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STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS
Evidentiary Hearing
August 19, 2014
Jefferson City, Missouri
Volume 10

In the Matter of Summit)
Natural Gas of Missouri)
Inc.'s Filing of Revised)
Tariffs to Increase its) Case No. GR-2014-0086
Annual Revenues for)
Natural Gas Service)

DANIEL R.E. JORDAN, Presiding,
SENIOR REGULATORY LAW JUDGE.
ROBERT S. KENNEY, Chairman
STEPHEN M. STOLL,
WILLIAM KENNEY,
DANIEL Y. HALL,
SCOTT T. RUPP,
COMMISSIONERS.

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1 P R O C E E D I N G S
2 (SUMMIT EXHIBIT NOS. 1 THROUGH 20,
3 STAFF EXHIBIT NOS. 100 AND 102 THROUGH 138, OPC
4 EXHIBIT NOS. 200 THROUGH 205, MSBA EXHIBIT NOS. 400
5 THROUGH 402, DOE EXHIBIT NOS. 500 THROUGH 504 AND
6 MPGA EXHIBIT NOS. 600 AND 601 WERE MARKED FOR
7 IDENTIFICATION.)

8 JUDGE JORDAN: Good morning,
9 everyone. Today is Tuesday, August 19th of 2014,
10 and the Missouri Public Service Commission is
11 calling the action in File No. GR-2014-0086. This
12 is in the matter of Summit Natural Gas of
13 Missouri's filing of revised tariffs to increase
14 its annual revenues for natural gas services.

15 My name is Daniel Jordan. I'm the
16 Regulatory Law Judge assigned to this action.
17 We're here for the evidentiary hearing. I will
18 begin by asking everyone to silence cell phones,
19 silence your cell phones and similar devices. I
20 have mine right here, and I'm going to make sure
21 that it's silenced, too. You don't have to turn it
22 off, but do make sure that it doesn't ring and
23 interrupt our proceedings.

24 And let's take entries of appearance
25 now. We will begin with the Applicant.

1 MR. COOPER: Thank you, your Honor.
2 Dean Cooper, Paul Boudreau and Diana Carter from
3 the law firm Brydon, Swearingen & England, P.C.
4 will appear on behalf of Summit Natural Gas of
5 Missouri, Inc. The court reporter has the address.

6 JUDGE JORDAN: Thank you. For the
7 Public Service Commission Staff.

8 MR. BORGMEYER: Thank you, your
9 Honor. Appearing on behalf of the Commission
10 Staff, John Borgmeyer, Kevin Thompson and Akayla
11 Jones, and the court reporter should have our
12 address.

13 JUDGE JORDAN: Thank you. For the
14 Office of the Public Counsel.

15 MR. POSTON: Thank you, Judge. Marc
16 Poston appearing for the Office of the Public
17 Counsel and the public.

18 JUDGE JORDAN: For the Missouri
19 School Boards Association.

20 MR. BROWNLEE: Richard Brownlee on
21 behalf of the Missouri School Boards Association.
22 Also, the reporter would have my address.

23 JUDGE JORDAN: Thank you. For the
24 Missouri Division of Energy.

25 MR. KNEE: For the Division of

1 Energy, Jeremy Knee, and the reporter has my
2 address as well.

3 JUDGE JORDAN: Very good. For the
4 Missouri Propane Gas Association.

5 MR. JARRETT: Terry Jarrett appearing
6 on behalf of the Missouri Propane Gas Association,
7 and my address and contact information are on file
8 with the court reporter.

9 JUDGE JORDAN: Thank you. We already
10 marked the exhibits that consist of prefiled
11 testimony. We did that off the record. And when
12 you're offering those exhibits, I'll remind the
13 parties to give a copy to the reporter if you
14 haven't done so already.

15 Now, the last time I checked there
16 were no preliminary matters to address before we
17 begin with opening statements, and my file shows no
18 motions pending. Am I correct in that or does
19 anyone have anything they wish to discuss on the
20 record?

21 (No response.)

