

Exhibit No.:
Issues: *Revisions to Direct Testimony,
Capital Structure, Embedded Cost
of Long-Term Debt, Embedded
Cost of Preferred Stock, Cost of
Short-Term Debt, Overall Rate of
Return*

Witness: *David Murray*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *True Up Direct Testimony*
Case No.: *GR-2006-0422*
Date Testimony Prepared: *December 27, 2006*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

TRUE UP DIRECT TESTIMONY

OF

DAVID MURRAY

MISSOURI GAS ENERGY

CASE NO. GR-2006-0422

*Jefferson City, Missouri
December 2006*

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariff)
Sheets Designed to Increase Rates for Gas Service) Case No. GR-2006-0422
in the Company's Missouri Service Area)

AFFIDAVIT OF DAVID MURRAY

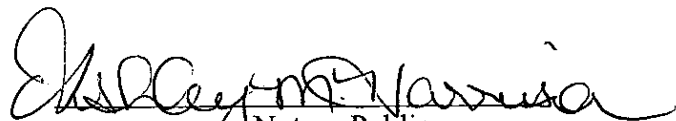
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David Murray, of lawful age, on his oath states: that he has participated in the preparation of the foregoing True Up Direct Testimony in question and answer form, consisting of 5 pages to be presented in the above case; that the answers in the foregoing True Up Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



David Murray

Subscribed and sworn to before me this 27th day of December 2006


Notary Public



ASHLEY M. HARRISON
Notary Public - State of Missouri
My Commission Expires August 31, 2010
Cole County
Commission #06883878

TRUE-UP DIRECT TESTIMONY

OF

DAVID MURRAY

MISSOURI GAS ENERGY

CASE NO. GR-2006-0422

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REVISIONS TO DIRECT TESTIMONY 2

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1 **REVISIONS TO DIRECT TESTIMONY**

2 Q. Do you have any corrections you need to make to your direct testimony?

3 A. Yes. Schedule 9 attached to my direct testimony indicated a long-term debt
4 balance of \$2,574,937,728. This amount was based the total amount of long-term debt indicated
5 in MGE's response to Staff Data Request No. 0065.1 net of unamortized issuance costs as of
6 December 31, 2005. After further review, Staff discovered that MGE's response included
7 \$420,000,000 of short-term debt as of December 31, 2005. This amount needs to be deducted
8 from the long-term debt balance. The resulting capital structure (see Revised Schedule 9 attached
9 to this testimony) as of the test year should have been 41.36 percent common equity, 5.40 percent
10 preferred stock, 52.03 percent long-term debt and 1.20 percent short-term debt. The new long-
11 term debt amount was determined by subtracting the \$420,000,000 of short-term debt and the
12 \$14,300,572 of unamortized issuance costs from the total debt amount of \$2,589,238,300.

13 Q. Does this affect your overall ROR recommendation for the test year?

14 A. Yes. My recommended ROR range is now 8.01 percent to 8.25 percent compared
15 to my original recommended ROR range of 8.01 percent to 8.23 percent. Please see the attached
16 Revised Schedule 22.

17 **CAPITAL STRUCTURE**

18 Q. Did you perform an analysis of Southern Union's capital structure as of
19 October 31, 2006, the end of the true-up period for this proceeding?

20 A. Yes, I did.

21 Q. What was the result of your analysis?

1 A. As of October 31, 2006, Southern Union's capital structure was as follows: 36.06
2 percent common stock equity, 4.71 percent preferred stock, 55.92 percent long-term debt and
3 3.30 percent short-term debt (see Schedule 1).

4 Q. Is this capital structure reasonable for purposes of estimating MGE's ROR in
5 this proceeding?

6 A. Yes. This capital structure is less leveraged than Southern Union's historical
7 capital structures even when its primary operations were natural gas distribution. Please see
8 pages 5 through 9 of my rebuttal testimony for a complete discussion on this matter.

9 **EMBEDDED COST OF LONG-TERM DEBT**

10 Q. What was the embedded cost of long-term debt for Southern Union on October 31,
11 2006?

12 A. The embedded cost of long-term debt for Southern Union was 7.649 percent as of
13 October 31, 2006, which excludes the cost of Panhandle Energy's debt, which is consistent with
14 the Commission's decision in the last MGE rate case, Case No. GR-2004-0209 (see Schedule 2).
15 Southern Union's embedded cost of long-term debt no longer includes debt issuances from PG
16 Energy (Pennsylvania distribution properties) or its Rhode Island Operations of New England
17 Gas Company because these properties were sold on August 25, 2006. The embedded cost of
18 long-term debt now includes a new 6.15 percent debt issuance, which was issued as part of a
19 remarketing of the senior notes attached to Southern Union's 5.75 percent equity units. Southern
20 Union also issued 7.20 percent subordinated notes as part of its refinancing of the \$1.6 billion
21 bridge loan used to purchase Sid Richardson Energy Services, Ltd.

