

Exhibit No.:
Issue: Rate of Return/Capital Structure
Witness: David Murray
Sponsoring Party: MoPSC Staff
Type of Exhibit: True-up Direct Testimony
Case No.: GR-2004-0209
Date Testimony Prepared: July 19, 2004

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

TRUE-UP DIRECT TESTIMONY

OF

DAVID MURRAY

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Jefferson City, Missouri
July 2004

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

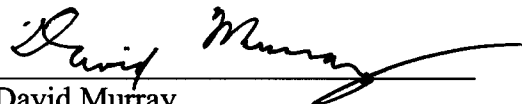
In the Matter of Missouri Gas Energy's)
Tariffs to Implement a General Rate)
Increase for Natural Gas Service)

Case No. GR-2004-0209

AFFIDAVIT OF DAVID MURRAY

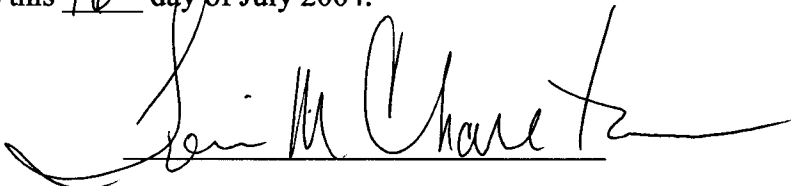
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

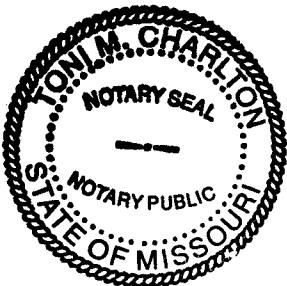
David Murray, being of lawful age, on his oath states: that he has participated in the preparation of the following true-up direct testimony in question and answer form, consisting of 4 pages to be presented in the above case; that the answers in the following true-up direct testimony were given by him; 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 16th day of July 2004.





TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

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OF
DAVID MURRRAY

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1 **Capital Structure**

2 Q. Did you perform an analysis of Southern Union's capital structure as of
3 April 30, 2004, the end of the true-up period for this proceeding?

4 A. Yes, I did.

5 Q. What was the result of your analysis?

6 A. As of April 30, 2004, Southern Union's capital structure was as follows:
7 29.99% common stock equity, 6.40% preferred stock and 63.61% long-term debt
8 (see Schedule 1).

9 Q. How does this compare to the capital structure you recommended for rate-
10 making purposes in your direct testimony?

11 A. Southern Union's capital structure as of April 30, 2004, is different from that
12 used for the period ending December 31, 2003, which was as follows: 25.91% common
13 stock equity, 6.13% preferred stock, 60.66% long-term debt and 7.30% short-term debt. The
14 major difference in the capital structure from December 31, 2003, and April 30, 2004, was
15 Southern Union's elimination of short-term debt.

16 **Embedded Cost of Long-term Debt**

17 Q. What was the embedded cost of long-term debt for Southern Union on
18 April 30, 2004?

19 A. The embedded cost of long-term debt for Southern Union was 6.151% on
20 April 30, 2004, (see Schedule 2). I arrived at this cost by calculating the consolidated
21 embedded cost of long-term debt for all of Southern Union's operations, which includes
22 Panhandle. I relied on the embedded cost of long-term debt, including Panhandle, provided
23 in Southern Union's response to Staff Data Request No. 0374.

1 Q. How does this compare with the embedded cost of long-term debt
2 recommended for the period ending December 31, 2003?

3 A. Southern Union's embedded cost of long-term debt is 23 basis points lower
4 than the embedded cost of long-term debt recommended for the period ending December 31,
5 2003. This is due to the debt refinancing that occurred at the Panhandle level between the
6 update period and the true-up date. This lower cost of debt was slightly offset by an
7 approximate \$50 million reduction in the lower-cost term loan held at the Southern Union
8 operating company level.

9 **Embedded Cost of Preferred Stock**

10 Q. What was the embedded cost of preferred stock for Southern Union on
11 April 30, 2004?

12 A. The embedded cost of preferred stock for Southern Union was 7.76% on
13 April 30, 2004 (see Schedule 3). I relied on the embedded cost of preferred stock provided
14 by Southern Union in response to Staff Data Request No. 0374. There has been no change in
15 the embedded cost of preferred stock from the update period to the true-up date.

