260 million of project finance debt outstanding at
16 December 31st, 2003. Although this debt is structured
17 without legal recourse to SUG or Panhandle, in Moody's
18 analysis the project finance debt is added to leverage
19 calculation for credit rating purposes.

20 Q. Does Moody's consider the Trunkline debt in
21 calculating Southern Union's leverage ratios?

22 A. I would presume, based on that statement,
23 that it does.

24 Q. And they would do that even though the
25 Trunkline debt is nonrecourse to Panhandle and nonrecourse

1 to Southern Union?

2 A. That's correct.

3 Q. What is a leverage ratio?

4 A. It is the same ratio that we speak of here

5 in terms of the long-term debt ratio, except that they

6 have made substantial adjustments into the capital

7 structure for a variety of liabilities which are generally

8 not considered in the regulatory process.

9 Q. With regard to the topic of leverage ratio,

10 why would a leverage ratio of a company be important?

11 A. As the amount of leverage increases, the

12 financial risk of the company increases. Companies also

13 have operating risk, and operating risk and financial risk

14 tend to compound each other. As the sum of the two or the

15 product of the two reaches a certain point, the company

16 becomes very unstable and earnings become very erratic,

17 and that's considered to be a very high risk situation.

18 In this particular case, the ratios are at a point where

19 that is not a problem, as of this point.

20 Q. Well, that's your opinion, right?

21 A. Well, they have chosen not to downgrade the

22 companies.

23 Q. Is Trunkline a subsidiary of Panhandle?

24 A. Trunkline is part of Panhandle, yes. I'm

25 not sure if it's a subsidiary.

1 Q. Well, if the debt is nonrecourse to
2 Panhandle, that is, Trunkline's debt is nonrecourse to
3 Panhandle and nonrecourse to Southern Union, then is the
4 debt recourse to Trunkline, Panhandle's subsidiary
5 operation?

6 A. Not necessarily. This is a project
7 financing, and in many cases a project financing is done
8 on the order of a first mortgage bond or first mortgage
9 position against a facility. I suspect what's happened
10 here is Trunkline has said that we want to build this
11 particular project. They've clearly defined it,
12 delineated it and valued it, and then they have found
13 someone to finance the project without recourse to any of
14 the entities involved, because whoever financed the
15 project believes the project has adequate merit to cause
16 it to be worth the amount of debt and then some.

17 Q. Would a Trunkline creditor have a right of
18 claim against Trunkline's assets?

19 A. Typically on a project financing, the
20 creditor would only have a claim against the project
21 itself. The project in this case could be a few hundred
22 feet or a few miles of pipeline, and that would be what
23 the creditor had a claim against, nothing more.

24 And that's typically why it's called
25 project financing. You borrow to do a project, and the

1 project stands on its own. If, in fact, the project
2 fails, the creditor gets the project, and obviously, since
3 the creditor chose to finance it in that way, the creditor
4 must like the project.

5 Q. So a creditor would have a right of claim
6 against the assets; in this case assets, perhaps, of the
7 project?

8 A. Right. I think you're -- what I hear you
9 saying is assets. It's the project that the claim is
10 against, and it's the assets within the project, but it's
11 not the general assets of the corporation.

12 Q. If we go up a level from Trunkline to
13 Panhandle, would Panhandle's creditors have a right of
14 claim against Panhandle's assets?

15 A. It depends on the terms and conditions of
16 the individual lendings, but typically, yes.

17 Q. And that would be true even if Panhandle's
18 debt is nonrecourse to Southern Union?

19 A. That's correct.

20 Q. Is Southern Union a holding company?

21 A. I don't believe so.

22 Q. Is it a subsidiary of an operating company?

23 A. Are you referring to Southern Union SUG,
24 the company which owns Panhandle and the natural gas
25 distribution companies, or are you referring to Southern

1 Union as the gas distribution companies only?

2 Q. No, the Southern Union of the first.

3 A. The consolidated entity?

4 Q. Correct.

5 A. And I'm sorry, but could you repeat your

6 question?

7 Q. It is not a subsidiary of an operating

8 company, correct?

9 A. It is not.

10 Q. Does Southern Union have a common equity

11 balance?

12 A. It does.

13 Q. Do you know what it is?

14 A. It has a consolidated equity ratio in the

15 upper 20 percent range, and it has a specific equity ratio

16 which is frequently referred to as a company-only equity

17 ratio in the low 40 percent range.

18 Q. I'm looking for a balance. Do you have a

19 balance figure?

20 A. Oh, the dollars?

21 Q. Yes.

22 A. I don't have those immediately available to

23 me. I can -- if you give me a moment, I might be able to

24 find them. And I can tell you now the only balance that

25 I'm looking for is the Southern Union gas distribution

1 company equity exclusive of Panhandle.

2 Q. No, that's not what I'm looking for.

3 A. You want the consolidated average?

4 Q. Yes.

5 A. That would be in --

6 JUDGE WOODRUFF: Mr. Dunn, before you

7 answer the question, could you move the microphone closer

8 to your voice, either move forward or move the microphone

9 closer to you?

10 Thank you.

11 THE WITNESS: The only thing I can do with

12 the information I have available right now is provide you

13 with data from schedules which are varying -- varying

14 dates from other testimonies. For example, I can supply

15 you with the information December 31st for the equity

16 balance, from the rebuttal testimony of Mr. Murray.

17 BY MR. BERLIN:

18 Q. Go ahead.

19 A. \$946,502,000.

20 Q. Thank you. Referring -- in going back to

21 your surrebuttal testimony, to page 3, line 22 through

22 page 4, line 2 --

23 A. I'm sorry, sir. Please say that again.

24 Q. Go to page 3, line 22, through page 4,

25 line 2. Are you there?

1 A. Yes, I have that.

2 Q. You indicate that all of the debt shown on
3 Mr. Murray's Schedule 10 was issued well before Southern
4 Union acquired Panhandle. Did Southern Union refinance
5 any debt at Panhandle since it was acquired by Southern
6 Union?

7 A. It did.

8 Q. Did Southern Union issue any new debt to
9 refinance this debt?

10 A. It did.

11 Q. Does this mean that some Panhandle debt was
12 issued after Panhandle was acquired by Southern Union?

13 A. It wasn't -- issued may not be the right
14 word. It was refinanced. Panhandle or Southern Union
15 tendered for the outstanding debt of Panhandle, which was
16 tenderable, and a certain amount of the owners of that
17 debt did tender for new debt.

18 Q. Have you seen any references to Southern
19 Union's stand-alone capital structure in any credit rating
20 agency reports that you have reviewed?

21 A. I have not.

22 Q. Looking at page 7, line 5 through 8 of your
23 surrebuttal --

24 A. Yes, sir, I have that.

25 Q. -- you indicate that Southern Union and

1 Panhandle have separate credit ratings. What Southern
2 Union operations does Moody's consider when assigning a
3 credit rating to Southern Union?

4 A. When assigning a credit rating to Southern
5 Union, they evaluate the entire company.

6 Q. Under that heading capital structure on
7 page 5, and going to your surrebuttal schedule JCD-2 --

8 A. Excuse me, sir. Can you start again?

9 Q. Sure.

10 JUDGE WOODRUFF: Before you go on to ask
11 the question again, it's time for a lunch break. This
12 seems like as good a time to break as any. We'll take a
13 break and come back at one o'clock.

14 Thank you.

15 (A BREAK WAS TAKEN.)

16 O JUDGE WOODRUFF: Mr. Dunn is on the stand
17 and Staff was cross-examining. Before you get started, I
18 do want to mention one thing. Before the break, we
19 admitted in a large deposition, and I'm not going to
20 revisit that question, but I know there have been a lot of
21 depositions taken in this case and there's been a tendency
22 to put the entire deposition into the record, either as
23 Staff just offered this directly or as an attachment to
24 other parties' testimony.

25 There isn't anything technically wrong with

1 that, but I would ask that the parties consider possibly
2 limiting the actual parts of the deposition that are being
3 placed into the record to those that are actually relevant
4 and those that you're going to be actually discussing for
5 the convenience of the Commissioners.

6 If this entire three inches of Mr. Dunn's
7 deposition comes in, the Commissioners have to read it
8 all, and it would be easier on them if we can limit that,
9 just for future consideration when you're making decisions
10 about what depositions to put in.

11 All right. You can proceed when you're
12 ready, Mr. Berlin.

13 MR. BERLIN: Thank you.

14 BY MR. BERLIN:

15 Q. Mr. Dunn, picking up from before the break,
16 I would direct you to page 5 of your surrebuttal
17 Schedule JCD-2.

18 A. Page 5, I have that.

19 Q. And do you see the header capital
20 structure?

21 A. Yes, sir, I do.

22 Q. If you would, would you please read the
23 first two sentences?

24 A. Of the answer beginning on line 14?

25 Q. Page 5 of surrebuttal, Schedule JCD-2, the

1 header is capital structure.

2 A. Yes, sir, I have that. You want the
3 question read, or the first two sentences of the answer?

4 Q. First two sentences. I believe what you're
5 looking at, so we're all on the same sheet here, is part
6 of Moody's analysis.

7 MR. HACK: Schedule JCD-2?

8 MR. BERLIN: Yes.

9 THE WITNESS: Oh, Schedule 2. I'm sorry.
10 I have that.

11 BY MR. BERLIN:

12 Q. Okay. If you would please just read the
13 first two sentences.

14 A. Leverage remains high at the consolidated
15 level with adjusted debt to capital at 77 percent and
16 unadjusted debt to capital at 70 percent. Although some
17 of this 2.7 billion adjusted debt burden can be attributed
18 to the Panhandle acquisition, SUG was highly leveraged
19 before it acquired Panhandle from previous LDC
20 acquisitions and incurred large amounts of goodwill
21 through various transactions.

22 Q. Does the evaluation of Southern Union's
23 capital structure include analysis of all the capital,
24 including Panhandle, that is in Southern Union's
25 applications?

1 A. For bond rating purposes, that's correct.

2 Q. Do you see any capital structure under that

3 heading that is even remotely similar to the capital

4 structure that you are proposing in this case?

5 JUDGE WOODRUFF: Mr. Dunn, before you

6 answer, you need to move the microphone over in front of

7 you again. Thank you.

8 THE WITNESS: As I indicated earlier,

9 Moody's puts a number of things into the capital structure

10 when they're evaluating bond ratings. For example, in the

11 third paragraph, it states that Moody's definition of

12 adjusted debt includes underfunded pension liabilities.

13 This capital structure is not comparable

14 to my capital structure is the point, and there are no

15 numbers here which are similar to the numbers in my

16 analysis, simply because of the lack of comparability.

17 They're trying to do something entirely different than

18 what I did.

19 BY MR. BERLIN:

20 Q. Please refer to Schedule JCD-1 of

21 surrebuttal.

22 A. I have that, sir.

23 Q. And could you please identify that

24 document?

25 A. This is a Standard & Poor's research report

1 on Southern Union Company with a date of 6 April 2004.

2 Q. And it's on Southern Union Company,
3 correct?

4 A. Yes, sir.

5 Q. Looking at that document, what business
6 profile rating is shown?

7 A. A-4.

8 Q. What was Southern Union's rating before it
9 acquired Panhandle?

10 A. I believe it was 5, but I'm not sure.

11 Q. Do you believe it might be 3?

12 A. It could have been 3. It moved by one;
13 that's right.

14 Q. And you would agree that the business
15 profile ranking moved from a three to a four as a result
16 of Panhandle acquisition?

17 A. I would say that's a reasonable assumption.

18 Q. If you go to page 3 of your surrebuttal,
19 Schedule JCD-1, do you see the header rating methodology?

20 A. Yes, I do.

21 Q. If you would, if you could read the first
22 sentence, please.

23 A. The corporate credit rating is based on the
24 consolidated business and financial profile of Southern
25 Union and its subsidiaries.

1 Q. Would you agree, then, that Southern
2 Union's credit rating is based on all of Southern Union's
3 operations?
4 A. I would.
5 Q. On page 8, line 9 through 14 of your
6 surrebuttal --
7 A. Are we in the testimony now?
8 Q. Yes. And I'm referring to, again, page 8,
9 line 9 through 14, you indicate that funds from the
10 October preferred issuance proceeds were not used to fund
11 the acquisition of Panhandle because this would constitute
12 a violation of the Stipulation & Agreement that was
13 previously approved by the Commission.
14 Can you show that none of the October
15 preferred issuance was used to pay off working capital
16 which was used in part to pay for the Panhandle purchase?
17 A. I have been advised by the company that the
18 bulk of the proceeds of the preferred issue were used to
19 refinance the TOPrs, and the balance was used to retire
20 short-term debt which was outstanding prior to the
21 Panhandle acquisition.
22 Q. Who owns the \$48.9 million of equity that
23 is related to the Panhandle purchase?
24 A. I don't know the current owner.
25 Q. Would it be CMS?

1 A. It could be, or they may have disposed of
2 it. I have no idea. It was originally a part of the
3 transaction involving CMS, and they would have been the
4 initial recipient.

5 Q. Can MGE make a PGA filing with this
6 Commission?

7 A. I don't believe so. I don't know.

8 Q. You don't believe that MGE is able to make
9 a PGA filing with the Commission?

10 A. I don't know if they have a PGA in their
11 tariff. If they do, they can; if they don't, they can't.

12 Q. Well, assuming that they can make a PGA
13 filing, would you agree that making a PGA filing would
14 help reduce the risk to MGE for the exposure to changes in
15 the rate -- I'm sorry -- to changes in the price of
16 natural gas that MGE purchases for its customers?

17 A. I assume that would be the intention, yes.

18 Q. Mr. Dunn, in your preparation of this
19 testimony, did you select a proxy group of companies?

20 A. I did.

21 Q. And what selection criteria did you use?

22 A. As I explained in my direct testimony, my
23 intention was to use all of the companies in the ValueLine
24 investment survey to make the analysis as broad as
25 possible. There are 18 such companies, and I excluded

1 3 companies.

2 Q. And from what source did you get your
3 information?

4 A. The ValueLine Investment Service.

5 Q. And when you made your selection of proxy
6 companies, what consideration, if any, did you give to the
7 amount of revenue that comparable companies derive from
8 natural gas distribution business?

9 A. As I indicated, my intention was to use all
10 of the companies in the ValueLine natural gas distribution
11 group, and I selected all of the companies, and then
12 eliminated three of them for various reasons.

13 Q. Mr. Dunn, have you in your testimony
14 provided any supporting documentation as to whether MGE
15 has received or will receive any of the proceeds from the
16 common stock issuances made by Southern Union?

17 A. In the future or in the past?

18 Q. In the past first, and then in the future.

19 A. In the past, MGE obviously has been the
20 beneficiary of previous or prior issuances, except for the
21 issuance which involved the acquisition of Panhandle
22 Eastern, the 3 million shares you previously discussed in
23 connection with the transaction. But to the extent that
24 there have been previous common share offerings, MGE has
25 been the beneficiary.

1 Q. With regard to those past issuances, where
2 is that in your testimony?

3 A. It isn't in my testimony.

4 Q. And what evidence do you have that these
5 funds that we've just discussed are targeted for direct
6 investment in MGE?

7 A. MGE has facilities, they have plant in
8 service, they have had continuing additions over the years
9 in the millions of dollars. Those additions have been
10 financed generally with a mix of debt and equity.

11 Q. If I go to page 18 of your surrebuttal
12 testimony, line 10 and 11, you indicate that additional
13 equity capital will be available to MGE, but do you have
14 any proof that it will be used for investment in MGE
15 infrastructure or facilities?

16 A. There will be funds available as a
17 consequence of the sale of the common stock. What we're
18 referring to here is the -- there is a strong
19 anticipation; in fact, it's beyond an anticipation. The
20 company has filed with other Commissions for approve to
21 sell new common stock.

22 And this particular section of the
23 testimony is discussing the fact that MGE will directly
24 benefit from that transaction and three ways are
25 identified, three benefits are identified, the first of

1 which is the fact that funds will flow to MGE which would
2 not have been available had not the common stock offering
3 been made. That's one way the company benefits.

4 Secondly, MGE will benefit in that the bond
5 rating of the company, Southern Union, will be maintained.

6 Q. Well, so it is fair to say that you would
7 agree that the issuance of equity will help Southern Union
8 maintain its investment grade bond rating?

9 A. Yes.

10 Q. And would you agree that the acquisition of
11 Panhandle made Southern Union's capital structure even
12 more highly leveraged?

13 A. It increased the leverage, yes.

14 Q. What agents -- or when agencies like S&P
15 and Moody's review the capital structure of Southern Union
16 and how it impacts Southern Union's credit rating, do
17 Standard & Poor's and Moody's consider all of the debt of
18 Southern Union?

19 A. I'm sorry, sir. You lost me. If the
20 question is simply do they consider all the debt in an
21 acquisition, the answer is yes.

22 Q. And when they review capital structure of
23 Southern Union and that capital structure's impact upon
24 Southern Union's credit rating, then you'd agree that they
25 would consider all of the debt of Southern Union?

1 A. Could you rephrase that for me, please?

2 Q. Sure. When the agencies like Standard &
3 Poor's and Moody's review capital structure of Southern
4 Union and how that capital structure impacts Southern
5 Union's credit rating, those agencies, Moody's and
6 Standard & Poor's, would indeed consider all of the debt
7 of Southern Union; is that fair to say?

8 A. Yes, it's fair to say.

9 Q. And that would mean that Standard & Poor's
10 and Moody's would also consider Southern Union with the
11 Panhandle debt, correct?

12 A. Yes.

13 Q. Does Southern Union have a plan to issue
14 \$150 million in common equity?

15 A. I don't know if the amount has been
16 established, but they have a plan to issue between 100 and
17 150 million. Excuse me. When you say plan, it is their
18 current anticipation to enter into a public transaction
19 selling 100 to 150 million common equity.

20 Q. And will the proceeds of this approximate
21 \$150 million issuance of common equity be used to pay down
22 Southern Union's debt?

23 A. Either to pay down Southern Union's debt or
24 to make plant additions and fund requirements of the
25 various activities of the company. The company is not

1 static. We can't cut the company off and say, here's the
2 company size as of December 31st, 1995 or 2005. It grows
3 every year, and it needs new debt and new equity each and
4 every year.

5 Q. Okay. Now, based on the credit rating
6 agency comments about leverage capital structure of
7 Southern Union, which includes all of Southern Union's
8 debt including Panhandle and debt that is paid down,
9 whether on Panhandle or Southern Union, whether that debt
10 is paid on Panhandle or Southern Union, such a pay-down of
11 debt would be equally beneficial to Southern Union's
12 credit rating, would it not?

13 A. Probably would, yes.

14 Q. Mr. Dunn, what are floatation costs?

15 A. Can we back up a second? If your question
16 is meant to imply that some of the proceeds from the
17 equity offering would be used to pay down Panhandle
18 long-term debt, I don't think that's possible. I think
19 Southern Union is committed to abiding by or complying
20 with the order of this Commission in connection with not
21 transferring funds from Southern Union to Panhandle. And
22 as a result, it's my understanding that none of those
23 funds will find their way to Panhandle Eastern, period.

24 Q. So are you changing your answer?

25 A. I'm not really changing my answer. I'm

1 just trying to qualify or clarify the answer, so that
2 there won't be any misunderstanding that some of the
3 proceeds of an equity offering by Southern Union would be
4 used to pay down Panhandle debt, which I thought might
5 have been implied by your question. It will not. It will
6 be used -- if it were used to pay down debt, it would be
7 used to pay down Southern Union debt only. I suspect it
8 will be used for general corporate purposes, including
9 plant additions.

