Section 490.065.3 as being based on the type of information and knowledge relied upon by experts on that subject in that field.

Flotation Costs

With absolutely no supporting analysis, MGE alleges that Mr. Allen's rate of return calculations are "unreliable" because he failed to account for equity flotation costs in his DCF calculation. (MGE Memorandum at p. 12). MGE's assertion that Mr. Allen's rate of return calculations are "unreliable" because he failed to account for equity flotation costs in his DCF calculation are just plain wrong.

First, this Commission has denied flotation costs it the past. (In the Matter of Capital City Water, WR-94-297 Feb. 8, 1995, p. 16 "The Commission is not adopting the company's DCF approach because the Company included a quarterly compounding adjustment and flotation cost adjustment. The Commission is of the opinion that these upward adjustments to the return on equity using the DCF approach are not appropriate."; In the Matter of Kansas Power and Light, GR-91-291 Jan. 22, 1992, p. 25 "The Commission determines that these flotation costs should not be accounted for in establishing the appropriate cost of equity for Company.") In fact, MGE witness Morin testified at his deposition that in his experience half of the utility commissions do not allow flotation cost adjustments. (Ex. 3, Sch. JCD-3, p. 93, l. 21-24; p. 84, l. 1-13).

Second the record evidence demonstrates that the reason MGE must issue equity is because its acquisition of Panhandle Eastern Pipeline. Granting a flotation cost adjustment would violate the Stipulation and Agreement in GM-2003-0238. Part E of the Stipulation and Agreement states:

> Southern Union will not recommend any increase or claim Staff should make an adjustment to increase the cost of capital for MGE as a result of

growth rate has received endorsement in several finance texts: Investment Analysis and Portfolio Management, Reilly, 1985 p. 289; Investment Analysis and Portfolio Management, Cohen, Zinberg, and Zeikel, 1982, p. 397; Investments, Sharpe, 1985, p. 427; Public Utility Economics and Finance, Howe and Rasmussen, 1982, p. Principles of Corporate Finance, Bresley and Myers, 1984, p. 50

In fact, MGE witness Morin in his book Regulatory Finance Utilities' Cost of Capital, (1994) at page 140 notes there are three general approaches to estimating growth for the DCF:

- historical growth rates
- analysts' forecasts
- sustainable growth rates

Witness Morin acknowledged in his deposition that the retention growth (sustainable growth) method was an appropriate way to determine the growth component for the DCF model. (Ex. 2, Sch. JCD-3, p. 68, l. 20-25; p. 69, l. -14).

MGE's circularity argument is incorrect. As noted at pages 35 through 37 of the Surrebuttal Testimony Exhibit 203 of Public Counsel witness Mr. Tuck discusses why this argument is wrong. The fact of the matter is that the market-derived cost of equity determination produced by the DCF model is self-correcting. (Ex. 203, p. 36, l. 18-22) MGE witness Morin notes this fact in his book at page 161 noting "[t]he circularity problem is somewhat dampened by the self-correcting nature of the DCF model." alleged "circularity" problem does not cause Mr. Allen's rate of return testimony to run afoul of subsection 3 of Section 490.065

Capital Asset Pricing Model