16 **Overall Rate of Return**

17 Q. How have the changes to capital structure and embedded costs affected the
18 overall rate of return for MGE?

19 A. MGE's overall rate of return as of April 30, 2004, has increased slightly.
20 Staff recommends the following overall rates of return based on a return on equity range of
21 8.52% to 9.52% with a midpoint of 9.02% (see Schedule 4):

True-Up Direct Testimony of
David Murray

1	<u>Return on Equity</u>	8.52%	9.02%	9.52%
2	Common Stock Equity	2.55%	2.70%	2.85%
3	Preferred Stock	.50%	.50%	.50%
4	Long-term Debt	3.91%	3.91%	3.91%
5	<u>Short-term Debt</u>	<u>.00%</u>	<u>.00%</u>	<u>.00%</u>
6	Overall Rate of Return	6.96%	7.11%	7.26%

7 Q. For comparison purposes, what was the overall rate of return recommended
8 for the period ending December 31, 2003?

9 A. Staff's recommended overall rates of return for MGE for the period ending
10 December 31, 2003, based on the above-referenced range for return on equity, were as
11 follows:

12	<u>Return on Equity</u>	8.52%	9.02%	9.52%
13	Common Stock Equity	2.21%	2.34%	2.47%
14	Preferred Stock	.48%	.48%	.48%
15	Long-term Debt	3.87%	3.87%	3.87%
16	<u>Short-term Debt</u>	<u>.14%</u>	<u>.14%</u>	<u>.14%</u>
17	Overall Rate of Return	6.70%	6.83%	6.96%

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

19 A. Yes, it does.

**Capital Structure as of April 30, 2004
for Southern Union Company**

Capital Component	Amount in Dollars	Percentage of Capital
Common Stock Equity	\$1,048,146,000	29.99%
Preferred Stock	223,828,509	6.40%
Long-Term Debt	2,223,356,723 *	63.61%
Short-Term Debt	0 **	0.00%
Total Capitalization	\$3,495,331,232	100.00%

**Gas Distribution Financial Ratio Benchmarks
Total Debt / Total Capital - Including Preferred Stock**

Standard & Poor's Corporation's Utility Rating Service, Financial Statistics as of July 7, 2000	Lower Quartile BBB	Median BBB	Upper Quartile BBB
	52%	56%	61%

Note: * See Schedule 2 for the amount of Long-Term Debt at April 30, 2004.
 **Short-term debt balance was \$0 as of April 30, 2004

Source: Southern Union Company's response to Staff's Data Request No. 0374.

**Embedded Cost of Long-Term Debt as of April 30, 2004
for Southern Union Company (Consolidated)**

Southern Union Company Parent Only Embedded Cost of Long-Term Debt

Description	Issuance Date	Maturity Date	Original Issue	Outstanding as of April 30	Ann Int Rate	Ann Int Costs	Interest Pmt Dates	Issuance Costs (Orig)	Unamortized Issuance Costs & Discounts as of April 30	Embedded Rate
7.6% Senior Notes	2/1/1994	2/1/2024	475,000,000	359,765,000	7.60%	27,342,140	2/1 & 8/1	(5,386,788)	(2,720,918)	7.697%
8.25% Senior Notes	11/4/1999	11/15/2029	300,000,000	300,000,000	8.25%	24,750,000	5/15 & 11/15	(6,659,906)	(5,650,648)	8.484%
PGE MTG Notes 9.34%	11/4/1999	9/1/2019	15,000,000	15,000,000	9.34%	1,401,000	3/1 & 9/1	(342,871)	(265,077)	9.625%
Providence Series M 10.25%	9/28/2000	7/31/2008	10,000,000	1,363,000	10.25%	139,708	1/31 & 7/31	(80,531)	(44,610)	11.393%
Providence Series N 9.63%	9/28/2000	5/30/2020	10,000,000	10,000,000	9.63%	963,000	5/31 & 11/30	(284,477)	(239,180)	10.018%
Providence Series O 8.46%	9/28/2000	9/30/2022	12,500,000	11,875,000	8.46%	1,004,625	3/31 & 9/30	(678,625)	(577,005)	9.169%
Providence Series P 8.09%	9/28/2000	9/30/2022	12,500,000	12,500,000	8.09%	1,011,250	3/31 & 9/30	(323,564)	(279,213)	8.399%
Providence Series R 7.5%	9/28/2000	12/15/2025	15,000,000	15,000,000	7.50%	1,125,000	6/15 & 12/15	(367,971)	(325,872)	7.769%
Providence Series S 6.82%	9/28/2000	4/1/2018	15,000,000	14,464,000	6.82%	986,445	4/1 & 10/1	(391,911)	(321,283)	7.138%
Providence Series T 6.5%	9/28/2000	2/1/2029	15,000,000	13,737,000	6.50%	892,905	2/1 & 5/1& 8/1 & 11/1	(2,485,117)	(2,172,654)	8.480%
Fall River 9.44%	9/28/2000	2/15/2020	6,500,000	6,500,000	9.44%	613,600	2/15 & 8/15	(226,342)	(186,063)	9.904%
Fall River 7.99%	9/28/2000	12/15/2026	7,000,000	7,000,000	7.96%	559,300	3/15 & 9/15	(135,410)	(116,935)	8.202%
Fall River 7.24%	9/28/2000	12/15/2027	6,000,000	6,000,000	7.24%	434,400	6/15 & 12/15	(109,972)	(95,707)	7.426%
Mandatory Convertibles 5.75%	6/11/2003	8/16/2006	125,000,000	125,000,000	5.75%	7,187,500	8/16, 11/16, 2/16 & 5/11	(411,010)	(345,450)	5.871%
Term Loan	7/15/2002	8/26/2005	311,086,956	111,086,956	LIBOR+87.5bp	2,449,699	monthly	(1,470,798)	(845,959)	2.798%
Acct 189 unamortized issue costs/discounts									(13,261,501)	
Acct 257 unamortized premiums									2,061,342	
Total for Southern Union Company			1,335,586,956	1,009,290,956		70,860,571		(19,355,293)	(25,386,733)	7.397%