10 Q. Okay. Just so I understand, you would
11 agree that the proceeds in the \$150 million issuance of
12 common equity that is planned by Southern Union will be
13 used to pay down Southern Union's debt?

14 A. Can be used. I said it may be used for
15 that, but it's most likely going to be used for plant
16 additions. There may be some debt reduction in the
17 process. Depending on the nature of their facilities,
18 they may pay down debt with it immediately, if they have
19 no short-term debt outstanding at the moment, and then add
20 to their short-term debt balance and then refinance that
21 subsequently. It's a constantly changing, evolving
22 situation.

23 Q. If I heard you right, you said that the
24 proceeds from that equity issuance that is anticipated
25 will be used to buy or purchase new facilities; is that

1 what you're saying?

2 A. That's correct.

3 Q. What are those facilities for?

4 A. I don't know what the capital budget is in

5 the state of Missouri right now, but I would suspect that

6 it's substantial. Over the years, I don't know how many

7 millions of dollars over the past 10 years have been spent

8 on Missouri property, but it's in the tens of millions of

9 dollars. Those kind of facilities is what I'm talking

10 about. They have the same requirement for new facilities

11 in their other gas distribution operations.

12 Q. So where in your testimony does it say that

13 an equity issuance from Southern Union will be used on MGE

14 facilities?

15 A. It says in my testimony that MGE will

16 benefit from such an equity offering, and I think it goes

17 on to say that there will be additional equity available

18 to MGE to add to the facilities which are used and useful

19 in supplying natural gas service to its Missouri

20 customers. That's on page 18, line 10 through 12.

21 JUDGE WOODRUFF: Which testimony was that?

22 THE WITNESS: This is in the surrebuttal.

23 JUDGE WOODRUFF: Thank you.

24 BY MR. BERLIN:

25 Q. Well, Mr. Dunn, I'm looking at your

1 surrebuttal testimony here, and I'm looking at your
2 Schedule JCD-5. Are you there?

3 A. No, sir. Yes, sir, I have that.

4 Q. Okay. And would you agree that the header
5 on this schedule is the Commonwealth of Massachusetts
6 Department of Telecommunications and Energy dated
7 May 28th of 2004?

8 A. Yes, sir.

9 Q. And if you go about four pages back, which
10 would indicate page 3 on that particular schedule, where
11 it says up in the upper left DTE 04-36. Do you see that?

12 A. I see that.

13 Q. I'm going to read just the first sentence
14 there, and you tell me if you agree with this. The
15 company states that the proceeds from the stock issuance
16 will be used to repay long-term debt in order to maintain
17 and enhance the company's financial position.

18 A. I see that.

19 Q. You agree with that?

20 A. I suspect that if it says the company
21 stated that, that it's true, but that is in no way
22 different than what I just got through saying to you. If
23 you remember the discussion about the refinancing of the
24 TOPrs, when they were refinanced, the TOPrs could not be
25 paid off that day, and the money was used to retire

1 short-term debt, and then when the TOPrs could be paid
2 off, the funds were taken out of short-term debt and put
3 back into repayment of the TOPrs.

4 It's simply a matter of capital fund
5 management, which is what's going on here. The company is
6 growing, and so long as it continues to grow, it will have
7 a requirement for new debt and equity. This is not their
8 last offering, and this is not going to be something that
9 will actually shrink the company for more than a very
10 short period of time.

11 Q. So what you're making the argument for,
12 then, is that this equity issuance is going to go into
13 infrastructure capital funding for MGE?

14 A. Eventually, some of it.

15 Q. But you have no documentation in your
16 testimony supporting that, other than a general statement;
17 is that correct?

18 A. I have no documentation, but I'm certain
19 that somewhere in this proceeding there's documentation
20 that there is a capital budget amounting to significant
21 amounts of money for MGE for the next two years.

22 Q. Mr. Dunn, if credit rating agencies conduct
23 an evaluation of a company, do they evaluate both business
24 risk and financial risk when they assign a credit rating
25 to a company?

1 A. They do.

2 Q. And what is your definition of financial
3 risk?

4 A. Financial risk is the risk which is caused
5 by the addition of debt to the capital structure.

6 Q. Mr. Dunn, are you aware of the trend in
7 interest rates and what that trend has been since '98?

8 A. Well, for a period of time it was down. I
9 have that with me.

10 Q. Is --

11 A. In 1998, 5-year government bonds -- federal
12 fund rates went way down. 10-year Treasury rates went
13 from 6 to the current rate of about 5 1/2. And the
14 3-month Treasury bill went from about 5 to about 1 to
15 1.10. Now, over the past year, the 5-year Treasury rate
16 has done from 2.29 to 3.84. So there's been a significant
17 increase in the last 12 months. It generally went down to
18 flat on longer term over the past 4 years, 5 years, and
19 now it's turned up rather sharply.

20 Q. Mr. Dunn, referring to page 29 of your
21 surrebuttal testimony.

22 A. I have that.

23 Q. Okay. Could you please tell me what stocks
24 comprise the market return of 11.82 percent that you
25 indicate on this page?

1 A. I have a list of the individual stocks. I
2 don't have them with me, but they were printed out and
3 supplied as a part of the calculation.

4 Q. Now, are those stocks -- would they be part
5 of what you might call a broad market index?

6 A. Yes.

7 Q. Now, assuming that this is a broad market
8 index return, do natural gas distribution companies tend
9 to be less risky in the broader market?

10 A. I would say so. It depends on how broadly
11 defined you get the market. As you go more and more broad
12 on the market, you tend to create a very substantial
13 portfolio effect, which causes the market indexes to
14 become much less risky than individual securities or even
15 sector indexes.

16 Q. Mr. Dunn, does your risk premium
17 calculation, page 29 of your surrebuttal testimony, serve
18 as a test of reasonableness of the cost of common equity
19 for natural gas distribution utility?

20 A. I believe it gives us an indicated cost of
21 common equity, making a calculation in accordance with an
22 accepted risk premium approach.

23 Q. Well, Mr. Dunn, shouldn't an adjustment be
24 made to consider that a natural gas distribution company
25 is less risky in the broader market?

1 A. There should be several adjustments to this
2 number. One of the adjustments would be a floatation
3 adjustment. One of the numbers may well be an adjustment
4 for risk not to the natural gas industry, but to a
5 specific company.

6 Q. Mr. Dunn, I have here a copy of a few pages
7 from the textbook titled Regulatory Finance, Utilities'
8 Cost of Capital, by Roger A. Morin. This is not a copy of
9 the entire book.

10 JUDGE WOODRUFF: Okay.

11 MR. FRANSON: Your Honor, before he
12 continues, may I approach with copies for yourself and all
13 the Commissioners?

14 JUDGE WOODRUFF: Certainly. Do you wish to
15 mark it as an exhibit, Mr. Berlin?

16 MR. BERLIN: Yes, please.

17 JUDGE WOODRUFF: That will be 845.

18 (EXHIBIT NO. 845 WAS MARKED FOR
19 IDENTIFICATION BY THE REPORTER.)

20 BY MR. BERLIN:

21 Q. Do you have it in front of you, Mr. Dunn?

22 A. No, I don't.

23 Q. Oh, you don't? Sorry about that.

24 MR. DUNN: May I approach the witness?

25 JUDGE WOODRUFF: You may.

1 BY MR. BERLIN:

2 Q. Mr. Dunn, if you would please refer to

3 page 283.

4 A. Yes, sir, I have that.

5 Q. You see a header called Risk Adjustments?

6 A. Yes, I have that.

7 Q. If you would, could you read the first

8 paragraph there, which looks like it's two sentences.

9 A. The risk premium estimate derived from a

10 composite market index must be adjusted for any risk

11 differences between the equity market index employed in

12 deriving the risk premium and a specified utility common

13 stock. Several methods can be used to affect the proper

14 risk adjustment.

15 Q. Thank you. On page 29 of your surrebuttal

16 testimony, Mr. Dunn, how did you determine your market

17 risk premium of 6.54 percent? Again, that's page 29 of

18 your surrebuttal.

19 Are you at page 29 of your surrebuttal?

20 A. Yes. I'm trying to get the number here.

21 Q. Okay. Sure. Can you find it, Mr. Dunn?

22 A. I'm getting it. For the risk premium, I

23 took an arithmetic average of 1928 to 2003, the market

24 return of 11.82 percent.

25 Q. All right. How did you calculate the risk

1 premium when you executed the CAPM on page 30 of your
2 surrebuttal testimony?

3 A. Let me check. I was going to get you the
4 rest of the numbers to go with it.

5 Q. Okay.

6 A. For the CAPM I used the 12.63 market
7 return. For the period 1993 to 2003, I reduced it by the
8 current long-term risk-free rate of 4.80. The latter was
9 taken from the Wall Street Journal. The former was taken
10 from the same source as the 1928-2003 calculation.

11 Q. All right. In trying to estimate the
12 investors' required risk premium over the return that can
13 be achieved over a period of time, would it not be
14 appropriate, Mr. Dunn, to look at the return on the
15 risk-free security for the same period of time, which is
16 what you did when you calculated your risk premium on
17 page 29 of your surrebuttal testimony?

18 A. I think it's done both ways. The risk
19 premium analysis historically tended to be a long-term
20 calculation, and the CAPM, as I performed it, was based on
21 a shorter period of time, because as I observed in my
22 direct testimony, the long period of time, 1928-2003, had
23 a different and slightly lower market return.

24 Now, I believe that somebody would look at
25 that and come to the conclusion that market returns are

1 trending upward or trending upward. And in part that
2 might have something to do with including the depression
3 years in the first calculation. But I selected a more
4 recent shorter period for the second calculation and
5 matched that up with a current cost.

6 Q. Mr. Dunn, I have here a document titled
7 Investment Valuation. It's prepared by Mr. Amman Darren
8 (phonetic spelling), if I have his name correct, and it's
9 tools and techniques for determining the value of any
10 asset.

11 A. Uh-huh.

12 MR. BERLIN: And I would like to, your
13 Honor, enter this into evidence. It's only a few pages.

14 MR. FRANSON: May I approach with those
15 copies?

16 JUDGE WOODRUFF: Yes. We're up to 846.

17 MR. HERSCHMANN: Is counsel trying to offer
18 this into evidence?

19 JUDGE WOODRUFF: At the moment I'm just
20 marking it.

21 MR. HERSCHMANN: Okay. That's what I
22 thought we were doing.

23 (EXHIBIT NO. 846 WAS MARKED FOR
24 IDENTIFICATION BY THE REPORTER.)

25 MR. BERLIN: May I approach the witness?

1 JUDGE WOODRUFF: Yes, you may.

2 BY MR. BERLIN:

3 Q. Do you have a copy of this --

4 A. I do.

5 Q. -- pamphlet?

6 I'd like to direct your attention to the

7 last page, and there's a header called Measurement of Risk

8 Premium.

9 A. I have that.

10 Q. I'll read the first sentence. The risk

11 premium used in the CAPM is generally based upon

12 historical data, and the premium is defined to be the

13 difference between average returns on stocks and average

14 returns on risk-free securities over the measurement

15 period.

16 Do you think that's a fair statement?

17 A. I think that was an accurate reading.

18 Q. So you don't agree that the same

19 measurement period should be used?

20 A. I think to properly clarify that statement,

21 you should read the rest of it, which goes on to say that

22 it's an issue of how long should the measurement period

23 be? Some periods range from 10 years all the way to

24 starting in 1926.

25 Q. But in your analysis, you didn't use the

1 same measurement period, correct?

2 A. I used one period that went back to 1928,
3 and I used one period for 10 years.

4 MR. BERLIN: No further questions.

5 JUDGE WOODRUFF: Did you wish to offer
6 Exhibits 845 and 846?

7 MR. BERLIN: Yes, I do.

8 JUDGE WOODRUFF: All right. Exhibits 845
9 and 846 have been offered into evidence. Is there any
10 objections to their receipt?

11 MR. HERSCHMANN: As to 845, no. As to 846,
12 yes.

13 JUDGE WOODRUFF: What's your objection?

14 MR. HERSCHMANN: Objection would be
15 hearsay, lack of foundation. Specifically I direct your
16 Honor to the first page dealing with the copyright where
17 it says, the book, it is sold with the understanding that
18 the publisher does not engage in rendering legal,
19 accounting or other professional service. If legal advice
20 or other expert assistance is required, the services of a
21 competent professional person should be sought.

22 I haven't seen this book, just the caveat
23 from the author, and I oppose its admission as lacking any
24 foundation.

25 MR. BERLIN: Your Honor, I withdraw

1 Exhibit 846.

2 JUDGE WOODRUFF: All right. 846, then, is
3 shown as withdrawn. 845 is admitted.

4 (EXHIBIT NO. 845 WAS RECEIVED INTO
5 EVIDENCE.)

6 MR. BERLIN: Thank you. That completes my
7 questions.

8 JUDGE WOODRUFF: Thank you. Then we'll
9 come up for questions from the Bench. Commissioner
10 Clayton?

11 COMMISSIONER CLAYTON: By default, I get to
12 go first.

13 QUESTIONS BY COMMISSIONER CLAYTON:

14 Q. Mr. Dunn, how many years have you been
15 doing utility finance work?

16 A. Well, I started my career here at the
17 Missouri Public Service Commission, I was recently advised
18 about 32 or 33 years ago.

19 Q. How does that make you feel?

20 A. Older.

21 Q. I understand. So you're actually an
22 employee with the Missouri Commission?

23 A. I was the chief of economic research when
24 the department was first started for about 2, 2 1/2 years.

25 Q. Well, forgive me. I've been doing this

1 about a year, so I need your help understanding some of
2 these figures.

3 A. That's supposed to be my job here is to
4 provide information to the Bench and help you make your
5 decision.

6 Q. I appreciate that.

7 First of all, I want to ask you if you have
8 a copy of the Staff document that was handed out at the
9 beginning of opening statements today that had a summary
10 of the dollar amount difference and positions of the
11 parties. Do you have that in front of you?

12 A. No, sir, I do not.

13 Q. Perhaps we could get that for you, and I
14 have some questions.

15 JUDGE WOODRUFF: For clarity, that was
16 Exhibit 842.

17 The court reporter has handed the witness a
18 copy of the document.

19 THE WITNESS: I have that, your Honor.

20 BY COMMISSIONER CLAYTON:

21 Q. Okay. Mr. Dunn, in looking over the
22 differences of the parties, this document, Exhibit 842,
23 reads that the issue of rate of return and capital
24 structure is a dollar amount difference between the
25 parties of some 23, almost \$24 million. Do you see where

1 I'm seeing that?

2 A. I see that, yes, sir.

3 Q. And this amount is more than half of the
4 overall increase that the company is requesting, you would
5 agree with that?

6 A. Yes, sir.

7 Q. So this is a fairly significant issue?

8 A. No doubt about it.

9 Q. The capital structure issue which comes
10 down basically to whether or not the debt of Panhandle
11 Eastern should be included in the capital structure, does
12 it not?

13 A. I think that is -- that is part of it.
14 That's the biggest part of it. It's -- the issue is
15 should you use a consolidated capital structure or a
16 capital structure which includes no Panhandle Eastern. So
17 there's a little -- when you take out Panhandle Eastern
18 debt, what we have done is taken out some equity also.

19 Earlier you heard mentioned 3 million
20 shares were given in the exchange to purchase Panhandle.
21 We took that out also. We took out Panhandle's retained
22 earnings since the date of acquisition. So we took out
23 all of their debt, a little bit of equity. But I think
24 you've got your finger on it, it's mainly the debt that
25 causes the problem.

1 Q. I think you performed that analysis in your
2 rebuttal testimony, as opposed to your direct testimony;
3 is that correct?

4 A. That's correct. I did half of it in the
5 direct and fine-tuned it in the rebuttal.

6 Q. I think as I recall reading the testimony,
7 and perhaps I have the order of reading the testimony
8 messed up in my head, but I think the Staff witness made
9 some comments in their testimony regarding whether or not
10 that equity should be backed out, and then you performed
11 that analysis in your rebuttal testimony; is that correct?

12 A. I know I backed out the 49 million in my
13 direct. I'm pretty sure I did. And then the 3 million,
14 I'm sure, came out in the second part, in the second
15 testimony, the rebuttal.

16 Q. And that included taking out the retained
17 earnings, as well as I think there was a hybrid security
18 that was included in that offering?

19 A. Right. The hybrid security I left in in my
20 original testimony.

21 Q. Now, that only changed the capital
22 structure in your analysis by a few percentage points in
23 the overall structure on each item; is that a fair
24 estimation?

25 A. I think so.

1 Q. Hypothetically speaking, if we did not have
2 the Stipulation & Agreement from the mergers and
3 acquisition order from a few years ago, would it still be
4 your position that that debt from Panhandle Eastern should
5 be excluded from the overall capital structure?

6 A. Absolutely.

7 Q. Would you explain that to me?

8 A. The Commission has adopted the Staff
9 position more than once, and the Staff has presented this
10 position here and before the Federal Energy Regulatory
11 Commission as a position of the Missouri Public Service
12 Commission, saying that if a company, Southern Union, has
13 a subsidiary, Panhandle, and that that subsidiary is
14 financially independent -- and they define financially
15 independent to mean it raises its own debt without
16 recourse to the parent -- then that subsidiary should be
17 treated separate from the total company.

18 Now, what that means for Southern Union is
19 that Panhandle when it goes to FERC -- it's a
20 FERC-regulated entity -- it will be taken out of the total
21 company and leave behind the distribution properties, and
22 at that point it will be regulated on its own bottom so to
23 speak, its own financial structure, its own capital
24 structure, leaving behind Southern Union.

25 Now, if you regulate Southern Union

1 distribution properties using that debt a second time,
2 mainly to depress the equity ratio, you very, very much
3 shortchange the distribution properties, and they end up
4 earning a lot less than what they're supposed to earn.

5 Q. And that last statement where you made
6 reference to depressing the return on either the overall
7 company or the distribution company, in a purely financial
8 analysis, that shouldn't -- it sounded like -- it sounded
9 like you were finding another reason in there to exclude
10 that debt, rather than that -- rather than just policy
11 purposes that because it's a stand-alone company it should
12 be included. Isn't that a different argument?

13 A. It's a different business. I'm not sure.
14 I hate to keep saying that I don't understand these
15 questions, but what seems to me to be going on here is we
16 have two companies, and financial analysis said they
17 happen to have -- they share a parent.

18 Q. Let me ask you this --

19 A. So they're brother and sister.

20 Q. Let me ask you this one question, just to
21 make sure that I'm clear on this. Southern Union has a
22 number of divisions?

23 A. Right.

24 Q. Is Panhandle Eastern the only stand-alone
25 subsidiary or does it have other corporate subsidiaries

1 that have its own -- that each, in turn, have their own
2 stand-alone debt?

3 A. It's the only meaningful subsidiary. There
4 may well be one or two tiny real estate subsidiaries or
5 this project finance program that we talked about that was
6 part of Trunkline. Trunkline may be a subsidiary of
7 Panhandle. But basically there are two pieces, the
8 Panhandle subsidiary and all of the rest of the company,
9 which is unincorporated except as Southern Union.

10 Q. Okay. So --

11 A. So there are no other Panhandle Easterns.

12 Q. Panhandle Eastern is different than any
13 other subsidiary, in your opinion?

14 A. Right. Any other -- none of these others
15 are subsidiaries.

16 Q. They're all divisions?

17 A. They're all just divisions. They have
18 taken the residual or the remaining part of Southern Union
19 and sliced it into pieces by jurisdiction.

20 Q. And how many distribution companies are
21 there owned by -- or divisions of Southern Union that
22 are --

23 A. I believe there are three; Providence and
24 areas in New England, plus Pennsylvania, plus Missouri.

25 Q. Okay. So the debt of Panhandle Eastern,

1 which is significant, you would agree with that?