22 JUDGE JORDAN: Okay. I am not seeing
23 anything. So I understand that what we'll be doing
24 this morning will consist of general opening
25 statements, and then as each issue comes up each

1 day, we will be doing more focused opening
2 statements relating to those issues. Do I
3 understand that to be correct?

4 MR. BORGMEYER: Yes, your Honor.

5 MR. COOPER: That's correct, your
6 Honor.

7 JUDGE JORDAN: Very good. And I
8 believe we have only two witnesses scheduled to
9 appear today, witnesses Anderson and Murray. The
10 witness Lawler who addresses the same issues, that
11 appearance is deferred until Friday; is that
12 correct?

13 MR. COOPER: That is correct.

14 JUDGE JORDAN: All right, then. Then
15 the Commission will hear the opening statement of
16 Summit Natural Gas of Missouri, Incorporated.

17 MR. COOPER: Thank you, your Honor.
18 My name is Dean Cooper. Along with my partners
19 Paul Boudreau and Diana Carter, we will be
20 representing Summit Natural Gas of Missouri, Inc.
21 in this week's hearing.

22 Summit Natural Gas of Missouri is a
23 natural gas corporation with approximately 17,800
24 customers being served through five operating
25 divisions in the state of Missouri. Those five

1 operating divisions are known as Gallatin, Warsaw,
2 Lake of the Ozarks, Rogersville and Branson.

3 This rate case involves all of those
4 divisions except for the Lake of the Ozarks
5 division. The Lake of the Ozarks division is a
6 system that's still under development, and as a
7 part of its certificate grant for that area, Summit
8 Natural Gas agreed to a 42-month rate moratorium
9 for that division only. The rate moratorium for
10 Lake Ozarks will remain in effect until December of
11 2015.

12 Summit Natural Gas of Missouri is the
13 current name of the corporate entity formerly known
14 as Missouri Gas Utility, Inc. When MGU was formed
15 in October of 2004, it had zero customers and
16 practically zero assets. MGU's parent, which is
17 now called Summit Utilities, was originally owned
18 by a large group of investors, none of which owned
19 more than 5 percent of Summit Utilities.

20 Shortly after formation, Missouri Gas
21 Utility acquired the municipal gas facilities of
22 Gallatin and Hamilton, Missouri. Those municipal
23 systems were available because both the Gallatin
24 and Hamilton town councils had elected to cease
25 payments on the certificates of participation used

1 to finance the original system, and the banks
2 representing the holders of those certificates had
3 foreclosed.

4 At the time MGU negotiated the
5 purchase of the systems and obtained PSC authority,
6 there was not enough gas supply available to serve
7 customers past December of 2004. MGU purchased gas
8 for the systems before it had even closed on those
9 transactions.

10 MGU began operation of the Gallatin
11 and Hamilton systems in January of 2005, and at
12 that time they had a total of approximately 740
13 customers in the state of Missouri.

14 Subsequently, MGU has expanded the
15 systems around Gallatin and Hamilton and built new
16 systems south from I-70 near Sedalia to Warsaw.

17 What is sometimes referred to as the
18 MGU legacy systems now provide natural gas service
19 through distribution facilities in the counties of
20 Harrison, Davies, Caldwell, Pettis, Benton, Morgan,
21 Camden and Miller Counties. These are the current
22 Gallatin, Warsaw and Lake of the Ozarks divisions
23 that I mentioned earlier.

24 The origins of the Rogersville and
25 Branson operating divisions are something quite

1 different and more complex. In 1993, an entity by
2 the name of Tartan Energy, doing business as
3 Southern Missouri Gas Company, filed for a
4 Certificate of Public Convenience and Necessity for
5 certain parts of southern Missouri. The
6 application for certificate was approved in the
7 fall of 1994, and since then this entity has gone
8 through multiple reorganizations and various owners
9 in its nearly 20-year history.

10 Most recently the company was known
11 as Southern Missouri Natural Gas. Southern
12 Missouri Natural Gas ultimately provided natural
13 gas service in the counties of Greene, Webster,
14 Laclede, Wright, Douglas, Texas, Howell, Stone and
15 Taney, and these systems, as I said, are now part
16 of the Rogersville and Branson divisions for this
17 company.