22 Q. How does this compare with the embedded cost of long-term debt recommended
23 for the period ending December 31, 2005?

1 A. Southern Union's embedded cost of long-term debt is 5 basis points lower than the
2 embedded cost of long-term debt recommended for the period ending December 31, 2005. This
3 can be attributed to the elimination of the higher cost debt from PG Energy and the Rhode Island
4 properties.

5 **EMBEDDED COST OF PREFERRED STOCK**

6 Q. What was the embedded cost of preferred stock for Southern Union on October 31,
7 2006?

8 A. The embedded cost of preferred stock for Southern Union was 7.76% on
9 October 31, 2006, (see Schedule 3). I relied on the embedded cost of preferred stock provided by
10 Southern Union in response to Staff Data Request No. 0265. There has been no change in the
11 embedded cost of preferred stock from the update period to the true-up date.

12 **COST OF SHORT-TERM DEBT**

13 Q. What was the average cost of short-term debt for Southern Union on
14 October 31, 2006?

15 A. The average cost of short-term debt was 5.25 percent as shown on Schedule 4.
16 Southern Union provided this information in response to Staff Data Request No. 0265.

17 **OVERALL RATE OF RETURN**

18 Q. How have the changes to the capital structure and embedded costs affected the
19 overall ROR for MGE?

20 A. MGE's overall rate of return as of October 31, 2006, has decreased slightly. Staff
21 recommends the following overall rates of return based on a return on equity range of 8.65% to
22 9.25% with a midpoint of 8.95% (see Schedule 5):

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David Murray

1	<u>Return on Equity</u>	8.65%	8.95%	9.25%
2	Common Stock Equity	3.12%	3.23%	3.34%
3	Preferred Stock	.37%	.37%	.37%
4	Long-term Debt	4.28%	4.28%	4.28%
5	<u>Short-term Debt</u>	<u>.17%</u>	<u>.17%</u>	<u>.17%</u>
6	Overall Rate of Return	7.94%	8.04%	8.15%

7 Q. What caused the slight decline in the ROR for the true-up period as compared
8 to the test year?

9 A. There are several factors that contributed to the slight decline. First, the
10 common equity ratio decreased slightly since the test year. Second, the cost of long-term debt
11 decreased slightly. Finally, although the short-term debt cost increased slightly, it now makes
12 up a larger percentage of the capital structure and because the cost of this debt was still below
13 the overall ROR, this decreased the ROR as compared to the test year.

14 Q. Does this conclude your prepared true-up direct testimony?

15 A. Yes, it does.

**Capital Structure as of December 31, 2005
for Southern Union Company**

<u>Capital Component</u>	<u>Amount in Dollars</u>	<u>Percentage of Capital</u>
Common Stock Equity	\$1,713,268,182	41.36%
Preferred Stock	223,828,509	5.40%
Long-Term Debt	2,154,937,800 *	52.03%
Short-Term Debt	49,818,667 **	1.20%
Total Capitalization	<u><u>\$4,141,853,158</u></u>	<u><u>100.00%</u></u>

**Gas Distribution Financial Ratio Benchmarks
Total Debt / Total Capital**

Standard & Poor's Corporation's RatingsDirect, Revised Financial Guidelines as of June 2, 2004	<u>BBB Credit Rating based on a "3" Business Profile</u> 55% to 65%
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Note: * Based on the principal amount of long-term debt outstanding less total unamortized issuance costs as of December 31, 2005 (2,589,238,300 - 420,000,000 - 14,300,572).

**Short-term debt balance equals average monthly short-term debt balance for 2005 calendar year less 2005 year-end construction work in progress balance (234,241,667 - 184,423,000).

Source: Southern Union Company's response to Staff's Data Request No. 0065.1 and Southern Union Company's 2005 Annual Report.

**Weighted Cost of Capital as of December 31, 2005
for Missouri Gas Energy**

Capital Component	Percentage of Capital	Embedded Cost	Weighted Cost of Capital Using Common Equity Return of:		
			8.65%	8.95%	9.25%
Common Stock Equity	41.36%	-----	3.58%	3.70%	3.83%
Preferred Stock	5.40%	7.76%	0.42%	0.42%	0.42%
Long-Term Debt	52.03%	7.61%	3.96%	3.96%	3.96%
Short-Term Debt	1.20%	3.98%	0.05%	0.05%	0.05%
	<u>100.00%</u>		<u>8.01%</u>	<u>8.13%</u>	<u>8.25%</u>

Notes:

See Revised Schedule 9 for the Capital Structure Ratios.