2 A. It's 1.2 billion, yes, sir.

3 Q. Not like a home mortgage.

4 A. It's similar in concept, actually. You

5 can't buy a car with your home mortgage and you can't buy

6 anything with this Panhandle debt other than what

7 Panhandle paid. They used it to put pipe in the ground.

8 Q. The entire 1.2 billion was used to put pipe

9 in the ground?

10 A. That's my understanding, that and various

11 kinds of facilities to go with their pipeline operations.

12 And when we spoke of Schedule 10, Panhandle was purchased

13 as an entity, as a unit, as a corporation from CMS, and

14 when it was purchased, it came with debt and facilities,

15 and that debt, part of it was issued in 1994. None of it,

16 I think, was issued after '98 or '99. It was all put in

17 the ground literally many years prior to the acquisition,

18 and that's detailed on Schedule 10 of the Staff direct

19 testimony.

20 Q. Were you a part of the Missouri Commission

21 case that involved the merger?

22 A. No, sir, I was not.

23 Q. There's another issue as part of this that

24 relates to the interest rate associated -- that is part of

25 this long-term debt of Panhandle Eastern, which is worth,

1 what, 3.7 million. Is that correct, roughly?

2 A. Yes, sir.

3 Q. Would you compare the position that you

4 have, I believe, written in your rebuttal testimony, where

5 you back out some of the equity -- or I assume, all of the

6 equity or just some of the equity?

7 A. For Panhandle?

8 Q. For Panhandle.

9 A. To my original position?

10 Q. Well, I'm looking at your -- I believe,

11 your surrebuttal testimony.

12 A. I have that on page 9. Is that where

13 you're looking at?

14 Q. Well, I don't have a page number. It's

15 from my notes where I am.

16 A. I believe it's on page --

17 Q. I tried to reduce the amount of paper that

18 I had on my desk and I failed with that task, but my notes

19 reflect from that your surrebuttal testimony that you

20 removed 3 million shares of common equity, \$91 million of

21 retained earnings, and \$145 million from the hybrid

22 security offering?

23 A. That's correct.

24 Q. Now, in your opinion, is that all the

25 equity that could be removed associated with that transfer

1 or with that transaction?

2 A. I believe that was our best effort to
3 remove it all.

4 Q. In terms of determining the return that a
5 company is entitled to, risk is a big part of that
6 analysis, is it not?

7 A. Yes, sir.

8 Q. Without getting into a comparison of the
9 various formulas that are available, in general, how does
10 risk get played into this analysis? Does the general
11 proposition that a riskier company is deserving of a
12 higher rate of return, is that a fair generality
13 associated with risk assessment?

14 A. I think that's the accurate generality,
15 except that it's usually stated that investors demand a
16 higher return for greater risk. It sort of goes backwards
17 to the notion that everybody's a little risk adverse.
18 Most people are a lot of risk adverse. If you make an
19 extra dollar, this is sort of the marginal utility of
20 money as far as economists are concerned. If you make one
21 more dollar, you get an increment of utility out of that,
22 but it's less than you got on the last dollar you made.
23 And if you lose a dollar, you lose more buying power,
24 personal satisfaction buying power than if you gain a
25 dollar. So you always want to avoid losing a dollar.

1 Q. Speaking in generalities, does that mean
2 that a customer that is being served by a more risky
3 utility will pay more for their utility service than one
4 not operating under a more riskier utility?

5 A. Should not.

6 Q. And why is that?

7 A. The very bottom line of all this capital
8 structure analysis and all this discussion back and forth
9 is that the after-tax or before-tax rate of return, which
10 is the cost of capital, should be the same for a company
11 no matter what their equity ratio is, plus or minus a
12 little adjustment for their cost of debt.

13 Q. Say that again for me. You say regardless
14 of their -- regardless of their capital structure, the
15 cost of capital should be the same; is that what you said?

16 A. Yes, that's what I said. You have a lower
17 equity ratio. You have a higher return on equity, but you
18 have more lower cost debt in the capital structure. You
19 have fewer dollars of income taxes associated with the
20 equity return. There's a calculation, I believe it's in
21 the -- it's either in the surrebuttal or the rebuttal
22 testimony that says if you adjusted the return on equity
23 for Southern Union's MGE properties only to account for
24 the difference in equity ratio, you would increase their
25 return to about 13 percent.

1 The numbers are off the top of my head
2 right now. That would be exactly the same as using the
3 Murray capital structure, Murray hypotheticals with a
4 9 percent return.

5 Q. I'm not following. You need to help me
6 with that.

7 A. Can we go to my direct testimony, which is
8 Exhibit 1?

9 If the rate of return is 9.46 -- or 9.41,
10 and it's -- it's largely dependent on two numbers; the
11 debt ratio --

12 Q. Excuse me, Mr. Dunn. 9.41, what are you
13 referring to?

14 A. I'm referring to the last number at the
15 lower right-hand side of the page.

16 Q. And which page was that?

17 A. This was Schedule 11 of my direct.

18 Q. Okay. Go ahead.

19 A. That 9.41 has a 43 percent equity ratio
20 associated with it and a certain amount of risk associated
21 with it. If you lower that equity ratio, that 43 percent,
22 say you knock it down to 30, what would happen is that the
23 46 percent debt ratio would go up.

24 The cost of the debt is lower than the cost
25 of the equity, and the cost of equity has associated with

1 it income taxes. So by the time you recalculate using
2 9.41, you would simply raise the cost of equity and there
3 would be no change in the overall cost to the customer.
4 The components of the calculation would stay the same, but
5 the before-tax cost of equity and the before-tax rate of
6 return would be the same.

7 Q. So --

8 A. I garbled that up pretty bad. Can I try
9 again?

10 Q. You can try again. You can try again.

11 A. The proper way to measure this is to
12 calculate the income taxes that go with that 9.41. This
13 is in every basic finance textbook that -- you name it,
14 it's there. You calculate the income taxes to go with the
15 9.41. There's only two pieces here that have income tax,
16 the preferred stock on the common equity, and their
17 numbers are roughly half of what the weighted costs are.
18 So we end up with, say, 9.12 or, I mean, 12 percent even
19 for a rate of return before tax.

20 Then you take that and apply it to the new
21 capital structure. You subtract from it the cost of debt.
22 Now you'll have a much higher debt ratio. Say, instead of
23 48, it'll be 65, and then you subtract from the cost of
24 preferred, and then you apply the income tax factor, and
25 you're going to have something left over for equity. You

1 divide that number by the equity ratio, which in this case
2 would be 30 instead of 43, and we haven't changed the cost
3 to the customer, but we have increased the cost of equity.
4 The cost of capital has not changed, but the component
5 parts of the cost of capital have changed.

6 Q. So if the actual -- your 9.41 percent,
7 which is the weighted cost of capital, correct?

8 A. Correct.

9 Q. If that number doesn't change, why does it
10 make any difference to the company?

11 A. Well, the Staff is not making this
12 adjustment. That's why it makes a big difference to the
13 company.

14 Q. Okay. Okay.

15 A. The Staff wants to give the company an
16 absolutely lower number without recognition of the fact
17 that there is a lower equity ratio and greater risk. All
18 we're doing is redistributing the cost of capital between
19 the various suppliers of capital, the debt supplier and
20 the equity supplier.

21 Q. Well, we have an argument on the actual
22 cost, as well as an argument on the percentage of
23 financing?

24 A. That's correct.

25 Q. Okay.

1 A. The argument on the cost will remain an
2 argument to the very end. I don't think that the argument
3 on whether or not there should be an adjustment is an
4 argument. I don't think you can find a textbook that says
5 there is no such thing as that adjustment that I talked
6 about.

7 Q. In general terms, should a Commission or a
8 regulatory body be looking at the company in terms of a
9 capital structure and a return the same way an investor
10 would be?

11 A. I think so. I think -- I think to a
12 certain degree that the Commission has to make the
13 investors happy, because you want capital to flow into the
14 service area. That seems to me to be one of your jobs is
15 to cause the money to flow into Missouri.

16 Q. I understand, but I mean, an investor
17 looking to invest money in the company -- and I know
18 you're talking about what our role is in balancing the
19 interests, but would an investor exclude the Panhandle
20 Eastern debt?

21 A. An investor would rely primarily -- this is
22 my personal view, and I think it's widely shared. An
23 investor would rely on banking houses, Moody's, Standard &
24 Poor's, to make a decision about whether or not to buy
25 Southern Union.

1 Now, that is an entirely different activity
2 than whether or not you should set a rate of return of 9
3 or 10 or 11 or 12 on the properties under your
4 jurisdiction. You have to make a reasonable contribution.
5 You have to regulate, it seems like to me, Missouri Gas
6 Energy in a fashion that's consistent with Hope and
7 Bluefield, just Missouri Gas Energy. Not Southern Union,
8 not Panhandle, not anything else.

9 And I honestly believe that that's one of
10 the reasons that the Staff or the Public Counsel came
11 around and said, you know, hypothetical capital structure
12 might be a really good idea.

13 Q. So the answer to the question is they're
14 actually treated -- an investor and a regulator, in your
15 opinion, should look at the capital structure differently?

16 A. Yes.

17 Q. Okay. So they shouldn't look at them in
18 the same way?

19 A. You should look at a microcosm, a piece.
20 They're looking at the whole thing.

21 Q. So an investor would include theoretically
22 the debt that is included on the bottom line from
23 Panhandle Eastern?

24 A. I'd say yes, except that in this particular
25 case, Panhandle Eastern's handled separate by Moody's and

1 Standard & Poor's.

2 Q. Okay.

3 A. But still an investor can't buy one piece
4 or the other. They have to buy all of Southern Union, no
5 doubt about it.

6 Q. Okay. Would you explain to me the
7 difference between your position and the position of the
8 Office of Public Counsel? They differ significantly from
9 Staff, do they not?

10 A. They differ most significantly on the issue
11 of capital structure in that they have proposed a
12 hypothetical capital structure with an equity ratio before
13 they make an adjustment for short-term debt of about
14 38 percent.

15 Q. What is the basis of that, do you know?

16 MR. MICHEEL: Your Honor, just so I can get
17 this straight about what the Office of the Public Counsel
18 recommends and make sure we're all talking on the same
19 thing, the item that Commissioner Clayton is looking at,
20 Exhibit 842, the numbers there do not relate to Public
21 Counsel's hypothetical capital structure. They relate to
22 Public Counsel's requested consolidated capital structure,
23 and I don't want the record to reflect something and it's
24 like the hypothetical capital structure that's on 842 and
25 related to the numbers there, because that would be

1 incorrect, your Honor.

2 JUDGE WOODRUFF: Thank you for that
3 clarification.

4 COMMISSIONER CLAYTON: So what you're
5 saying is, what is the number on 842, then, the add in,
6 the add back for \$4.3 million?

7 MR. MICHEEL: That's because we calculate
8 the consolidated capital structure in a different method
9 than the Staff dots, your Honor.

10 COMMISSIONER CLAYTON: Right. And that's
11 what I'm asking Mr. Dunn, what the difference between the
12 position -- the consolidated capital structure of Staff
13 and the capital structure of Office of Public Counsel on
14 Exhibit 842.

15 BY COMMISSIONER CLAYTON:

16 Q. Which I'm not sure I asked it before,
17 but --

18 A. It's my understanding that the major
19 difference between the OPC and the Staff on the capital
20 structure issue is either the hypothetical or the fact
21 that they did not include Panhandle debt in the
22 calculation of the cost of debt. They included it in
23 their capital structure, but they didn't include it in the
24 cost.

25 Q. So to say that it's in capital structure is

1 different; it's the actual cost?

2 A. It probably should be headed value
3 difference in long-term debt rates.

4 Q. Okay. In your testimony, do you pick a
5 point in time at which we should use -- we should take the
6 snapshot of the capital structure of the company, or do
7 you use various times for an overall hypothetical capital
8 structure?

9 A. I have used points in time.

10 Q. For example, I know that you've used
11 April 30th, 2004 as the date that you would take that
12 there was zero short-term debt. That was one time period
13 that stuck out in my mind. Are there other time periods
14 that are incorporated in your hypothetical structure?

15 A. There were, and I didn't propose a
16 hypothetical specifically. I proposed the concept. I
17 said if we couldn't come to to some sort of agreement on
18 capital structure, a hypothetical was good. The reason I
19 used April 30th is that's the true-up date. The parties
20 have previously agreed, it's my understanding, that they
21 would true everything up, including the capital structure,
22 at April 30th, and I used those dates prior to that. I
23 used the test year date in my original testimony. And
24 then I used December 30th, 2003 in my rebuttal testimony
25 because that was what was available to me at that point.

1 The typical way things are done, as far as
2 the capital structure, is to use a point in time for the
3 equity balance, the debt balance and the preferred
4 balance, and if short-term debt is included, some sort of
5 average of 6 months or 12 months short-term debt balances.
6 That's the typical Staff proposal, the typical company
7 proposal, if there is no short-term debt, is to use a
8 point in time with no short-term debt.

9 Q. Is the fact that the company has no
10 short-term debt an anomaly in this analysis, similar to
11 like what you suggested about the low debt ratio,
12 long-term debt ratio for Southern Union?

13 A. I would say it's very unusual for the
14 company. They have had short-term debt for a long period
15 of time, and I think it's reasonable to say that during
16 this period of very low cost interest, that they have used
17 short-term debt to finance part of their rate base. I
18 think they're moving out of a period of short-term debt.
19 They're readying themselves not to use short-term debt to
20 finance rate base. I think that's a trend that goes all
21 the way across the utility industry right now.

22 A separate problem is the fact that natural
23 gas distribution companies end up with a couple of periods
24 of very high borrowing, usually around the winter months
25 where they have their highest accounts receivable, they

1 have a lot of gas on the meters that have been delivered
2 to consumers and consumed but not yet billed. And when
3 you add that into an 13-month average, you're pumping up
4 the average to a degree, but you're not fully reflecting
5 the fact that that's a one-time anomaly also, that
6 November to April period.

7 Q. I suppose that you could always have some
8 anomaly somewhere in a formula with a snapshot in time,
9 could you not?

10 A. You could, but the general principle on
11 capital structure is to try to be as forward-looking as
12 possible, because it's progressing through time.

13 Q. Well, in your analysis --

14 A. With the exception of short-term debt.

15 Q. In your analysis, would you assume that the
16 company would have some short-term debt in the future as
17 we look forward?

18 A. I would assume that the company, given what
19 they're doing at the moment, would not have short-term
20 debt for at least a year. And I say that because they do
21 not pay a dividend. Unlike most natural gas distribution
22 companies, this company doesn't pay a dividend. They do
23 have an equity offering schedule, and they do have the
24 hybrid security, so their equity ratio will be just fine.

25 Q. Did you include those in your analysis,

1 those potential offerings in the future?

2 A. No, I did not.

3 Q. You did not. Do you know if those are
4 scheduled to occur within the next 12 months, or is it
5 just at some point in the future?

6 A. I think the equity is scheduled to occur
7 before the end of the year. The hybrid security converts
8 in 2006. The continue -- far as I know, there is no
9 inclination on the part of the company to begin paying the
10 cash dividend.

11 Q. With regard to the dividend and
12 establishing a figure for growth for the company, I think
13 you've made a number of -- or stated a number of items in
14 your testimony regarding dividends not being an accurate
15 reflection of growth of a company; is that correct?

16 A. Yes, sir, that's correct.

17 Q. One of those being that negative growth
18 should not be included in determining that level of growth
19 for a company?

20 A. If I may, the dividend thing was a separate
21 issue than the negative thing. The dividend thing is that
22 when you look at growth in dividends, growth in earnings
23 and growth in book value, you'll see that growth in
24 dividends is very, very low as compared to the other two,
25 and there are stated reasons why in virtually every

1 ValueLine, and the stated reason is that companies in the
2 natural gas distribution business have reduced their
3 dividend growth because they're trying to accumulate
4 equity to improve their payout ratios. They're trying to
5 really overcome some past problems of paying out too great
6 a debt. So that's one issue.

7 The separate issue is whether or not you
8 include negatives in these calculations, and my view and
9 the view of the Public Counsel on the negatives is that no
10 investor buys a company anticipating that growth in
11 dividends will be negative for the foreseeable future or
12 that growth in earnings will be negative for the
13 foreseeable future.

14 Q. Or is it a fair statement that no investor
15 will buy a company with negative growth in dividends?
16 It's not that they ignore negative growth in dividends;
17 it's the fact that they're not going to look favorably on
18 a company that has such negative growth?

19 A. That is true, and they will exclude those
20 companies from their consideration. They go off their
21 radar.

22 COMMISSIONER CLAYTON: I don't think I have
23 any more questions at this time.

24 THE WITNESS: Thank you.

25 JUDGE WOODRUFF: Commissioner Davis?

1 COMMISSIONER DAVIS: No questions at this
2 time.

3 JUDGE WOODRUFF: I have a question.

4 QUESTIONS BY JUDGE WOODRUFF:

5 Q. And we've been talking about hypothetical
6 capital structures quite a bit today. Can you tell me the
7 purpose of using a hypothetical capital structure in
8 determining rates?

9 A. I think there are two purposes. One is to
10 comply with the basic rationale of ratemaking, and the
11 other is to solve a problem that you're confronted with
12 when you have a capital structure that either has too
13 little or too much equity. In the past, this Commission
14 has confronted the problem of too much equity in St. Joe
15 Power & Light, and substituted a hypothetical capital
16 structure.

17 In this case you're confronted with the
18 problem if you think that the consolidated capital
19 structure is appropriate, you're confronted with the
20 problem of too little equity. So you select a
21 hypothetical capital structure which puts the company on a
22 footing equal to other companies similarly situated, which
23 to my understanding as a layman is precisely what you're
24 trying to do, in accordance with the court cases which
25 tend to control what goes on here.

1 Secondly, the sort of colloquial definition
2 of regulation is a process to try and mimic what goes on
3 in the competitive marketplace. In the competitive
4 marketplace, most companies are offered assuming that
5 they're equally efficient, basically, the same pre-tax
6 rate of return.

7 If you make widgets and you do a good job
8 of it and I make widgets and do a good job of it, we both
9 sell them one dollar apiece and we both should be dropping
10 20 cents down to the bottom line, unless -- if we're
11 equally efficient and we're operating in a competitive
12 environment. And that has always been one of the thoughts
13 behind regulation is that it produces an outcome similar
14 to the competitive market.

15 Q. Can I summarize it by saying that you do a
16 hypothetical capital structure with this kind of company
17 where there's a parent with a division so that the
18 division, MGE, can be compared to other similarly situated
19 distribution companies?

20 A. That's correct.

21 Q. Okay. Does the management decision about
22 what kind of capital structure the company actually has
23 have anything to do with the hypothetical, the purpose of
24 a hypothetical capital structure?

25 A. I don't think it does. I heard discussion,

1 at least in the opening arguments, that, you know,
2 management has created a circumstance. There's
3 circumstances which, first of all, the theory of finance
4 gives you precise tools to deal with, and secondly, you
5 can deal with it with a hypothetical capital structure.
6 You're regulating Missouri Gas Energy, which is only a
7 piece of the whole thing.

8 How they deal with the whole thing is
9 really not, I guess, something that the Commission should
10 be thinking about, unless it jeopardizes the operation of
11 Missouri Gas Energy, obviously. But I think you find what
12 you find and you deal with it and set its rates in
13 accordance with the law. And if management is out of
14 control, you deal with management, but otherwise I don't
15 think that the Commission wants to get into the business
16 of substituting its judgment for management's judgment.