Panhandle Eastern Pipe Line Company Embedded Cost of Long-Term debt

Description	Issuance Date	Maturity Date	Original Issue	Outstanding as of April 30	Ann Int Rate	Ann Int Costs	Interest Pmt Dates	Issuance Costs (Orig)	Unamortized Issuance Costs & Discounts as of April 30	Embedded Rate	Annualized cost
2.75% Senior Notes	3/12/2004	3/15/2007	200,000,000	200,000,000	2.750%	5,500,000	3/15 & 9/15	(1,050,187)	(955,679)	2.765%	5,529,033
7.875% Senior Notes	8/15/1994	8/15/2004	100,000,000	52,455,000	7.875%	4,130,831	2/15 & 8/15	(6,659,906)	(12,657)	8.437%	4,425,570
6.50% Senior Notes	7/15/1999	7/15/2009	200,000,000	60,623,000	6.500%	3,940,495	1/15 & 7/15	(342,871)	(481,768)	6.511%	3,947,262
8.25% Senior Notes	4/1/2000	4/1/2010	100,000,000	40,500,000	8.250%	3,341,250	4/1 & 10/1	(80,531)	(25,551)	8.257%	3,343,943
7.00% Senior Notes	7/15/1999	7/15/1999	300,000,000	66,305,000	7.000%	4,641,350	1/15 & 7/15	(284,477)	(1,328,703)	7.007%	4,645,755
4.80% Senior Notes	8/15/1994	9/30/2022	300,000,000	300,000,000	4.800%	14,400,000	2/15 & 8/15	(678,625)	(2,282,345)	4.811%	14,432,648
6.05% Senior Notes	8/18/2003	9/30/2022	250,000,000	250,000,000	6.050%	15,125,000	2/15 & 8/15	(323,564)	(2,200,165)	6.058%	15,144,601
Term Loan	12/21/2001	1/31/2007	290,000,000	269,569,500	4.464%	12,033,582	1/31,4/30,7/31,10/31	(10,937,822)	(7,519,753)	4.639%	12,505,238
Embedded Cost of long-term debt for Panhandle Eastern Pipe Line Company			1,740,000,000	1,239,452,500		63,112,509		(20,357,983)	(14,806,621)	5.161%	63,974,050
Total consolidated embedded cost of long-term debt for Southern Union Company			3,075,586,956	2,248,743,456		133,973,080		(39,713,275)	(40,193,354)	6.151%	
Long-Term Debt Balance for Capital Structure in Schedule 1				2,223,356,723							

Source: Company Response to Data Request 0374.

**Embedded Cost of Preferred Stock as of April 30, 2004
for Southern Union Company**

			(1)	(2)		Annualized Cost to Company (1 * 2)
Preferred Stock	Issuance Date	Original Issue	Outstanding as of 4/30/2004	Annual Interest Rate	Unamortized Issuance Cost	
7.55% Preferred Securities	10/1/03	230,000,000	\$230,000,000	7.55%	(6,171,490.72)	\$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%

Notes:

Source: Southern Union Company's response to Staff's Data Request 0374

**Weighted Cost of Capital as of April 30, 2004
for Missouri Gas Energy**

Capital Component	Percentage of Capital	Embedded Cost	Weighted Cost of Capital Using Common Equity Return of:		
			8.52%	9.02%	9.52%
Common Stock Equity	29.99%	-----	2.55%	2.70%	2.85%
Preferred Stock	6.40%	7.76%	0.50%	0.50%	0.50%
Long-Term Debt	63.61%	6.15%	3.91%	3.91%	3.91%
Short-Term Debt	0.00%	-----	0.00%	0.00%	0.00%
	<u>100.00%</u>		<u>6.96%</u>	<u>7.11%</u>	<u>7.26%</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.