**Capital Structure as of October 31, 2006
for Southern Union Company**

Capital Component	Amount in Dollars	Percentage of Capital
Common Stock Equity	\$1,713,268,182	36.06%
Preferred Stock	223,828,509	4.71%
Long-Term Debt	2,656,850,817 *	55.92%
Short-Term Debt	156,971,164 **	3.30%
Total Capitalization	<u><u>\$4,750,918,673</u></u>	<u><u>100.00%</u></u>

**Gas Distribution Financial Ratio Benchmarks
Total Debt / Total Capital**

Standard & Poor's Corporation's RatingsDirect, Revised Financial Guidelines as of June 2, 2004	<u>BBB Credit Rating based on a "3" Business Profile</u> 55% to 65%
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Note: * Based on the principal amount of debt outstanding less short-term debt and total unamortized issuance costs as of October 31, 2006 (2,832,319,300 - 155,000,000 - 14,300,572).

**Short-term debt balance equals average monthly short-term debt balance for the twelve months ended October 31, 2006 less the October 31, 2006 construction work in progress balance (283,333,333 - 131,362,169).

Source: Southern Union Company's response to Staff's Data Request No. 0265 and 0265.1.

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**Embedded Cost of Long-Term Debt as of October 31, 2006
for Southern Union Company (Excluding Debt Held at Panhandle Eastern Pipe Line Subsidiary)**

Description	Outstanding LTD October 31, 2006	Annual Interest Rate	Annual Interest	Unamortized Issuance Costs, Discounts, and Premiums	Amortization of Issuance Cost	Embedded rate
7.6% Senior Notes	359,765,000	7.60%	27,342,140	(2,376,498)	137,768	7.689%
8.25% Senior Notes	300,000,000	8.25%	24,750,000	(5,096,662)	221,594	8.468%
Fall River 9.44%	6,500,000	9.44%	613,600	(156,608)	11,782	9.859%
Fall River 7.99%	7,000,000	7.99%	559,300	(103,870)	5,226	8.186%
Fall River 7.24%	6,000,000	7.24%	434,400	(85,580)	4,051	7.413%
6.15% Senior Notes	125,000,000	6.15%	7,687,500	0	0	6.150%
7.20% Subordinated Notes	600,000,000	7.20%	43,200,000	(9,936,000)	1,987,200	7.658%
Mandatory Convertibles 5.00%	100,000,000	5.00%	5,000,000	(131,106)	112,377	5.119%
Acct 189 unamortized issue costs/discounts				(14,051,764)	799,668	
Acct 257 unamortized premiums				1,804,970	(104,372)	
Total LTD	<u>1,504,265,000</u>		<u>109,586,940</u>	<u>(30,133,118)</u>	<u>3,175,295</u>	<u>7.649%</u>

Source: Southern Union Company's response to Staff's Data Request 0265

**Embedded Cost of Preferred Stock as of October 31, 2006
for Southern Union Company**

Preferred Stock	Issuance Date	Original Issue	Outstanding as of 10/31/2006	Annual Interest Rate	Unamortized Issuance Cost	Annualized Cost to Company (1 * 2)
7.55% Preferred Securities	10/1/03	230,000,000	\$230,000,000	7.55%	(\$6,171,491)	\$17,365,000
			<u><u>\$230,000,000</u></u>			<u><u>\$17,365,000</u></u>

Embedded Cost of Preferred Stock	=	\$17,365,000

		\$223,828,509
	=	7.76%

Source: Southern Union Company's response to Staff's Data Request 0265

**Weighted Average Cost of Short-Term Debt as of October 31, 2006
for Southern Union Company**

Month	Average STD Balance During Month	Interest Cost per Month
11/30/05	377,000,000	1,212,760
12/31/05	420,000,000	1,565,016
1/31/06	375,000,000	1,460,237
2/28/06	355,000,000	1,409,580
3/31/06	305,000,000	1,465,249
4/30/06	268,000,000	1,216,323
5/31/06	250,000,000	1,177,037
6/30/06	251,000,000	1,145,218
7/31/06	290,000,000	1,317,187
8/31/06	219,000,000	1,264,009
9/30/06	195,000,000	977,670
10/31/06	155,000,000	940,351
	<u>\$288,333,333</u>	<u>\$15,150,637</u>
AVERAGE	\$288,333,333	\$1,262,553
		= 5.25%

Source: Southern Union's response to Staff Data Request No. 0265.1

**Weighted Cost of Capital as of October 31, 2006
for Missouri Gas Energy**

Capital Component	Percentage of Capital	Embedded Cost	Weighted Cost of Capital Using Common Equity Return of:		
			8.65%	8.95%	9.25%
Common Stock Equity	36.06%	-----	3.12%	3.23%	3.34%
Preferred Stock	4.71%	7.76%	0.37%	0.37%	0.37%
Long-Term Debt	55.92%	7.65%	4.28%	4.28%	4.28%
Short-Term Debt	3.30%	5.25%	0.17%	0.17%	0.17%
	<u>100.00%</u>		<u>7.94%</u>	<u>8.04%</u>	<u>8.15%</u>

Notes:

See Schedule 1 for the Capital Structure Ratios.

See Schedule 2 for the Embedded Cost of Long-Term Debt.

See Schedule 3 for the Embedded Cost of Preferred Stock.

See Schedule 4 for Weighted Average Cost of Short-Term Debt.