17 I don't know where you draw the line and
18 say, I think you're out of control and I'm not going to
19 let you go any further. I don't think that's happened
20 here clearly. But that's when you substitute your
21 judgment for management judgment. If management wants to
22 and believes it can, and the rating agencies clearly
23 believe it can operate with the equity ratio that it has
24 today, why would that be a problem, other than what's been
25 said at the podium in the opening statements?

1 The opening statements, everybody's saying
2 management created a problem. They created no problem.
3 They decided that it would be in the best interest of the
4 company to have a highly levered company for a while,
5 because they had a business opportunity that was very good
6 and they didn't want to pass it up. So they bought
7 Panhandle Eastern Pipeline, and it's been doing quite
8 well.

9 And consequently in another two years, it
10 will be a better company because of that management
11 decision. I don't see how any of that affects the
12 customers of Missouri Gas Energy.

13 JUDGE WOODRUFF: All right. With that
14 we're going to go ahead and take a break for about
15 15 minutes. We'll come back at 2:35.

16 (A BREAK WAS TAKEN.)

17 JUDGE WOODRUFF: We just finished questions
18 from the Bench. Before we go to recross based on those
19 questions, I know Commissioner Murray wanted to be here
20 this afternoon and was called away. When she comes in,
21 she may have further questions for this witness. Will you
22 be here tomorrow and subsequent days of the hearing, or is
23 this the last day you'll be here?

24 THE WITNESS: I'll be here tomorrow.

25 JUDGE WOODRUFF: Again, it's a possibility

1 we may recall you, and if we do, then we'll give a chance
2 for further recross and redirect based on Commissioner
3 Murray's questions.

4 At this time then, we'll go ahead and begin
5 with recross based on questions from the Bench, and
6 beginning with -- Kansas City's not here. Neither is
7 Joplin.

8 Federal Agencies?

9 MR. PAULSON: No. I'm sorry. No
10 questions, your Honor.

11 JUDGE WOODRUFF: All right. Jackson County
12 and Midwest Gas indicate they don't have any questions.
13 Public Counsel?

14 MR. MICHEEL: Yes, I have questions.

15 JUDGE WOODRUFF: I thought you might.

16 MR. MICHEEL: I think that it will be a
17 similar refrain throughout the proceeding.

18 RECROSS-EXAMINATION BY MR. MICHEEL:

19 Q. Judge Woodruff asked you some questions
20 about the hypothetical capital structure. Do you recall
21 those questions, Mr. Dunn?

22 A. Generally, yes.

23 Q. Is it correct that Witness Allen did an
24 analysis exactly the same as the analysis the Commission
25 adopted in the St. Joe Light & Power case?

1 A. I didn't compare to that. He did a
2 hypothetical analysis which he paralleled in his testimony
3 to the St. Joe.

4 Q. Is it correct that the hypothetical capital
5 structure that was adopted by the Commission in the
6 St. Joe Light & Power case was the hypothetical capital
7 structure recommended by Public Counsel witness, at that
8 time, John Tuck?

9 A. I don't know.

10 Q. Commissioner Clayton asked you some
11 questions about equity investors. Do you recall those
12 questions?

13 A. Yes, sir.

14 Q. And earlier we talked about it. I think
15 you said it was correct that the equity investor cannot
16 make an investment in Southern Union Company less
17 Panhandle Eastern; is that correct?

18 A. That's correct.

19 Q. And so is it your testimony that when an
20 equity investor is making their determination to invest in
21 Southern Union Company, that they will look at something
22 other than the consolidated capital structure and the
23 entire workings of Southern Union Company?

24 A. They will look at the entire thing, some
25 individual pieces, some in its entirety. They will make

1 several different kinds of analysis, but mostly they will
2 rely on information supplied to them by various
3 organizations which supply information to the investing
4 public.

5 Q. And the investment that that equity
6 investor will make in Southern Union Company will include
7 the consolidated capital structure, will it not?

8 A. They will purchase a part of the
9 consolidated capital structure, yes, sir.

10 Q. And that will be the actual capital
11 structure, the 26 percent, isn't that correct, 26 percent
12 equity?

13 A. I'm sorry. I don't understand your
14 question.

15 Q. That's currently existing?

16 A. When the investor makes a purchase --

17 Q. Yes.

18 A. -- the equity ratio of the company he
19 purchases would be 26 percent.

20 Q. Commissioner Clayton asked you some
21 questions regarding your attribution of equity to
22 Panhandle Eastern. Do you recall those questions?

23 A. Yes, sir, I do.

24 Q. You indicated in response to one of
25 Commissioner Clayton's questions that you took out \

1 \$49 million worth of equity in your direct testimony. Do
2 you recall that answer?

3 A. Yes, I do.

4 Q. Could you turn to your Schedule JCD-11 in
5 your direct testimony, and let me know when you're there.

6 A. I'm there.

7 Q. Does that indicate that the common equity
8 at that time that you included was \$920,437,000?

9 A. No. It indicates it's -- oh, yes, it does.

10 Q. That's a yes?

11 A. Yes.

12 Q. Now, if you could go to your rebuttal
13 testimony, and I'm focusing there on page 17, line 19.
14 And let me know when you're there.

15 A. I'm there.

16 Q. Does that indicate there that the common
17 equity ratio now is or at least the amount of common
18 equity is \$900 million? 924 -- \$900,247,000?

19 A. It does.

20 Q. And that's another change that you made; is
21 that correct?

22 A. This capital structure is the capital
23 structure that was developed by Mr. Gillen.

24 Q. And finally, sir, if you turn to page 9
25 of your surrebuttal testimony, and I'm focusing there on

1 line 15.

2 A. What page, sir?

3 Q. Page 9, line 15. And let me know when

4 you're there.

5 A. I'm there.

6 Q. Is it correct now that you're suggesting

7 that the common equity amount is approximately

8 \$823,453,000?

9 A. Yes, sir.

10 Q. And those are all changes you've made since

11 your direct testimony; isn't that correct?

12 A. That's correct.

13 Q. And isn't it correct in your direct

14 testimony that you attributed absolutely no equity to

15 Panhandle Eastern; you didn't do that until your rebuttal

16 testimony?

17 A. I don't believe that's correct. I think

18 that the Panhandle Eastern retained earnings was removed

19 from the direct testimony.

20 Q. And why don't you show me where that is in

21 the direct testimony, Mr. Dunn, because I've looked at it

22 and I do not see it.

23 A. Well, it doesn't say that in the direct

24 testimony.

25 Q. Why don't you turn to page 16 of your

1 rebuttal testimony, sir.

2 A. I have that.

3 Q. And I'm focusing there on -- starting on

4 line 29 through line 32. Is that where you first suggest

5 that you've taken out \$49 million of retained earnings for

6 Panhandle?

7 A. It says, since that time Panhandle has

8 produced approximately 49 million -- and I may be confused

9 as to timing, but it was my recollection that I took the

10 49 million out of the original. Clearly it's out of the

11 second.

12 Q. And you can't point to any specific place

13 in your direct testimony where you did that?

14 A. I cannot, but if I happen to be recalled

15 and I get a worksheet between here and there, I'll provide

16 it to you.

17 MR. MICHEEL: Thank you.

18 JUDGE WOODRUFF: Staff?

19 MR. BERLIN: No questions.

20 JUDGE WOODRUFF: All right. Redirect?

21 REDIRECT EXAMINATION BY MR. HERSCHMANN:

22 Q. Mr. Dunn, I'm going to follow up with some

23 questions by the OPC and the Staff, as well as

24 Commissioner Clayton.

25 First, do you recall being asked many

1 questions by Mr. Micheel using MGE witness
2 Dr. Morin's textbook as the reference?

3 A. Yes, I do.

4 Q. And were you present when Mr. Murray, the
5 witness for the Staff, had indicated that he believed that
6 Professor Morin was one of the leading authorities in the
7 country?

8 A. In his deposition, yes, sir.

9 Q. And have all the questions or references
10 that Mr. Micheel used in his cross-examination of you, was
11 the book that he referenced most often from Professor
12 Morin?

13 A. Yes.

14 Q. And did you have occasion to read
15 Professor Morin's deposition testimony?

16 A. I did.

17 Q. Do you recall being asked certain questions
18 by Mr. Micheel about Professor Morin's deposition?

19 A. I do.

20 Q. Did Professor Morin have any direct
21 criticisms of the OPC witness, Mr. Allen?

22 A. He might have had a minor criticism, but I
23 think generally he said that he was not retained to
24 discuss or review or analyze Mr. Allen's work, and
25 consequently he did not do so.

1 Q. Do you know whether Mr. Allen had testified
2 or been deposed at the time that Professor Morin was
3 deposed?

4 MR. MICHEEL: I'm going to object. That's
5 beyond the scope of any questions that I asked, your
6 Honor.

7 JUDGE WOODRUFF: Your response?

8 MR. HERSCHMANN: I believe it's proper
9 follow-up in light of the questions raised in relationship
10 to Professor Morin's deposition testimony, as well as
11 proper follow-up in light of the Commissioner's questions.

12 MR. MICHEEL: Your Honor, I only asked him
13 specific questions to impeach this witness from specific
14 pages of Dr. Morin's deposition. I didn't ask him
15 numerous questions. Now, if Mr. Herschmann wants to ask
16 this witness specific questions about the questions I
17 asked about Dr. Morin, I think that's appropriate, but
18 this going far afield, I think, is beyond the scope, and
19 I'm going to object.

20 JUDGE WOODRUFF: I'm going to overrule the
21 objection at this time. You can answer the question or
22 ask to have it repeated, if you need to.

23 THE WITNESS: Could you repeat the
24 question, please?

25 BY MR. HERSCHMANN:

1 Q. Sure. Do you have Professor Morin's
2 testimony in front of you?

3 A. No, I do not.

4 Q. Is it attached as an exhibit to your
5 testimony?

6 A. Oh, you're right.

7 MR. FRANSON: Your Honor, I assume
8 Mr. Herschmann by using the term "testimony" means his
9 deposition, rather than his pre-filed testimony.

10 JUDGE WOODRUFF: Is that correct?

11 MR. HERSCHMANN: Yes.

12 JUDGE WOODRUFF: Thank you.

13 THE WITNESS: I have that.

14 BY MR. HERSCHMANN:

15 Q. Can you turn to pages 105 to 106?

16 A. Yes, sir.

17 Q. Do you recall being asked questions by
18 Commissioner Clayton dealing with how many years you have
19 been appearing before this Commission?

20 A. Yes, sir, I do.

21 Q. And do you recall Commissioner Clayton
22 discussing with you your experience in the 32 years of
23 acting as a utility finance expert?

24 A. Yes.

25 Q. What is the primary source of reliance that

1 this Commission has used in relationship to returns on
2 equity?

3 A. I think this Commission almost exclusively
4 has relied on the discounted cash flow analysis.

5 Q. Is that the methodology that you relied
6 upon in this matter?

7 A. It is.

8 Q. Now, do you recall being asked questions by
9 Mr. Berlin dealing with Moody's and S&P rating Southern
10 Union as a whole for its debt financing?

11 A. I do.

12 Q. And are there any jurisdictional
13 restrictions on S&P or Moody's as far as rating Southern
14 Union?

15 A. No, none whatsoever. They can look at
16 anything they choose to look at.

17 Q. And does this Commission have any
18 jurisdictional restrictions?

19 A. It has -- I would assume you would refer to
20 them as jurisdictional restrictions --

21 MR. FRANSON: Your Honor, I object at this
22 point. If jurisdictional was in some kind of legal sense,
23 this witness is not qualified to make such a statement
24 about the Commission's jurisdictional limitations or
25 otherwise.

1 JUDGE WOODRUFF: Can you clarify your
2 question as to what you're getting to?

3 MR. HERSCHMANN: Sure.

4 BY MR. HERSCHMANN:

5 Q. And let me just base it on your 32 years of
6 experience. In your 32 years of experience, does this
7 Missouri Commission regulate MGE or would it regulate
8 other divisions of Southern Union?

9 A. It would regulate only MGE. But in
10 response to the question that you were posing, not about
11 the jurisdictional part, it seems to --

12 MR. FRANSON: Your Honor, that previous
13 question still has a standing objection if it's going back
14 to the legal -- some legal conclusion of this witness
15 regarding some jurisdictional question. This witness has
16 a habit of going back and trying to add to it.

17 JUDGE WOODRUFF: I'll sustain the objection
18 as to being nonresponsive, but he can answer the question
19 you asked. You can ask him your next question.

20 BY MR. HERSCHMANN:

21 Q. In your experience, is this Commission
22 involved in setting the rates for MGE?

23 A. It is, solely and completely.

24 Q. And what an investor buys is Southern
25 Union; is that right?

1 A. That's correct also.

2 Q. What do you believe that this Commission
3 should look at in relationship to MGE as it relates to
4 setting rates for MGE?

5 A. I think it should look at MGE. I think
6 that all of this discussion so far about MGE and what
7 stock you buy and what capital structure is totally beside
8 the point, irrelevant for what's going on here. What is
9 going on here is setting rates for MGE, not for Southern
10 Union, not for Panhandle, not for any other company. And
11 the Commission, I believe, and the people that appear
12 before it should be focused on MGE and not on other
13 companies.

14 And in this context, Southern Union and
15 Panhandle are other companies. MGE is the subject of this
16 particular activity, and that contrasts not just with the
17 witnesses here, it's also true of the rating agencies.
18 They're doing something entirely different than what this
19 Commission is doing.

20 Q. Now, as far as looking at Panhandle, being
21 asked a series of questions by both OPC and Staff counsel
22 dealing with Panhandle, to your knowledge, did both OPC
23 and Staff take any steps to try to insulate the MGE
24 ratepayers from the Panhandle acquisition?

25 A. Absolutely. The stipulation entered into

1 between the parties and ultimately approved by the
2 Commission is a document which I believe insulates MGE
3 from Panhandle in virtually every conceivable way. I can
4 think of no other ways that you might try and insulate MGE
5 from Panhandle that don't appear in that document.

6 Q. And did you attend Mr. Murray's deposition
7 in this case?

8 A. I did.

9 Q. Do you recall whether or not Mr. Murray was
10 asked questions whether or not there was any claim
11 whatsoever that MGE or Southern Union had violated any
12 stipulations, agreements or orders of the Commission?

13 MR. FRANSON: Your Honor, I'm going to
14 object. The deposition of David Murray is already in
15 evidence as an attachment to this witness' testimony, and
16 the record would speak for itself. This witness'
17 interpretation of Mr. Murray's deposition is hearsay and
18 it's inappropriate, your Honor, and it's certainly not
19 relevant.

20 JUDGE WOODRUFF: I'll sustain the
21 objection.

22 BY MR. HERSCHMANN:

23 Q. Are you aware of any complaints that have
24 been filed by either the Staff or OPC in relationship to
25 MGE allegedly violating any stipulation, orders or

1 agreements?

2 MR. MICHEEL: Objection, it's beyond the
3 scope of any cross-examination that occurred or any
4 questions from the Bench, your Honor.

5 MR. HERSCHMANN: The questions that dealt
6 with Panhandle, the risks of Panhandle, the potential
7 detriments to the MGE ratepayers directly goes to this
8 point.

9 JUDGE WOODRUFF: I'll overrule the
10 objection.

11 You can answer the question.

12 THE WITNESS: No. And I would assume,
13 given the attitude of -- what I perceive to be the
14 attitude about the acquisition of Panhandle, that if there
15 was even a hint that there was some violation of the
16 stipulation or the Order of the Commission, that a
17 complaint would have been filed immediately.

18 BY MR. HERSCHMANN:

19 Q. Do you recall being asked certain questions
20 by both the OPC and the Staff and actually Commissioner
21 Clayton dealing with leverage issues about Southern Union
22 and its capital structure?

23 A. I do.

24 Q. And in your experience, are all companies
25 leveraged differently?

1 A. Generally, they are. They're leveraged
2 based on the attitude and the desires of management and
3 the board of directors.

4 Q. And simply by the fact that companies are
5 leveraged differently, does that mean that management is
6 acting improperly?

7 A. Absolutely not.

8 Q. And is it common that in doing a DCF
9 analysis, that a true financial expert would take into
10 account the differences in the capital structure and
11 leverages of each of the comparable companies?

12 A. Absolutely. An appropriate way to do a
13 discounted cash flow analysis is to do the analysis on a
14 proxy group of companies, complete the analysis and
15 develop a benchmark rate of return. Then that return has
16 to be adjusted to the target company for differences in
17 risk between the proxy group and the target company;
18 differences in leverage, differences in business risk,
19 differences in operating risks.

20 Q. And did you take this into account when
21 doing your DCF analysis and making adjustments in this
22 case?

23 A. I did.

24 Q. On recross, Mr. Micheel asked you about an
25 equity investor could only invest in the parent of the

1 company, right, only Southern Union; do you recall that
2 question?

3 A. I recall that.

4 Q. And based on that, do you understand that
5 the OPC and Staff are now saying that the Commission
6 should not consider either divisional or hypothetical
7 capital structure for ratemaking purposes because
8 investors can only invest in Southern Union?

9 A. I understand that to be the sort of new
10 position.

11 Q. And if that were true -- well, withdrawn.

12 To your knowledge, have other commissions
13 ever used divisional or hypothetical capital structures
14 for ratemaking purposes?

15 A. To my knowledge, the use of hypothetical
16 capital structures is reasonably widespread and, in fact,
17 in connection with a Southern Union division in the state
18 of Rhode Island, the Rhode Island Commission used a
19 hypothetical capital structure.

20 Q. And in your experience, have other
21 commissions used hypothetical or divisional capital
22 structures for ratemaking purposes?

23 A. This particular Commission has in the past
24 used a hypothetical capital structure in St. Joe Light &
25 Power Company.

1 Q. Can you turn to page 21 of your rebuttal
2 testimony, please?

3 A. I have that.

4 Q. First what is a Journal of Financial
5 Practice and Education?

6 A. It's a journal which, I believe, is issued
7 by the American Institute of Financial Analysts. It is a
8 recognized journal collected by libraries all over the
9 country which reports on financial practice and education.

10 Q. What is the reason that you included a cite
11 to the Journal of Financial Practice and Education in this
12 case?

13 A. In 1998, an issue of the journal contained
14 a -- the results of a survey made by three authors on best
15 practices in estimating the costs of capital, and that was
16 the reason why I included it in my testimony.

17 Q. And what was the recommendation in
18 relationship to the divisional capital structure?

19 A. The conclusions were that out of
20 27 corporations, 10 financial advisors and 7 textbooks and
21 trade books, that in valuing a multi-division company --
22 and Southern Union can be classified as multi-division
23 company -- the individual parts of that company are valued
24 and then aggregated to develop a total company with a
25 total value. And each of those involved a separate --

1 each of those valuations involved a separate weighted cost
2 of capital for each of the divisions.

3 Q. And is that something that you've tried to
4 accomplish in this case?

5 A. It is.

6 (EXHIBIT NOS. 27 and 28 WERE MARKED FOR
7 IDENTIFICATION BY THE REPORTER.)

8 BY MR. HERSCHMANN:

9 Q. Mr. Dunn, do you have Exhibits 27 and 28 in
10 front of you?

11 A. Yes, sir, I do.

12 Q. And do you recall being asked certain
13 questions by Commissioner Clayton dealing with the
14 calculations of the ratio of the costs and the weighted
15 costs?

16 A. Yes, sir, I do.

17 Q. Can you walk us through how you do the
18 calculations as it relates to specifically this matter?

19 A. Schedule 27 is a typical cost of capital
20 table with long-term debt, preferred equity and common
21 equity included in the capital structure. And the first
22 column after that is the ratio or the mix of capital, the
23 percentages of each type of capital and the capital
24 structure. In this particular example, the long-term debt
25 constitutes 47.39 percent of the total capital, the

1 preferred equity 11.49 percent, and the common equity
2 41.13 percent.

3 Under cost, the column headed cost is the
4 cost of each of those types of capital. For example, the
5 cost of long-term debt is 7.434 percent, and the cost of
6 preferred equity, 7.758 percent, and the cost of common
7 equity 12 percent.

8 The weighted cost or the last column is the
9 product of multiplying the ratio times the cost. So the
10 first entry in the weighted cost column of
11 3.52 percent is simply the product of multiplying the
12 long-term debt ratio of 47.39 percent times the cost of
13 7.434 percent to produce the weighted cost of
14 3.52 percent. The same is true for each of the next two
15 lines.

16 Q. And then when you total the weighted cost,
17 does that give you an overall rate of return?

18 A. That's correct. You total the four -- or
19 the three components of the weighted cost, the
20 3.52 percent, the .89 percent and the 4.94 percent, and
21 you end up with the overall rate of return which is
22 9.35 percent, which is, in fact, the average cost of that
23 mix of capital based on the individual costs of the
24 individual capital types.

25 Q. If you can look at Exhibit 28, can you

1 describe for us what is Exhibit 28?

2 A. 28 is a comparison of four capital
3 structures, beginning with the MGE capital structure, and
4 the next column is the Staff capital structure, then the
5 OPC capital structure, and the OPC proposed hypothetical
6 capital structure.

7 The table is set up slightly differently
8 than the first table in that common equity is the first
9 line, preferred equity is the second line and long-term
10 debt is on the third line. This schedule also includes a
11 short-term debt line, a return on equity line and a rate
12 of return line.

13 Q. We talk about return on equity. What is
14 that number?

15 A. The return on equity number is the number
16 recommended by each of the parties in this proceeding.

17 Q. And what methodologies did you rely upon in
18 coming up with your return on equity number?

19 A. I relied on the DCF methodology.

20 Q. And since the Commissioners were not here
21 when we began, you mentioned before about your 32 years of
22 experience before this Commission. What is the primary
23 methodology that this Commission has relied upon?

24 MR. MICHEEL: I'm going to object. That's
25 been asked and answered already, your Honor.

1 MR. FRANSON: Staff will join in that
2 objection, your Honor.

3 JUDGE WOODRUFF: I'll sustain the
4 objection.

5 MR. HERSCHMANN: I really don't question
6 that I'd asked it beforehand.

7 BY MR. HERSCHMANN:

8 Q. Now, can you look at the chart for us, and
9 what is the reason that the short-term debt you reflect as
10 zero?

11 A. Because that is the short-term debt balance
12 at April 30, 2004, the true-up date.

13 Q. And what is a true-up date?

14 A. The true-up date is a date which the
15 parties agree upon prior to the hearing in a rate
16 proceeding where all of the numbers which are agreed upon
17 in principle or subject to change are trued up to the
18 actual number as of a date certain, and that particular
19 date certain in this case is the true-up date.

20 Now, for example, Mr. Micheel pointed out
21 that I had proposed during the course of this case,
22 beginning in November of last year, three different
23 capital structures, and that is because the capital
24 structure had changed through the course of the
25 proceeding. The capital structure which appears under MGE

1 on Exhibit No. 28 is the capital structure which we
2 believe is the true-up date capital structure. The other
3 capital structures were the test year capital structure
4 and the capital structure at December 31st using Mr.
5 Gillen's methodology.

6 This capital structure is the true-up date
7 using Mr. Gillen's methodology plus a definitive effort to
8 remove any Panhandle from the capital structure.

9 Q. Now, if you look at the last column where
10 it says OPC proposed hypothetical --

11 A. Yes, sir.

12 Q. -- can you tell us what that is?

13 A. The OPC has proposed in, I believe, their
14 rebuttal testimony the use of a hypothetical capital
15 structure. I proposed in my direct testimony the possible
16 use of a hypothetical capital structure. I think in the
17 surrebuttal testimony OPC indicated further endorsement of
18 the hypothetical capital structure. The hypothetical
19 capital structure is a calculated capital structure
20 designed to be similar in ratios, not precisely the same,
21 but similar to and calculated from the proxy group of
22 companies.

23 In this particular case, OPC took my proxy
24 group of companies and made a 5-year average of the equity
25 ratios for each of the companies, calculated a standard

1 deviation for that series of averages, and produced a
2 range of capital structures from, I believe, about
3 39 percent to about 59 percent. They selected the very
4 bottom of that page, 39 percent, as their hypothetical
5 equity ratio, and added to it the preferred equity
6 associated with MGE and the long-term debt associated with
7 MGE, and then adjusted those balances for the short-term
8 debt.

9 And that is their hypothetical capital
10 structure, which has, based on their costs of equity of
11 9.01 to 9.31, a rate of return of 7.49 to 7.61 percent.

12 Q. Did you ask the OPC witness to prepare a
13 proposed hypothetical capital structure or was that done
14 on their own?

15 A. They did that on their own.

16 (EXHIBIT NO. 29 WAS MARKED FOR
17 IDENTIFICATION BY THE REPORTER.)

18 BY MR. HERSCHMANN:

19 Q. Can you please take a moment and look at
20 Exhibit 29?

21 A. Yes, sir.

22 Q. And can you tell us what is contained in
23 Exhibit 29?

24 A. Exhibit 29 is a comparison of the common
25 equity ratios, the three parties, MGE, Staff and OPC, and

1 a comparison of their recommended capital structure ratios
2 or common equity ratios to the common equity ratios of
3 their comparable companies.

4 Q. And is it accurate that in the boxed area,
5 the three boxes, it's the actual average of the comparable
6 companies that you used, the comparable companies that
7 Mr. Murray used and the comparable companies that
8 Mr. Allen identified?

9 A. Yes, sir, that's an accurate statement.

10 Q. And if you look back at Exhibit 28 for a
11 moment, do you see that had Mr. Allen used a proposed
12 hypothetical capital structure with his purported
13 comparable companies, that the common equity ratio would
14 have been 40 percent and not 34.96 percent?

15 A. I'm not sure that I made that calculation,
16 so I don't know for sure that his hypothetical would be
17 40, but it would be very close to 40.

18 Q. Now, do you recall being asked questions
19 about Southern Union's proposed common stock issuance?

20 A. Yes, sir, I do.

21 Q. And do you recall being asked questions
22 about Southern Union's policy dealing with stock
23 dividends, not paying cash dividends?

24 A. I do.

25 Q. Do you recall being asked questions dealing

1 with the conversion of the equity units in 2006 into
2 common equity?

3 A. I do.

4 Q. And what would the result be of Southern
5 Union's consolidated capital structure once those events
6 occur?

7 A. It's my understanding when those events
8 occur, it moves the common equity ratio on a consolidated
9 basis very close to 40 percent.

10 Q. And the three items that we discussed, the
11 proposed common stock issuance, the continuation of the
12 stock dividend policy and the conversion of the equity
13 into common equity are all events that are known today,
14 right?

15 A. They are.

16 Q. And in making a recommendation for an ROE,
17 you look towards what investors expect today for the
18 future, right?

19 A. Absolutely.

20 MR. HERSCHMANN: I'd like to mark this now
21 as Exhibit 30.

22 (EXHIBIT NO. 30 WAS MARKED FOR
23 IDENTIFICATION BY THE REPORTER.)

24 BY MR. HERSCHMANN:

25 Q. Do you have Exhibit 30 in front of you?

1 A. Yes, sir, I do.

2 MR. MICHEEL: At this point I'm going to
3 object to any questioning with respect to Exhibit 30.
4 There was no questions either from myself or Mr. Berlin
5 regarding this exhibit. It's already in the record as
6 JT-2.

7 MR. HERSCHMANN: If there's no objection --

8 MR. MICHEEL: It's beyond the scope of
9 cross.

10 MR. HERSCHMANN: If there's no objection,
11 I'd offer Exhibit 30 into evidence at this time.

12 JUDGE WOODRUFF: Mr. Micheel, are you
13 objecting to the exhibit itself or --

14 MR. MICHEEL: It's redundant, your Honor.
15 It's already attached as Schedule JT-30 (sic) to
16 Mr. Tuck's surrebuttal testimony, and it's -- and if he's
17 going to question this witness with respect to this,
18 nobody asked this witness any questions, so it's improper.

19 JUDGE WOODRUFF: Your response?

20 MR. HERSCHMANN: I guess if I can address
21 the exhibit first. There's an objection to Mr. Tuck's
22 testimony, we filed a motion to exclude his testimony, so
23 I would offer Exhibit 30 in by itself. I presume there is
24 no objection, since OPC and the Staff have already tried
25 to offer in the testimony.

1 MR. FRANSON: Actually, Mr. Herschmann's
2 wrong. Staff has not tried to offer this into evidence.
3 OPC is trying to offer it into evidence. There's a
4 fundamental difference.

5 Also, this evidence that Mr. Herschmann is
6 trying to put in is not within the proper scope of
7 redirect. There have been no questions from anyone that
8 I've heard to Mr. Dunn about this particular Exhibit
9 No. 30. So in that regard, Judge, Staff objects to this
10 as beyond the proper scope of redirect.

11 JUDGE WOODRUFF: Do you have any response
12 to that? Was there any question asked about this on
13 direct?

14 MR. HERSCHMANN: Not by showing the
15 witness, but by asking the questions and occasionally
16 lifting words directly from it, yes. And the questions
17 dealing with and raised in Mr. Micheel's opening statement
18 were specifically addressed to the risks associated with
19 the higher debt when the company created the problem.
20 That was one of the lines of questioning that he raised,
21 as did Staff, in relationship to the capital structure of
22 MGE.

23 MR. MICHEEL: Your Honor, I talked about
24 this in opening statements, and I indicated that's in
25 JT-2, but I did not ask this witness one question

1 regarding this item, and it's beyond the scope of
2 redirect. I mean, the Commission rules are pretty clear,
3 redirect is supposed to be limited to questions from the
4 Bench or cross-examination questions from counsel. No one
5 asked him anything about this, your Honor.

6 JUDGE WOODRUFF: Nobody asked him
7 specifically about this exhibit, but there certainly were
8 questions about the risk to the company.

9 MR. FRANSON: Your Honor, if I may, before
10 you rule, the fact remains that the only reference to this
11 exhibit has been that it was mentioned by Mr. Micheel in
12 his opening statement, and this is offered, a specific
13 document, and proper scope of redirect would require that
14 there be specific questions that go to this document, and
15 there were not any.

16 So Staff would also submit that this is
17 beyond the scope of proper redirect and should not be
18 permitted into evidence.

19 JUDGE WOODRUFF: I'm going to go ahead and
20 overrule the objection, because as I indicated, there was
21 not any specific questions about this exhibit, but there
22 certainly were questions about the additional risk that
23 was inherent in MGE and Southern Union. For that purpose
24 I think it's a proper redirect. You can go ahead and
25 inquire about the document.

1 MR. HERSCHMANN: Is the objection from OPC
2 withdrawn as to admitting it? They've already offered it
3 as an attachment.

4 MR. FRANSON: Your Honor, if this -- I'm
5 sorry, Mr. Micheel.

6 JUDGE WOODRUFF: Go ahead, Mr. Micheel, if
7 you have something.

8 MR. MICHEEL: My only objection, your
9 Honor, was to questions that this -- asking questions of
10 this witness regarding this document.

11 JUDGE WOODRUFF: And I've overruled that.

12 MR. MICHEEL: I understand that.

13 MR. FRANSON: Your Honor, Staff has further
14 objection, but if Mr. -- if it's being offered at this
15 time, I have a further objection. There's handwriting on
16 here that hasn't been explained, and an e-mail ordinarily
17 would not have handwriting on it. So we haven't heard
18 about that, and at the moment, your Honor, I would object
19 that we don't have a proper foundation.

20 JUDGE WOODRUFF: I agree we don't have
21 proper foundation. You've offered it. Go ahead and ask
22 questions about it and try and lay a foundation, and then
23 I'll rule on its admissibility.

24 MR. HERSCHMANN: I guess the objection
25 deals with the handwriting.

1 BY MR. HERSCHMANN:

2 Q. Mr. Dunn, do you recognize the handwriting

3 on the exhibit?

4 A. I do, sir.

5 Q. Whose handwriting is that?

6 A. It's mine.

7 Q. Did you write those words?

8 A. Yes, I did.

9 Q. Did you produce this document to

10 Mr. Micheel?

11 A. I did.

12 Q. Do you know that Mr. Micheel arranged for

13 Mr. Tuck to attach it as an exhibit in this proceeding?

14 A. Mr. Micheel had a number of documents from

15 my files copied, and this was one of them, and I assume

16 that he arranged to have Mr. Tuck do it.

17 Q. Did you ever see Mr. Tuck review any of

18 your documents?

19 A. No.

20 Q. At Brydon, Swearngen & England?

21 A. No.

22 Q. Were you aware of whether or not

23 Mr. Micheel came by to review the documents?

24 A. Yes, sir, he did.

25 MR. HERSCHMANN: Renew and offer it into

1 evidence in light of objections being only the words.

2 MR. FRANSON: I still object on foundation.

3 Mr. Dunn seems to be saying he created this document, but

4 it clearly is from someone else that has not been

5 identified, Christina Dodd, whoever that is. So for the

6 moment I still submit we have an improper foundation in

7 that we have had no explanation of exactly what this

8 document is, where it came from, who created it, what

9 knowledge this witness has of it, and at this point we

10 have an improper foundation.

11 JUDGE WOODRUFF: Can you lay more

12 foundation for this, please?

13 MR. HERSCHMANN: Sure.

14 BY MR. HERSCHMANN:

15 Q. Mr. Dunn, do you know the circumstances as

16 to how this document came into existence?

17 A. This is an e-mail that was sent from

18 Christina Dodd, an attorney for MGE, who is with Watson

19 Bishop. It was sent to Mr. Hack, with a copy to

20 Mr. Herschmann and a copy to Mr. -- I guess no copies to

21 anyone else other than that.

22 Q. And there --

23 A. Mr. Hack sent a copy to me.

24 Q. Did you know the subject or the genesis for

25 the creation of this exhibit?

1 A. The exhibit was a consequence at least in
2 part of discussions we had had about the fact that the
3 equity ratio proposed by the Staff and Public Counsel was
4 an issue because they had not made an appropriate
5 adjustment to the return on equity to compensate for the
6 extremely low equity ratio in both of these proposals.

7 We had spent a great deal of time
8 discussing the issue, and I guess in a burst of optimism I
9 wrote not a problem, because I presume that the Commission
10 would recognize the fact that if the equity ratio is out
11 of line, it's appropriate to make an adjustment and that
12 eventually the Staff and Public Counsel would recognize
13 the fact that they needed to make an adjustment.

14 MR. MICHEEL: Your Honor --

15 JUDGE WOODRUFF: Do we have an objection
16 here?

17 MR. MICHEEL: I have an objection. He said
18 that it was discussing the direct testimonies of the
19 Office of the Public Counsel and the Staff. And I mean,
20 you can look at the document and see that the date of the
21 e-mail is Thursday, April 1st, 2004, and the direct
22 testimony in this case was filed on April 15th, 2004.

23 So unless Mr. Dunn is a savant or a mind
24 reader, he wasn't aware of what the testimony of the
25 Office of the Public -- direct testimony of the Office of

1 the Public Counsel was going to be. So that portion of
2 his statement is just simply incorrect.

3 JUDGE WOODRUFF: Mr. Herschmann, what's the
4 relevance of this document?

5 MR. HERSCHMANN: Your Honor, I think the
6 relevance of the document is to address some of the
7 questions that both OPC and the Staff have raised dealing
8 with the risks associated with Panhandle Eastern Pipeline,
9 but also to address the genesis for the creation of the
10 document in light of Mr. Micheel's mini opening today that
11 dealt directly this issue. And the source of producing
12 this document came from this witness.

13 Mr. Tuck can't authenticate the document
14 because he has no idea of its genesis. This is the only
15 witness that can discuss where it came from, what were the
16 circumstances, and actually offer it into evidence. I'm
17 only surprised because they offered it into evidence. Now
18 they seem to be objecting that it's potentially going to
19 come into evidence.

20 MR. MICHEEL: Your Honor, I'm not objecting
21 for that at all. That's an incorrect statement and
22 position. This document came into our possession in
23 response to a Public Counsel Data Request, I think it was
24 2255, where we asked for all of Mr. Dunn's work papers. I
25 went over. I look at all of his work papers. I copied

1 the portions of his papers that I thought were relevant.
2 So it's directly in response to a Data Request.

3 That was not my objection, and I don't
4 appreciate the misstatement of what the objection was.
5 The objection merely was, there were no questions about
6 this document on re-- on cross-examination.

7 JUDGE WOODRUFF: Well, this seems to be a
8 document relating conversation between the attorneys for
9 MGE. Is that essentially what we're talking about here?

10 MR. HERSCHMANN: That's correct.

11 JUDGE WOODRUFF: And Public Counsel has
12 attached it to a -- its testimony?

13 MR. MICHEEL: And I have no objection. I
14 think he's laid a proper foundation. It's not my
15 objection about the foundation.

16 MR. FRANSON: It's mine, and I don't think
17 he's there. I don't think he's anywhere close.

18 MR. MICHEEL: And all I was objecting to,
19 your Honor, was asking questions about this document.

20 MR. HERSCHMANN: If I can get it received
21 in evidence, I can address this issue pretty quickly.

22 MR. FRANSON: I guess, Judge, that brings
23 it back to me. My objection remains, improper foundation.
24 This witness, based on the document, didn't create this
25 document. He received it, and the person that created it

1 is ordinarily the one what comes in and authenticates it.
2 That would appear to be a Christina Dodd; she isn't here.
3 MR. HERSCHMANN: Yes, she is.
4 MR. FRANSON: Okay. She's not up here.
5 JUDGE WOODRUFF: We're not bringing her up
6 to the stand either.
7 MR. FRANSON: Well, ordinarily that's how
8 foundations are laid, Judge.
9 JUDGE WOODRUFF: I understand.
10 MR. FRANSON: And it's not there.
11 JUDGE WOODRUFF: I'm not convinced that
12 this document has any relevance to anything.
13 MR. FRANSON: I'll make that objection on
14 relevance, too, your Honor.
15 JUDGE WOODRUFF: I'm going to let it in for
16 the purposes of asking questions of this witness. The
17 objections will be overruled. Exhibit 30 will be brought
18 into evidence.
19 (EXHIBIT NO. 30 WAS RECEIVED INTO
20 EVIDENCE.)
21 MR. HERSCHMANN: In light of that, your
22 Honor, rather than ask the witness questions, and I can
23 alleviate I guess some of the objections since it's in
24 evidence, I can just read in the paragraphs that are
25 relevant.

1 MR. FRANSON: Your Honor, I hate to go back
2 here, but if this is in evidence, we don't need it read
3 unless there's a question to the witness. If it's already
4 in, it's not necessary to read it.

5 JUDGE WOODRUFF: I'll sustain that
6 objection. It is already into evidence. So if you have a
7 question of this witness, you can go ahead and ask it.

8 BY MR. HERSCHMANN:

9 Q. Mr. Dunn, what did you mean when you wrote
10 the words "not a problem"?

11 A. As I indicated in response to an earlier
12 question, I anticipated as a consequence of reviewing many
13 Staff testimonies at the Missouri Commission that they
14 would use a consolidated capital structure and produce a
15 very low equity ratio, and may either say that that equity
16 ratio stays without adjustments or that it's a risk
17 created by the company that needs not be compensated in
18 return. No, I don't believe that's a problem because, as
19 I indicated, I believe that the Commission would make an
20 appropriate adjustment for the higher leverage.

21 Apparently Mrs. Dodd believed that there
22 might have been a problem here, and we had spent a great
23 deal of time in various meetings talking about the
24 possibility that the Staff would use a consolidated
25 capital structure, and that it would create a sidetrack

1 for the entire process here.

2 MR. HERSCHMANN: If I could have one
3 moment?

4 MR. MICHEEL: Your Honor, I'm assuming that
5 all of these new exhibits that I've not had any chance to
6 cross-examine this witness on I'm going to get an
7 opportunity to do that. I have an absolute right to
8 cross-examine with respect to these documents, and if not,
9 it's wholly inappropriate for him to put it in in redirect
10 where I don't have one opportunity to talk about these.

11 JUDGE WOODRUFF: As you're very well aware,
12 Mr. Micheel, that's not the normal procedure here at the
13 Commission, but I think it is the correct procedure. I
14 mean, what you've proposed is correct, and I'm going to
15 give the parties an opportunity to cross-examine on these
16 new exhibits.

17 COMMISSIONER CLAYTON: And if he gets a
18 shot, I get a shot.

19 JUDGE WOODRUFF: Yes, and Commissioner
20 Murray is here, so we'll give her a shot as well.

21 MR. FRANSON: And, Judge, that raises a
22 whole other question -- well, if we're going through all
23 at once.

24 MR. HERSCHMANN: I'd offer Exhibits 27 and
25 28, 29 into evidence at this time.

1 MR. MICHEEL: I have an objection with
2 respect to Exhibit 29, your Honor.

3 JUDGE WOODRUFF: What would that be?

4 MR. MICHEEL: When Mr. Herschmann asked
5 Mr. Dunn with respect to the 40 percent capital structure
6 that would result from Witness Allen's comparable
7 companies, he indicated that he hasn't seen that
8 calculation and that, therefore, he didn't know if that
9 was an appropriate calculation or not, the calculation in
10 the box. So based on that, I would object to the
11 admission of Exhibit 29 because it lacks foundation.

12 JUDGE WOODRUFF: I think the question dealt
13 with the comparison between the 40 percent on Exhibit 29
14 and the 20 -- Exhibit 28, 34.96 percent. It didn't deal
15 with the 40 percent itself, so I'll overrule the
16 objection.

17 Exhibits 27, 28 and 29 are admitted into
18 evidence.

19 (EXHIBIT NOS. 27, 28 AND 29 WERE RECEIVED
20 INTO EVIDENCE.)

21 JUDGE WOODRUFF: Did you have anything
22 further, Mr. Herschmann?

23 BY MR. HERSCHMANN:

24 Q. If we can go back to a question that was
25 previously overruled and look at Dr. Morin's testimony on

1 pages 105 and 106, do you see the question? This was by
2 Mr. Micheel, and if you had that example that I just gave
3 you of a DCF range of 9.01 to 9.34 percent and a CAPM
4 result of 9.17 percent, wouldn't that indicate that your
5 CAPM and your DCF were compatible? Answer: It would
6 probably indicate to me that they're both wrong.

7 Do you know whose percentages Mr. Micheel
8 is using when he phrased that question to Dr. Morin?

9 MR. MICHEEL: Objection, it's beyond the
10 scope of any cross-examination that I did with respect to
11 this witness. I didn't talk to him about the CAPM, I
12 didn't talk to him about this page of Dr. Morin's
13 deposition. And if you closely read that, I said
14 hypothetically if you have that, and so it calls into
15 speculation what was in my mind when I asked that
16 question.

17 JUDGE WOODRUFF: I'll sustain the objection
18 based on what you said at the end, that it calls into
19 question about speculation about what Mr. Micheel might
20 have been thinking.

21 MR. HERSCHMANN: Could I have one moment?

22 BY MR. HERSCHMANN:

23 Q. If you look at Exhibit 28 and you look at
24 the return on equity, in whose column do you see the
25 9.34 percent?

1 A. It appears in the OPC columns.

2 Q. And just for purposes of clarification, who

3 does Mr. Micheel represent?

4 A. The Office of Public Counsel, OPC.

5 Q. And who is the witness for OPC?

6 A. Mr. Murray.

7 Q. Do you mean Mr. Allen?

8 A. Or Mr. Allen. Excuse me.

9 MR. HERSCHMANN: I have no further

10 questions at this time.

11 JUDGE WOODRUFF: All right. Thank you.

12 All right. To wing a procedure here, we'll come back for

13 questions from the Bench, and I'll ask the Commissioners

14 if they have any questions about these last four exhibits

15 to come in, and ask them at this time also --

16 MR. FRANSON: Your Honor, actually I might

17 suggest since we've got new evidence, the traditional

18 practice -- and I know we're winging it here -- would be

19 the parties ask their cross-examination, then the Bench.

20 JUDGE WOODRUFF: I think that would be an

21 unnecessary duplication because the parties are going to

22 have a chance to do recross again.

23 MR. FRANSON: Thank you, your Honor.

24 JUDGE WOODRUFF: We'll come up for

25 questions from the Bench. I'll begin with Commissioner

1 Murray.

2 COMMISSIONER MURRAY: Thank you.

3 QUESTIONS BY COMMISSIONER MURRAY:

4 Q. I apologize that I could not be here
5 earlier. I just have a few questions from your testimony,
6 and I'm referring to your surrebuttal. On page 7, you
7 speak about the S&P analysis of February 4th that is
8 attached as your JCD- 2, and you say it is clear from that
9 document that Panhandle Eastern has a rating separate from
10 Southern Union, and I would like to know if you can point
11 out where in that document it is clear?

12 A. If you'll bear with me just a minute to
13 find the document. Now, it was the Moody's document
14 you're referring to or the Standard & Poor's?

15 Q. It's Moody's. I apologize. JCD-2.

16 A. A sort of first step is on page 1, which is
17 the first page under rating rationale. It says Southern
18 Union Company's rating, in the very first line.

19 Q. Yes.

20 A. And if you go to the top of the next page,
21 it says Panhandle's ratings, and virtually throughout the
22 document they deal with Southern Union on one hand,
23 Panhandle on the other. And when they do this, Panhandle
24 is a part of Southern Union, but when they do the
25 Panhandle work, Southern Union is not a part of Panhandle.

1 So they're ranking Panhandle by itself and Southern Union,
2 the two companies combined.

3 Q. But when they are ranking Southern Union,
4 they're including Panhandle?

5 A. That's correct.

6 Q. On page 13 of your surrebuttal, you
7 mention -- you talk about depreciation rates at line 18,
8 the depreciation rates for MGE are lower than for the
9 Staff comparative group. How much lower?

10 A. A small amount, enough probably to extend
11 things by 4 to 5 years, so that instead of depreciating
12 the property, say, over 27 years, it might be 32 years.

13 Q. And it's your position that that's
14 additional risk?

15 A. Yes. Any -- any extension of time where
16 your funds are exposed creates risk.

17 Q. And on page 18 of your surrebuttal, at
18 line 17 -- actually the question posed at line 16, will
19 any of these funds be used for the direct benefit of
20 Panhandle Eastern? And you answer, no, none of these
21 funds related to the proceeds of the sale of equity
22 securities will be distributed to Panhandle Eastern.

23 Will they be used to pay down the debt of
24 Panhandle Eastern?

25 A. No, ma'am. None of the funds will be --

1 will cross that line from Southern Union into Panhandle.
2 The Panhandle debt is held inside the Panhandle
3 corporation, and in many respects it's inaccessible to
4 Southern Union. The only way to finish up -- the only way
5 that Southern Union could pay down debt of Panhandle would
6 be for Southern Union to make an additional equity
7 investment in Panhandle or to loan Panhandle money, and
8 then Panhandle could do something with those funds that it
9 obtained from Southern Union.

10 But Southern Union is powerless to act
11 directly on Panhandle, not necessarily by virtue of the
12 stipulation, but just by virtue of the fact that it's a
13 separate legal entity. The stipulation prohibits any kind
14 of financial transaction.

15 Q. Okay. Now I'm going to go to your
16 Exhibit JCD-1, which is the Standard & Poor's.

17 A. Yes, ma'am, I have that.

18 Q. All right. All right. On page 3 of that
19 exhibit, rating methodology --

20 A. Yes, ma'am.

21 Q. -- how do you read that paragraph there
22 under rating methodology in terms of whether they are
23 considering a consolidated structure or separate
24 structure?

25 A. I believe that says the same thing as what

1 we said a few moments ago, that when they rate Southern
2 Union, they rate them -- rate both companies together,
3 that they rate -- the rating methodology includes Southern
4 Union and Panhandle Eastern.

5 Q. In a consolidated fashion?

6 A. Yes. And then they differentiate.
7 Ordinarily they would rate down, I believe, Southern Union
8 and -- or Southern Union, and they don't do that here.

9 Q. Would you go to JCD-7? Yes, JCD-7. It's
10 return on equity comparison. It may have been filed
11 separately.

12 A. With respect to the surrebuttal?

13 Q. It was referred to in the chart, and I
14 guess it was not a separate document filed.

15 A. JCD-3 or 4.

16 Q. 7.

17 A. On the surrebuttal or the rebuttal?

18 Q. Your surrebuttal, Schedule JCD-7. It's a
19 return on equity comparison.

20 MR. HACK: If I might approach to speed
21 things along?

22 JUDGE WOODRUFF: You may.

23 THE WITNESS: I have that now. It was
24 filed separately. I have it.

25 JUDGE WOODRUFF: Thank you, Mr. Hack.

1 BY COMMISSIONER MURRAY:

2 Q. In looking at the chart, it appears that
3 since 1998, with one exception, Staff's ROE recommendation
4 has been below that of Office of the Public Counsel. Is
5 that your interpretation of that?

6 A. Since 1997?

7 Q. Or '98.

8 A. It appears to be.

9 Q. Do you --

10 A. A second case in 2001, Staff had a
11 10.05 recommendation and Public Counsel had a 9.90. In
12 all other cases, Staff was below the Public Counsel.

13 Q. And sometimes fairly significantly below,
14 it appears?

15 A. Yes, ma'am.

16 Q. Did you do any comparison of average
17 recommendations in other jurisdictions comparing the
18 Staff's recommendations and the Public Counsel's
19 recommendations?

20 A. Yes, I did. I have a schedule that was
21 used to prepare this schedule. I don't have copies of it,
22 but it's what I'm looking at is a comparison of the
23 results in other jurisdictions with the recommendations of
24 the Staff and the recommendations of OPC.

25 Q. That was -- was that placed in evidence?

1 Was that a part of your -- I don't recall seeing it.

2 A. I don't believe that this particular
3 schedule has been placed in evidence. It's very similar
4 to this schedule, except that it has all the backup data
5 on it so that it's easier for me to read anyway.

6 Q. What does it indicate in terms of a -- or
7 is there any conclusion you can draw from that data to
8 compare jurisdiction by jurisdiction the recommendation of
9 Staff versus Office of Public Counsel or their equivalent?

10 A. Oh, I'm sorry. I misunderstood your
11 question. I possibly can develop that information, but I
12 don't have that. I only have Missouri Staff and Missouri
13 Public Counsel and nationwide results.

14 Q. All right. Yes, you did misunderstand.
15 And you've not done any --

16 A. No.

17 Q. -- comparison?

18 COMMISSIONER MURRAY: All right. Thank
19 you. That's all I have.

20 JUDGE WOODRUFF: All right. Commissioner
21 Clayton?

22 FURTHER QUESTIONS BY COMMISSIONER CLAYTON:

23 Q. I just have a few questions since I already
24 had a shot, and I'm not going to take up everyone else's
25 time.

1 Mr. Dunn, did you testify in MGE's last
2 rate case?

3 A. Yes, I did.

4 Q. You were the -- were you the witness for
5 capital structure and return on equity rate of return
6 issues?

7 A. Yes, sir, I was.

8 Q. Do you recall the position of MGE relating
9 to capital structure in that case?

10 A. I believe we proposed a hypothetical
11 capital structure.

12 Q. And do you recall what that was?

13 A. No, I don't.

14 Q. That rate case was prior to the merger or
15 acquisition of Panhandle Eastern, was it not?

16 A. It was prior to.

17 Q. On the document that you were reviewing
18 with Commissioner Murray, I believe it was either the
19 Moody's -- excuse me -- the Moody's analysis relating to
20 capital structure, there's a clause in here that caught my
21 attention. It said Southern Union Gas was highly
22 leveraged before it acquired Panhandle from previous LDC
23 acquisitions and incurred large amounts of goodwill
24 through various transaction.

25 I guess my question is, how is the actual

1 consolidated capital structure of the company now versus
2 what the average capital structure of the company was
3 prior to the merger and acquisition? Do you have the
4 answer to that?

5 A. The equity ratio is slightly higher as a
6 consequence of the acquisition of Panhandle. And
7 "slightly" is the operative word. I think it was probably
8 24, 25 percent prior to the acquisition; 26 to 28 percent
9 after the acquisition.

10 Q. Okay.

11 A. So there was a fair amount of equity issued
12 in connection with the transaction.

13 Q. Okay. But if we were to go back prior to
14 this transaction and we were to remove all of the debt of
15 Panhandle Eastern, the \$1.2 billion, and still the common
16 equity in the structure was only still 24, 25,
17 26 percent?

18 A. That's correct.

19 Q. Okay. And in that case -- and I guess
20 there is a question of whether or not this is relevant.
21 In that case you all proposed a hypothetical capital
22 structure, correct?

23 A. That's correct.

24 Q. Now, hypothetically speaking, without the
25 Stipulation & Agreement, which supposedly separates the

1 division from the parent, why would hypothetical capital
2 structure be appropriate in that instance?

3 A. Well, because the capital structure is
4 currently an anomaly, it is currently relatively low in
5 equity on a consolidated basis. If you divide the two
6 companies properly, there's much more equity in Southern
7 Union Company. But if you look at a consolidated capital
8 structure, you still have a very low equity ratio, and the
9 proper way to deal with that either is to make a very
10 substantial adjustment to return on equity or to use a
11 hypothetical.

12 Q. But for capital structure purposes,
13 wouldn't a valid way to look at this structure, if there's
14 a problem or an anomaly or an issue with the significance
15 of the debt with a subsidiary the Panhandle Eastern debt,
16 wouldn't the appropriate analysis include just going back
17 to -- going back before that transaction actually occurred
18 and looking at the structure of the corporation at that
19 time? Wouldn't that be a more appropriate method than
20 just taking out a part of it? Shouldn't we remove the
21 whole transaction?

22 A. If we remove the equity that was issued --
23 the equity is there today. And the benefit of that equity
24 will carry forward, and I don't think it would be
25 appropriate to remove the equity and say that here's a

1 piece of capital that we're not going to deal with in this
2 particular rate proceeding.

3 Part of what is going on, I think that the
4 conversation, the discussion, the dialogue has been turned
5 to the point that there's way too much discussion about
6 the appropriate capital structure. It's a fairly
7 straightforward matter. Either the capital structure
8 ratios are relatively low, which they are, and they need a
9 very high return on equity; that's one compensation, which
10 is mentioned in many textbooks and well accepted.

11 The other approach to avoid the problem of
12 making an incorrect calculation of that adjustment is to
13 use a hypothetical capital structure.

14 A low capital structure in and of
15 itself is not a problem, and if you go back and get a 26
16 or 25 percent equity ratio, you still have to adjust that
17 return on equity up to the point where you have a
18 reasonable return on equity for the level of risk
19 associated with a 25 percent equity ratio.

20 JUDGE WOODRUFF: Mr. Dunn, if you can move
21 a little bit closer to your microphone.

22 THE WITNESS: I'm sorry, sir.

23 BY COMMISSIONER CLAYTON:

24 Q. I struggle with the use of the word "need."
25 Your term is, we need to increase the return on equity,

1 when we need to come up with a hypothetical capital
2 structure to achieve the rate of return necessary for this
3 company. And I'm struggling with who needs it? The
4 company needs it, the shareholders need it?

5 A. In order to obtain more equity in the
6 future, the company must have a reasonable return today.
7 That's the first rule. The second rule is that it's my
8 understanding the operative findings of various courts,
9 the Supreme Court in particular, say that this company
10 should be able to earn at a level commensurate with its
11 risk equivalent to other companies similarly situated.

12 All of those things apply here, and that
13 means that we have to do certain things to achieve a
14 result which is consistent with those findings of the
15 court. And perhaps the best way to -- or one way,
16 certainly, to look at it, the federal government's pretty
17 much all-powerful in this country, but they need to raise
18 the interest rate that they pay on 5 percent -- or 5-year
19 notes in order to sell them. They can't sell them
20 otherwise. They need to do it.

21 And their customers just won't be there to
22 buy the 5-year notes. They need to raise the interest
23 rates on 10-year notes even higher. Otherwise the
24 customers won't be there to buy it. And we're sellers in
25 an equity market. Companies sell like -- it isn't

1 automatic. They just can't get it by being there.

2 It's one of those things that, I think,
3 most important, though, rather than talking about
4 consolidated and talking about things that really, I
5 guess, sort of complex up this whole discussion, what we
6 ought to be talking about is what do you have to do to
7 find a reasonable rate of return for Missouri Gas Energy?

8 You have to find a capital structure that's
9 reasonable. You have to find a return on equity that's
10 reasonable and find a cost of debt. We know the cost of
11 debt, preferred, those are not an issue. What's the
12 capital structure? Well, if you're going to comply with
13 what the various courts say, what the tradition in
14 Missouri has always been to give a commensurate return,
15 then you have to pretty much provide a return pretty
16 similar to somebody like Laclede, and capital structure is
17 more or less irrelevant in that whole process.

18 I think the whole business of talking about
19 consolidated capital structure is truly a red herring. It
20 is something that finance theory just does not deal with,
21 except in a very negative way. You're going to hear two
22 other people get up here and say the consolidated capital
23 structure is the only way to go, and I frankly believe
24 they'll be hard pressed to go very far beyond what they
25 have said in the past. You raise your money one place

1 through -- under one name, and consequently, the
2 consolidated capital structure that goes with that name
3 applies to everything that that money's used for.

4 Well, that's not true. Professor Morin's
5 book says it. I can parade out every single introductory
6 textbook in finance -- I mean, every intermediate textbook
7 in finance. Risk wells up from the assets. The costs
8 associated with making an investment wells up from that
9 investments. If I'm going to finance a car for somebody,
10 it is the financial action of financing that car that
11 causes me risk and requires a return. It isn't the fact
12 that I took my good credit and borrowed money at a bank.

13 I should be entitled to a return that's
14 equal to the risk associated with lending money to someone
15 for a project. A car, a project, a pipeline. And it's
16 that project that causes the cost. It's not the source of
17 the money, it's the use of money.

18 We use the money to build pipelines, and
19 that's where the cost arises from. The risk of a
20 pipeline, the risk of weather, the risk of longer
21 depreciation, those are the things that lead to cost of
22 capital.

23 And we have to compete to get that capital
24 with other companies. There's a limited number of
25 investors and there's a lot of companies that want to get

1 the money. We have to be as good as they are or we can't
2 get it.

3 As a personal note, it seems to me like
4 Missouri doesn't want to get itself in a position where it
5 gets the reputation, I guess, for not providing adequate
6 returns for its utilities, because there are two or three
7 utilities in the state that are solely Missouri utilities.

8 Q. In determining how a case is going to be
9 prosecuted, it seems that the result that is desired is
10 chosen by each of the parties, and then the formulas, the
11 mechanisms, percentages, capital structure, cost of debt,
12 cost of equity, whatever, the growth mechanisms, that that
13 revenue requirement is determined first and then
14 everything flows from that backwards, rather than
15 logically forward from determining the growth, determining
16 what the capital structure is, determining what each of
17 the cost items are to achieve that revenue requirement.
18 Is that an inappropriate observation on my part?

19 A. If I understand what you're saying, you're
20 suggesting that you know what the end result is and then
21 you figure out all the ways to get to the end result?

22 Q. Well, that's what it seems like, because we
23 have a number of formulas, and this is no commentary on
24 your testimony. It's a matter of frustration. But we
25 have these set formulas, but there's so many anomalies,

1 there's so many differences in exactly what we're talking
2 about that if we're not going to use a capital structure,
3 which is part of these formulas, then I question the
4 overall use of formulas. Everything is, well, we have to
5 make an adjustment or an assumption.

6 And this isn't an inquiry based on yours,
7 but it seems that the positions are -- of the companies
8 overall are generating the figures that are back in the
9 formulas. Do you see where I could get that?

10 A. That there's circularity in the process or
11 that there's contrivance in the process?

12 Q. Well, I'm not saying that it's necessarily
13 inappropriate, but it is frustrating to find each of these
14 pieces when the pieces can be modified or changed and
15 adjusted. In your opinion, how do you explain that?

16 A. I don't think there's any explanation. I
17 think that honestly if you get 10 different people up here
18 to talk about a growth rate, you're going to get
19 10 different growth rates, maybe 11.

20 Q. I'm an attorney. I understand that.

21 A. But I disagree really with the notion that
22 the end result, the amount of money is something that you
23 derive the amount of money and then you figure out how you
24 get there. As I remember this case, as it unfolded, the
25 number, the requested number was much lower and the costs

1 and the different studies were done, and as they were done
2 and completed, the number went up, and the filing request
3 was higher than originally expected.

4 It wasn't a question of the company comes
5 up with a number, we want to file for \$45 million, go out
6 and prove it. It was more a case of, we think we're short
7 this amount of money right now, let's see where we really
8 are, and it turned out we were really shorter than we
9 thought.

10 Q. Okay.

11 A. I just don't think that -- I think you're
12 confronted with the problem sitting here trying to weigh
13 this stuff, and some of it does fall in the category of
14 stuff, but -- and it's not going to be easy, but there's
15 an awful lot of it that's resolved. You don't have to at
16 every case hear the capital structure issue. You don't
17 have to at every single case hear about whether or not I'm
18 buying a share of Southern Union and, therefore, that
19 affects MGE. The rules are so simple.

20 And, I mean, it's a huge logical construct
21 that runs across economics and finance that the cost of
22 operating that particular podium arises from that podium.
23 It doesn't arise from who owns it. It arises from the
24 frequency of use and where it's located and things like
25 that, but it isn't who owns the podium. It's the podium

1 itself that creates the costs.

2 COMMISSIONER CLAYTON: Thank you.

3 JUDGE WOODRUFF: Commissioner Appling, do

4 you have any questions?

5 MS. GARDNER: No questions, Judge.

6 JUDGE WOODRUFF: We'll go back then to

7 recross. Kansas City's not here. Joplin's not here.

8 Federal Agencies, any recross?

9 MR. PAULSON: No, sir.

10 JUDGE WOODRUFF: Jackson County and Midwest

11 Gas are not here. So we'll go to Public Counsel.

12 FURTHER RECROSS-EXAMINATION BY MR. MICHEEL:

13 Q. All right. Mr. Dunn, I want to start with

14 some questions that Commissioner Clayton asked you, and he

15 asked you some questions about the consolidated capital

16 structure. Do you recall those questions?

17 A. Yes, sir, I do.

18 Q. Is it correct that in your time as an

19 analyst, you have recommended consolidated capital

20 structures be adopted before this Commission?

21 A. Yes, I have.

22 Q. And so you're one analyst who's recommended

23 that consolidated capital structures be utilized for

24 determining the cost of capital; isn't that correct?

25 A. My recollection is that I recommended a

1 consolidated capital structure on a company that was a
2 water company that had a series of subsidiaries that were
3 all water company subsidiaries and all substantially the
4 same, much like Southern Union without Panhandle is a
5 series of distribution companies which are substantially
6 the same.

7 Q. Is that the only time that you've
8 recommended a consolidated capital structure for use in
9 ratemaking?

10 A. That's the only time I can think of
11 offhand. I may have 25 years ago recommended something,
12 but --

13 Q. I want to talk to you a little bit about
14 Exhibit 30. It's correct that the date on Exhibit 30 is
15 April 1, 2004, correct, the initial date, the date it was
16 sent from Christina Dodd sent to Rob Hack with a --

17 A. Yes.

18 Q. -- carbon copy to Eric Herschmann?

19 A. That is correct.

20 Q. And that was prior to the Office of the
21 Public Counsel and the Staff filing direct testimony in
22 this proceeding; is that correct?

23 A. That's correct.

24 Q. In the second paragraph here when it
25 states, as Mike puts it, why should MGE benefit from its

1 failure to optimize its own capital structure, that Mike
2 is Michael Fay, an attorney with Kasowitz Benson; is that
3 not true?

4 A. Yes.

5 Q. And that's his belief, is it not?

6 MR. HERSCHMANN: Objection, calls for
7 speculation.

8 JUDGE WOODRUFF: Sustained.

9 BY MR. MICHEEL:

10 Q. Well, what does this document indicate, as
11 Mike puts it?

12 A. The document states as Mike puts it, yes.

13 Q. And that's referring to Michael Fay; is
14 that correct?

15 A. I don't know for sure, but I assume it
16 might be.

17 Q. And so those are Mr. Fay's thoughts?

18 A. There are other Mikes involved here.

19 MR. HERSCHMANN: Same objection.

20 JUDGE WOODRUFF: Same result. The document
21 speaks for itself.

22 BY MR. MICHEEL:

23 Q. Let me ask you this: Who was all at the
24 meetings that were talked -- where this issue was talked
25 about during the meetings with great detail?

1 A. I think that Mr. Hack was in some of the
2 meetings. Mr. Herschmann was in some of the meetings.
3 Ms. Dodd was in some of the meetings; perhaps most of them
4 for all of them. I don't remember Mr. Fay being be in any
5 of those meetings, frankly, other than to come in and
6 speak for a moment and introduce himself.

7 And Mr. Fay was, at this point in time,
8 working on the Daubert motions, and Mr. Fay was not an
9 integral part of the discussions that we were having about
10 this particular issue.

11 Q. And were you in on every one of these
12 meetings?

13 A. No, I was not, and there were others, if
14 you want me to continue to try to list them.

15 Q. Let me ask you some questions about
16 Exhibit 29. Could you tell me, did you prepare this
17 exhibit?

18 A. I provided input. I actually didn't do the
19 typing for the exhibit.

20 Q. Did you do the calculations that led to
21 this exhibit?

22 A. This is an exhibit of, find this number
23 from this testimony and find this number from this
24 testimony.

25 Q. And where did you find the 40 percent

1 comparable companies number from? Whose testimony did you
2 find that from?

3 A. That comes from Mr. Allen's testimony, is
4 my recollection.

5 Q. Mr. Allen's testimony has his comparable
6 companies as 40 percent?

7 A. Yes, sir.

8 Q. And where is that in Mr. Allen's testimony?
9 Where is that calculation in Mr. Allen's testimony?

10 A. Schedule TA-2.

11 Q. Which testimony are you in, sir?

12 A. Direct testimony.

13 Q. And it's your testimony that Mr. Allen in
14 his direct testimony, Schedule TA-2, calculated a
15 hypothetical capital structure for Missouri Gas Energy?

16 MR. HERSCHMANN: Objection, misstates --

17 THE WITNESS: This is Witness Allen --

18 JUDGE WOODRUFF: Wait until your attorney's
19 done.

20 MR. HERSCHMANN: Objection. I think it
21 misstates what's in the exhibit. The exhibit says OPC
22 Witness Allen, comparable companies 40 percent, not
23 hypothetical for MGE, as Mr. Micheel just raised in the
24 question.

25 JUDGE WOODRUFF: Can you clarify exactly

1 what you're asking, and maybe that will clear this up?

2 BY MR. MICHEEL:

3 Q. Is that a hypothetical calculation
4 appearing there, Mr. Dunn?

5 A. No, sir. It is the average of Mr. Allen's
6 comparable companies as shown on Schedule TA-2. It is
7 just what it says in the box, OPC Witness Allen comparable
8 companies.

9 Q. I believe it was Commissioner Clayton asked
10 you some more questions about the hypothetical capital
11 structure and the historic low equity ratio that Southern
12 Union Company has. Do you recall those questions?

13 A. Yes, sir, I do.

14 Q. Is it correct that Southern Union Company's
15 equity ratio in this proceeding is low because of the
16 Panhandle acquisition?

17 A. I think it is low simply because of
18 acquisitions which occurred prior to that. As I
19 indicated, the equity ratio did not change a lot as a
20 consequence of the Panhandle acquisition.

21 Q. So for a number of years Southern Union has
22 had an aberrationally low equity ratio; is that your
23 testimony?

24 A. No, I didn't describe it a aberrationally
25 low. Southern Union's capital structure began at a

1 relatively low point, grew up into the 30s, as I
2 recollect, and then an acquisition was made which dropped
3 it back down.

4 Q. Do you know if --

5 A. So it has been more or less on a process of
6 up and down improving in some years, most years towards a
7 target.

8 Q. Do you know if a 30 percent equity ratio is
9 consistent with normal equity ratio for gas distribution
10 companies?

11 A. It's different from the equity ratios
12 associated with the comparable groups in this case.

13 Q. And it's lower, is it not?

14 A. Yes, it is.

15 Q. And historically, isn't it correct for the
16 last 10 years Southern Union Company has had a low equity
17 ratio vis-a-vis the natural gas local distribution group?

18 A. I don't think I can answer that question
19 any further than I already answered it. It has been up
20 and down over the period, but I have not done the study,
21 so I don't know.

22 MR. MICHEEL: Thank you very much.

23 JUDGE WOODRUFF: For Staff?

24 MR. FRANSON: Thank you, your Honor.

25 RECROSS-EXAMINATION BY MR. FRANSON:

1 Q. Mr. Dunn, let's identify some players.
2 Could you look at Exhibit 30, please? Do you have that in
3 front of you?
4 A. Yes, I do.
5 Q. Okay. You received this e-mail; is that
6 true?
7 A. Yes, sir.
8 Q. When did you receive it?
9 A. 4/16 apparently.
10 Q. Okay. Do you know the first time you read
11 it?
12 A. The time I received it.
13 Q. Okay. So you were at your desk and read
14 it, you remember that specifically?
15 A. Well, I would have read it as I received
16 it, simply because it's dated received on the bottom on
17 April 16th. I printed it, and I would have printed it and
18 read it.
19 Q. Okay. Now, who is Christina Dodd?
20 A. Christina Dodd is an attorney with Watson
21 Bishop.
22 Q. And where is she located? Where is Watson
23 Bishop?
24 A. I believe it's in Austin, Texas.
25 Q. Okay. Is it fair to say she does work for

1 Southern Union and MGE?

2 A. Yes, sir.

3 Q. And Mr. Herschmann does work for MGE and

4 Southern Union; is that correct?

5 A. Yes, sir.

6 Q. And Mr. Hack obviously does work for MGE

7 and Southern Union?

8 A. Yes, sir.

9 Q. Okay. Now, have you ever testified before

10 this Commission on behalf of MGE before?

11 A. I filed testimony. It's my recollection

12 that the last case was settled and there was no testimony

13 of this type. The testimony was filed under affidavit in

14 the case.

15 Q. Okay. So you did file testimony in the

16 last rate case, GR-2001-292?

17 A. That's my recollection.

18 Q. Okay. And you understood the terms of the

19 settlement in that case?

20 A. I was not involved in the entire

21 settlement.

22 Q. Okay. But have you ever seen the

23 settlement or have an understanding of the settlement?

24 A. No, sir.

25 Q. Okay. But it's fair to say that it was a

1 unanimous settlement, and MGE agreed to something, even
2 though you don't know the details?

3 A. I would assume they agreed, yes.

4 Q. Have you ever been told that MGE agreed to
5 a Unanimous Stipulation & Agreement in Case No.
6 GR-2001-292?

7 MR. HERSCHMANN: Your Honor, I'm going to
8 object to this being outside the scope of redirect or
9 recross or further questioning by any of the
10 Commissioners.

11 MR. FRANSON: Well, your Honor,
12 Mr. Herschmann opened up a wide -- I just can't describe
13 it wide enough area here. And if I can have just a little
14 leeway, I will tie this in very promptly.

15 MR. HERSCHMANN: I thought the recross was
16 limited to the exhibit, that the recross was limited to
17 the new exhibits and the redirect was based on the
18 cross-examinations that had existed.

19 JUDGE WOODRUFF: That is correct. It does
20 seem very far. Can you tell me where you're going with
21 this?

22 MR. FRANSON: Your Honor, perhaps I can try
23 it a different way.

24 BY MR. FRANSON:

25 Q. Mr. -- all I really need is a couple

1 things. Mr. Dunn, you were a witness in the prior case,
2 correct?

3 A. As I indicated, I filed direct testimony.
4 I just don't know where you draw the line between being a
5 witness, as in sitting here answering questions, and
6 filing testimony.

7 Q. Let me ask you this: Rates currently in
8 effect were a result of this case?

9 A. Yes.

10 Q. Now, so right now, is it fair to say that
11 really what Exhibit 30 is, you received it, and it would
12 appear to be strategizing between -- meaning attorneys are
13 creating strategies for this case. Is that fair statement
14 of what this is?

15 MR. HERSCHMANN: Objection, your Honor, the
16 document speaks for itself.

17 MR. FRANSON: Your Honor, I'm entitled to
18 ask the witness to interpret a document, and that's what
19 I'm doing.

20 JUDGE WOODRUFF: I'm going to overrule the
21 objection.

22 THE WITNESS: I don't know if strategizing
23 is the proper word. I think -- it seems like to me she's
24 recounting parts of the discussion.

25 BY MR. FRANSON:

1 Q. Okay. Is it fair to say that on April 1,
2 of 2004, that direct testimony had not been filed by Staff
3 in this case?

4 A. Yes, it is.

5 Q. Do you know when Staff and all the other
6 parties or MGE actually filed their direct testimony?

7 A. I think April 15th, but I'm not sure.

8 Q. Okay. So is it fair to say that what we
9 have here is you received an e-mail anticipating attacks
10 that could be made by MGE upon Staff well before testimony
11 was actually filed?

12 MR. HERSCHMANN: Objection, calls for
13 speculation.

14 JUDGE WOODRUFF: I'll sustain that
15 objection.

16 MR. FRANSON: Well, your Honor, I believe
17 my question was, does this witness know, and I believe the
18 way that's phrased --

19 JUDGE WOODRUFF: Objection is sustained.

20 MR. FRANSON: Thank you, your Honor.

21 BY MR. FRANSON:

22 Q. Mr. Dunn, prior to receiving this e-mail,
23 had you ever discussed with anyone from MGE or anyone
24 representing MGE various attacks that could be made upon
25 Staff?

1 Let me rephrase that. Before April 15, did
2 you discuss with anyone at MGE and/or their attorneys
3 possible attacks that could be made upon Staff positions
4 that might be taken?

5 A. I discussed the matter. I think your
6 choice of words is inappropriate. I don't think anyone
7 was speaking about attacks on anyone. I think what
8 happened was that we anticipated the kind of filing that
9 would be made. Given the fact that three testimonies in
10 the three prior cases were virtually verbatim, we had a
11 good idea what the testimony in this case was going to be.

12 And at that point in time, I don't believe
13 we were thinking that there was going to be an OPC case.
14 These were not attacks. We just were anticipating what
15 was going to be filed and how to respond. Attack's just a
16 poor choice of words. I thought you said at the beginning
17 to try and make the process more gentlemanly.

18 Q. Is this a gentlemanly document?

19 MR. FRANSON: Your Honor, I'll withdraw
20 that.

21 MR. HERSCHMANN: If anything, it's a
22 womanly document, your Honor.

23 MR. FRANSON: Your Honor, no further
24 questions.

25 JUDGE WOODRUFF: All right. Thank you.

1 Redirect?

2 FURTHER REDIRECT EXAMINATION BY MR. HERSCHMANN:

3 Q. Very, very briefly to follow up on

4 Mr. Franson. During the course of these meetings, did I

5 discuss the fact that I believe the Daubert standard

6 should apply to Missouri even before the McDonagh (ph.

7 sp.) decision came down by the Supreme Court?

8 A. I'm sorry. Are you referring specifically

9 to this document?

10 Q. Not the document. Refers to the meetings.

11 Do you recall having discussions about the fact that I

12 believe the Daubert standard should probably apply to

13 Missouri months before the Missouri Supreme Court came

14 down with the McDonagh decision?

15 A. Yes, you did.

16 Q. That was also in anticipation of how to

17 handle this proceeding; is that correct?

18 A. That's correct.

19 MR. HERSCHMANN: I have nothing further.

20 Thank you.

21 JUDGE WOODRUFF: All right. Then, with

22 that, you can step down.

23 THE WITNESS: Thank you, your Honor.

24 JUDGE WOODRUFF: The next name on the

25 witness list is Mr. Gillen. I believe he won't be here

1 until tomorrow; is that right?

2 MR. HACK: That is correct.

3 JUDGE WOODRUFF: And then Dr. Morin won't

4 be here until Monday. Actually, the next witness would be

5 Travis Allen.

6 MR. MICHEEL: We would call Travis Allen,

7 your Honor.

8 And your Honor, I had EFIS'd an Allen

9 errata sheet, and I guess I'll just mark that now. I

10 think it would be Exhibit 215.

11 MR. HERSCHMANN: Your Honor, can we just

12 take a five-minute recess before Mr. Allen?

13 JUDGE WOODRUFF: Yes, let's do that.

14 Five-minute recess. We'll come back at 4:20.

15 (A BREAK WAS TAKEN.)

16 (EXHIBIT NOS. 200, 201, 202 AND 215 WERE

17 MARKED FOR IDENTIFICATION BY THE REPORTER.)

18 (Witness sworn.)

19 JUDGE WOODRUFF: You may be seated.

20 MR. MICHEEL: May I proceed, your Honor?

21 JUDGE WOODRUFF: You may proceed.

22 TRAVIS ALLEN testified as follows:

23 DIRECT EXAMINATION BY MR. MICHEEL:

24 Q. Would you state your name.

25 A. Travis Allen.

1 Q. And how are you employed?

2 A. I'm employed as a public utility financial
3 analyst with the Office of the Public Counsel and the
4 State of Missouri.

5 Q. And did you cause to be filed your direct
6 testimony, the direct testimony of Travis Allen that's
7 been marked for purposes of identification as Exhibit 200
8 in this proceeding?

9 A. Yes.

10 Q. And if I asked you the questions contained
11 in that direct testimony, would your answers be the same
12 or substantially similar?

13 A. Yes.

14 Q. And did you also cause to be filed the
15 rebuttal testimony of Travis Allen which has been marked
16 for purposes of identification as Exhibit 201?

17 A. Yes.

18 Q. And if I asked you those questions, would
19 your answers be the same or substantially similar?

20 A. Yes.

21 Q. Did you also cause to be filed the
22 surrebuttal testimony of Travis Allen which has been
23 marked for purposes of identification as Exhibit 202 in
24 this matter?

25 A. Yes.

1 Q. And if I asked you those same questions
2 today, would your answers be the same or substantially
3 similar?

4 A. Yes.

5 Q. And did you also cause to be filed an
6 errata sheet which has been marked for purposes of
7 identification as Exhibit 215?

8 A. Yes.

9 Q. And do those contain some corrections both
10 to your direct, your rebuttal and your surrebuttal
11 testimonies?

12 A. Yes.

13 Q. And do you have some corrections stated in
14 the body of your rebuttal testimony and in the body of
15 your surrebuttal testimony?

16 A. Yes.

17 Q. And if I asked you all those questions
18 today, would your answers be the same?

19 A. Yes.

20 MR. MICHEEL: And with those corrections,
21 your Honor, I would move the admissions of Exhibit 201,
22 202, 200 and 215.

23 JUDGE WOODRUFF: Exhibits 200, 201, 202 and
24 215 have been offered into evidence.

25 MR. HERSCHMANN: Objection, and may I have

1 an opportunity to address this witness as to the issue and
2 potentially voir dire the witness?

3 JUDGE WOODRUFF: Yes, you may. Is it an
4 objection to all four documents?

5 MR. HERSCHMANN: Yes.

6 MR. MICHEEL: Your Honor, they've already
7 filed a motion to strike all of his testimony, so I would
8 just ask what the purpose of this voir dire is and, you
9 know, just to move things along, because if it's going to
10 be more rehash of what their motion is, you've said you're
11 going to take that with the case.

12 JUDGE WOODRUFF: Well, that is understood
13 by the parties. I'm sure the motion is already in front
14 of us, and I'm assuming you're not going to be repeating
15 that.

16 MR. HERSCHMANN: No, I will not be
17 repeating the motion. Actually if I can really move
18 things along, I just want to make a record that we're
19 objecting; it's an ongoing objection. I can move it
20 along, if your Honor will give me about 13 minutes, which
21 is the time that I would just offer in the questions that
22 were posed which are really voir dire questions of this
23 witness in a deposition, play it from the video, and then
24 I would just pass the witness back, and renew my
25 objection.

1 JUDGE WOODRUFF: What would be the reason
2 for playing the video?

3 MR. HERSCHMANN: It would actually expedite
4 the process, I believe, since it's sworn testimony from
5 last week. It wouldn't be in the motion, because the
6 testimony -- we just received the transcripts.

7 JUDGE WOODRUFF: The transcripts were
8 attached to your motion, were they not?

9 MR. MICHEEL: They were.

10 MR. HERSCHMANN: They were; however, this
11 selected portion goes directly to the admissibility of the
12 testimony versus credibility issue.

13 JUDGE WOODRUFF: Okay. I'll go ahead and
14 allow it.

15 MR. FRANSON: Your Honor, I guess my
16 question is how is this preserved, how is that going to be
17 done?

18 MR. HERSCHMANN: Typically speaking, the
19 reporter will take down the questions and answers, but I
20 don't think we have a dispute. I've done it several ways
21 when we use videotapes, and one is the parties can just
22 agree this is the transcript and it becomes part of the
23 official record, or the reporter can retype it again, but
24 I don't think that really is going to be necessary.

25 MR. MICHEEL: Your Honor, I think I'm

1 entitled to look at other portions of the transcript on
2 the video to determine if I want other portions of the
3 transcript and the video of the deposition in.

4 JUDGE WOODRUFF: All right. I certainly
5 think that's correct.

6 MR. MICHEEL: I mean, he's cut out a
7 snippet of 13 minutes that he says covers the whole
8 waterfront of what he wants to do, but I think I'm
9 entitled and I haven't seen this movie yet. I was at the
10 deposition, but I don't know what excerpts he's taken out
11 and what parts are included.

12 MR. HERSCHMANN: Just wait.

13 JUDGE WOODRUFF: You'll have an opportunity
14 to include additional portions of the deposition if you
15 feel you need to. You can go ahead and proceed.

16 THE COURT REPORTER: Do you want me to take
17 this?

18 JUDGE WOODRUFF: Before you start this,
19 let's ask -- the court reporter just asked if she needs to
20 take down the transcript from the video.

21 MR. HERSCHMANN: We don't believe it's
22 necessary. I'm sure we can agree on --

23 JUDGE WOODRUFF: This is additional
24 transcript, I assume. It's coming off your computer?

25 MR. HERSCHMANN: That's correct, and we

1 have the excerpts. I'm sure we can come to an agreement
2 so the reporter doesn't need to retype it.

3 JUDGE WOODRUFF: Does any party object to
4 that?

5 MR. MICHEEL: I'll work with them. That's
6 not a problem. I don't want to cause Kellene extra work.

7 JUDGE WOODRUFF: If need be, this can be
8 entered as an electronic exhibit into the Commission
9 system, I assume.

10 MR. HERSCHMANN: Yes, it can.

11 JUDGE WOODRUFF: All right. At this point,
12 then, the court reporter can stop taking notes about
13 what's appearing on the screen.

14 (Excerpts from the videotaped deposition of
15 Travis Allen were played.)

16 MR. HERSCHMANN: Your Honor, if I could
17 have just a couple of very brief follow-up questions for
18 the witness on voir dire.

19 VOIR DIRE EXAMINATION BY MR. HERSCHMANN:

20 Q. Mr. Allen, my name is Eric Herschmann. I'm
21 an attorney representing Missouri Gas Energy. I'm just
22 going to ask you a few questions. If you don't understand
23 any of them, just tell me and I'll try to rephrase them.
24 Is that okay?

25 A. Yes.

1 Q. That testimony that you gave was last week;
2 is that correct?

3 A. Last Wednesday.

4 Q. And had you ever testified before that
5 date?

6 A. No.

7 Q. How long were you looking for a job before
8 you came to work at OPC in the financial industry?

9 A. Approximately nine months.

10 Q. Where else did you apply for employment?

11 A. As I stated in my deposition, I applied to
12 various government agencies, as well as banks.
13 Specifically the ones that I remembered were, I applied to
14 Integra Bank, I applied to Old National Bank.

15 Q. Which departments did you apply to in those
16 banks?

17 A. For the bank positions, I applied for
18 credit analyst and financial analyst positions.

19 Q. Did you get interviews at those locations?

20 A. I got an interview at Integra Bank for a
21 credit analyst position, as well as an interview at Old
22 National Bank for a credit analyst position.

23 Q. And were you offered employment by either
24 of those banks?

25 A. No.

1 Q. Is it safe to say that it was not your
2 first choice to go from graduate school into work as a
3 package handler at FedEx Ground? I mean that with all due
4 respect, sir. I really do.

5 A. Yeah, I think that's safe to say.

6 Q. And when you had your first interview with
7 the OPC, they told you you were going to be an expert
8 witness in this case, right?

9 A. They told me that I would be filing
10 testimony in this case, yes.

11 Q. As an expert witness, right?

12 A. Yes.

13 Q. Did you have the foggiest idea in the world
14 what the standards were to be an expert witness before
15 agreeing that you had those qualifications?

16 A. Could you clarify that? What do you mean?

17 Q. Sure. Did you have any idea about Missouri
18 statute qualifications that are necessary for expert
19 testimony?

20 A. No, I did not.

21 Q. You didn't even know it as of last week,
22 right, sir?

23 A. That's correct. I didn't know it.

24 Q. Do you understand how much money's at stake
25 for MGE in this case just on your one issue?

1 A. Absolutely I do.

2 Q. That's \$19 million, right?

3 A. Approximately.

4 Q. And you're prepared to tell this Commission

5 that you accepted employment and agreed to be an expert

6 witness never having once understood the standards to be

7 an expert witness or ever applied a DCF model in a real

8 life environment, right? If you could answer that yes or

9 no, I'd appreciate it.

10 A. I really can't answer that yes or no,

11 because the simple fact is that I had the fundamental

12 background and understanding of how to do this

13 appropriately. So the fact that you're saying that I've

14 never done it, I have done it.

15 Q. You had a fundamental expertise before you

16 came to the Commission? Is that your testimony now, sir?

17 A. I had the fundamental background to perform

18 this job at a high level, yes.

19 Q. Why did you go through all the self

20 training then in the last couple of weeks before you

21 submitted your testimony if you already what the

22 expertise, sir? Let me withdraw that.

23 You read Mark Burdette's testimony, right?

24 A. I had read previous filings of Mark

25 Burdette, yes.

1 Q. And you told us -- we just saw it on video
2 a moment ago -- that you had never spoken to him, right?

3 A. I have -- well, you didn't include
4 everything that I said in there. I have had -- I had
5 conversed with him via e-mail, but, no I've never had a
6 face-to-face conversation with Mark Burdette.

7 Q. What do you know about Mark Burdette's
8 qualifications as an expert, if anything?

9 A. My understanding is that --

10 Q. Actually, let me see if I can withdraw
11 that. I'll lay some foundation.

12 Did you ever discuss with Mr. Burdette,
13 whether it be via e-mail or on the telephone, about what
14 his qualifications supposedly were?

15 A. I did not discuss that with Mr. Burdette.
16 I was under the assumption that my office would not hire
17 somebody if they did not think that he had the expertise
18 to perform this job.

19 Q. You think because the OPC hired you, that
20 makes you an expert pursuant to the Missouri statutes and
21 case law; is that what you just said?

22 MR. MICHEEL: I'm going to object; it calls
23 for a legal conclusion, your Honor.

24 JUDGE WOODRUFF: Sustained.

25 BY MR. HERSCHMANN:

1 Q. Did you have occasion to review Professor
2 Morin's book at any point?

3 A. No, I haven't read Dr. Morin's book, the
4 book that they had been talking about in this case. I
5 have not had the opportunity since I've been employed to
6 do that as of yet.

7 Q. Is that because Mr. Micheel's been studying
8 it so carefully recently?

9 A. No, that's not the reason. I just simply
10 have not had the time to read that book as of yet.

11 Q. Are you prepared to tell this Commission
12 that you're going to hold up your credentials as a CVS
13 pharmacy clerk, a Bueller's pharmacy tech, a Walgreens
14 pharmacy tech, a graduate assistant at Southern Illinois
15 University in Edwardsville, and as a package handler at
16 FedEx Ground against Professor Morin's expertise?

17 A. I'm telling the Commission that I have the
18 fundamental background in finance. I have both a
19 bachelor's degree and master's degree in finance, and a
20 fundamental understanding of this criteria to say that I
21 developed an appropriate and a -- what I consider to be a
22 fair cost of equity and rate of return analysis for MGE in
23 this case, absolutely.

24 Q. And that's after being at OPC for two
25 weeks, right?

1 Let me take a step back. You started on
2 March 15th of this year; is that right?

3 A. I don't remember the exact date, but it was
4 approximately the second week of March, yes.

5 Q. And you began drafting your testimony, we
6 just saw, on April 1st of this year. Do you recall that
7 testimony, sir?

8 A. I believe I said that I started drafting my
9 testimony approximately two weeks before. I did not give
10 a date because I was not sure.

11 Q. And you tell us that before you came to the
12 Commission, you believed you were qualified to perform the
13 duties and you said at a high level; is that right?

14 A. That's correct.

15 Q. Which means you thought you were an expert
16 before you ever got to the Commission, right?

17 A. Again, I'm going to reiterate, I thought
18 that -- I think that through my education and my -- my
19 performance in my studies, that I had the fundamental
20 background and understanding to perform this job,
21 absolutely. I wouldn't have applied if I didn't think
22 that I had the qualifications, and I'm sure that my
23 employers would not have hired me if they didn't think
24 that I had the expertise to do this job at a high level.
25 That goes without saying.

1 MR. HERSCHMANN: Would you read back the
2 question that I asked?

3 THE REPORTER: "Question: Which means you
4 thought you were an expert before you ever got to the
5 Commission, right?"

6 MR. MICHEEL: Your Honor, I think he
7 answered that question to the best of his abilities.

8 JUDGE WOODRUFF: I believe it's a yes or no
9 question. Can you answer yes or no?

10 THE WITNESS: If I'm -- yeah, I can answer,
11 yes, I believe I had the expertise to perform this job.

12 BY MR. HERSCHMANN:

13 Q. Would you say you've been studying hard
14 lately since you came to the Commission about rates of
15 return, return on equity and things like that?

16 A. Absolutely. I take my job very seriously,
17 and I want to make sure that I got this right, because
18 this is a big issue, and I don't take that lightly.

19 Q. How much new information did you review
20 after you accepted the position as an expert, compared to
21 the information that you knew beforehand?

22 A. I don't -- I don't understand the question.
23 Could you try to clarify that for me? What do you mean by
24 new information?

25 Q. Well, you started reviewing some books when

1 you got to the Commission, right -- I mean to the OPC,
2 right?

3 A. Yes, I have done a thorough review prior to
4 filing my direct testimony in this case.

5 Q. Did a thorough review of what, sir? I'm
6 not asking you to pull out anything now. I'm just
7 asking -- you said you did a thorough review. You did a
8 thorough review of a book; is that it?

9 A. No. in my deposition, which was not in
10 this testimony --

11 Q. Mr. Allen, I want you to answer the
12 questions that I ask now, and if your counsel wants to get
13 up and try to rehabilitate you, that's fine. But if you
14 can answer the question that I ask, and if you don't
15 understand it, please tell me and I'll try to rephrase it.

16 MR. MICHEEL: Your Honor, he's trying to
17 answer that question. Mr. Herschmann asked him, what did
18 he do to review, and he's about to tell him what he did to
19 review, and he hasn't even attempted to answer the
20 question.

21 MR. HERSCHMANN: I can eliminate this as a
22 dispute. I'll withdraw the question. Let me try to
23 rephrase it. All right?

24 JUDGE WOODRUFF: All right.

25 BY MR. HERSCHMANN:

1 Q. When you first got to the OPC, did anyone
2 give you any books dealing with rates of return or return
3 on equity?

4 A. No one gave me a book, no.

5 Q. Was there a library that had books in them?

6 A. Yes, obviously we keep copies of seminal
7 books.

8 Q. And did you have any of those seminal books
9 at home, like Mr. Parcell's book?

10 A. No, I do not have that book at home.

11 Q. Did you have Mr. Morin's book at home?

12 A. No, I do not.

13 Q. Did you subscribe to any financial utility
14 trade journals at home prior to working at the OPC?

15 A. Could you clarify that question, please?

16 Q. Are you aware of any financial utility
17 trade journals?

18 A. No, I'm not aware of the ones that you're
19 speaking of. If you'd clarify, I can tell you if I
20 applied to them.

21 Q. I'm asking if you're aware of any. It's
22 yes or no. You either know about them or you don't.

23 A. No.

24 Q. Now, you received no certification as being
25 an expert in anything prior to accepting the position at

1 OPC, right?

2 A. I have no certificates, but like I said, I
3 have an extensive education in finance.

4 Q. Were you aware prior to the deposition last
5 week whether or not there was something known as a
6 certified rate of return analyst?

7 A. I was not aware of that designation, no.

8 Q. Are you -- well, withdrawn.
9 As of March 15th of this past year, were
10 you a member of any society of utility regulatory
11 financial analysts?

12 A. No, I was not.

13 Q. In fact, sir, after you started at the OPC,
14 you went to take a basics class in utility finance, right?

15 A. I didn't have to.

16 Q. That wasn't the question, sir. Did you?

17 A. I did take a course.

18 Q. And that was in basics of utility finance,
19 right?

20 A. It was in the basics of public utility in
21 general. It wasn't specific just to finance. It was just
22 a general background in public utilities, and the course
23 that I studied in was natural gas. It wasn't specifically
24 geared just to finance, no.

25 MR. HERSCHMANN: Your Honor, I'm going to

1 renew my objection at this point. I don't think there's
2 any way that this witness can lay a proper foundation
3 under 490.065 or McDonagh. I think he's actually, by his
4 answers now and the videotape clip that we played,
5 abundantly clear that somebody who comes to the Commission
6 and believes he's an expert because they told him he's an
7 expert doesn't meet any standard.

8 I think it's impossible to do that. Entire
9 textbooks have been written about this exact issue on what
10 we're addressing at this point. We're on a \$19 million
11 issue. For OPC to come before this Commission and say a
12 witness who just went to a basics class now has the
13 qualifications to opine on this issue, I really think is
14 completely contrary to every law that's been briefed on
15 this issue.

16 MR. MICHEEL: Your Honor, do I get a chance
17 to question this witness on voir dire also?

18 JUDGE WOODRUFF: If you can make it quick;
19 otherwise I'll give you a chance to do it tomorrow.

20 MR. MICHEEL: It's not going to be quick,
21 your Honor, and we have a deposition at 5:30. I'd like
22 some time to eat some dinner.

23 JUDGE WOODRUFF: We will come back to this
24 witness tomorrow. I believe Mr. Gillen is first up
25 tomorrow, and then we'll come back to Mr. Allen after

1 that.

2 I do want to ask, how did we preserve what

3 was on the video screen to put it in the record?

4 MR. HERSCHMANN: I can provide the court

5 reporter and opposing counsel with clips of the actual

6 questions and answers with the page cites. It can just be

7 incorporated into the record.

8 JUDGE WOODRUFF: All right. That's

9 certainly acceptable to me.

10 MR. MICHEEL: That's acceptable to me.

11 JUDGE WOODRUFF: With that, then, we are

12 adjourned until 8:30 tomorrow morning.

13 Thank you.

14 WHEREUPON, the hearing was recessed until

15 June 22, 2004.

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1	I N D E X	
2	Opening Statement by Mr. Hack	90
	Opening Statement by Mr. Franson	104
3	Opening Statement by Mr. Micheel	117
	Opening Statement by Mr. Conrad	122
4	Opening Statement by Mr. Paulson	126
	Opening Statement by Mr. Comley	127
5		
6		
7	RATE OF RETURN	
8	Opening Statement by Mr. Herschmann	131
	Opening Statement by Mr. Berlin	142
9	Opening Statement by Mr. Micheel	149
10	MGE'S EVIDENCE:	
11	JOHN C. DUNN	
	Direct Examination by Mr. Herschmann	159
12	Cross-Examination by Mr. Micheel	170
	Cross-Examination by Mr. Berlin	190
13	Questions by Commissioner Clayton	223
	Questions by Judge Woodruff	246
14	Recross-Examination by Mr. Micheel	250
	Redirect Examination by Mr. Herschmann	255
15	Questions by Commissioner Murray	290
	Further Questions by Commissioner Clayton	295
16	Further Recross-Examination by Mr. Micheel	306
	Recross-Examination by Mr. Franson	312
17	Further Redirect Examination by Mr. Herschmann	319
18	OPC'S EVIDENCE:	
19	TRAVIS ALLEN	
20	Direct Examination by Mr. Micheel	320
	Voir Dire Examination by Mr. Herschmann	326
21		
22		
23		
24		
25		

1	EXHIBITS INDEX		
2		MARKED	RECEIVED
3	EXHIBIT NO. 1		
4	Direct Testimony of John Dunn		170
5	EXHIBIT NO. 2		
6	Rebuttal Testimony of John Dunn		170
7	EXHIBIT NO. 3		
8	Surrebuttal Testimony of John Dunn		170
9	EXHIBIT NO. 27		
10	Cost of Capital Table	267	287
11	EXHIBIT NO. 28		
12	Capital Structure Comparison	267	287
13	EXHIBIT NO. 29		
14	Common Equity Rates Comparison	272	287
15	EXHIBIT NO. 30		
16	Risk Adjustment E-Mail	274	284
17	EXHIBIT NO. 844		
18	Deposition of John Dunn	188	190
19	EXHIBIT NO. 845		
20	Excerpts from Regulatory Finance,		
21	Utilities' Cost of Capital, by		
22	Roger A. Morin	217	223
23	EXHIBIT NO. 846		
24	Investment Valuation	220	
25			