18 You will hear mentioned in this case
19 an entity by the name IIF, or Infrastructure
20 Investment Fund. IIF is a private entity fund with
21 various holdings. One of those holdings is Summit
22 Utilities, the parent of Summit Natural Gas of
23 Missouri.

24 IIF first invested in Summit
25 Utilities in 2007. In 2010 IIF purchased all of

1 the remaining shares of Summit Utilities. IIF
2 obtained a majority interest in Southern Missouri
3 Natural Gas in 2008 and completed its purchase of
4 Southern Missouri Natural Gas in 2011.

5 After receiving this Commission's
6 approval, Southern Missouri Natural Gas was merged
7 into Missouri Gas Utility on January 1st of 2012,
8 and at that time Missouri Gas Utility changed its
9 name to Summit Natural Gas of Missouri, Inc., the
10 name it uses today.

11 The current parent, Summit Utilities,
12 only took full control of the Southern Missouri
13 Natural Gas operations and properties after the
14 2012 merger.

15 Summit has constructed significant
16 new gas facilities and has experienced increased
17 operating expenses, including increased property
18 taxes associated with these new facilities. This
19 is the first rate case for Summit Natural Gas as it
20 now exists post merger and the post-construction
21 rate case for several areas of its service
22 territory.

23 In regard to the issues, I'll start
24 with the good news. The parties yesterday
25 afternoon have filed two stipulations. These

1 stipulations can be considered unanimous by
2 Commission rule as all parties are either
3 signatories or have stated affirmatively that they
4 do not oppose the stipulations and do not request
5 any hearings on those issues.

6 Summit believes that the stipulations
7 constitute a just and reasonable resolution of the
8 issues addressed by those stipulations. And by my
9 count, those stipulations remove approximately 24
10 of the issues that were listed on the original list
11 of issues for Commission hearing. So I think they
12 substantially cut down the amount of work that we
13 need to do here this week, if they are ultimately
14 accepted by the Commission.

15 However, issues do remain for the
16 Commission this week. Unlike many rate cases, much
17 of the minutia of the revenue requirement elements
18 are not up for decision for the Commission this
19 week. We have only a few what I would call revenue
20 requirement issues, but they are big issues.

21 Summit agrees with Staff's
22 calculation of the revenue requirement for the
23 various operating divisions and, again, we're
24 asking you to come up with revenue requirements for
25 each of the four divisions that are at issue in

1 this case, with the exception of the cost of money
2 issues related to return on equity, a debt issue
3 and capital structure.

4 My partner Paul Boudreau will provide
5 more detail as to Summit's position on those issues
6 shortly when we move to the hearing of those
7 issues.

8 The Office of the Public Counsel's
9 alleged two rather large issues associated with
10 revenue requirement. First, Public Counsel
11 suggests that there should be no increase in any of
12 the divisions or, in the alternative, imputations
13 of revenues or customers or something else because
14 OPC believes that the company has not obtained
15 projections found in the original feasibility
16 studies for those areas.

17 As to the Rogersville division,
18 Summit will present evidence that this is just
19 incorrect. The system has met the targets, and
20 these are old targets. These are 1994 targets.
21 But again, we believe that the company has met
22 those targets.

23 As to Gallatin, as I described
24 earlier, that system consists of small troubled
25 municipal systems that were brought onto the

1 company's books at a much lower value than the
2 original construction costs. This division has
3 grown from the 740 customers that I mentioned
4 earlier to almost 1,600 customers today. We don't
5 think there's any justification as to that division
6 for any imputation or otherwise adjusting the
7 ultimate revenue requirement for that division.

8 As to the Warsaw and Branson
9 divisions, Summit recognize that there's some level
10 of underutilization of its assets. Because of
11 this, Summit has asked the Commission to direct it
12 to transfer a portion of the mainline investments
13 in both of those divisions into Uniform System of
14 Account 105, which is plant held for future use.

15 Staff has made a similar proposal,
16 and Summit agrees with the adjustments proposed by
17 Staff in regard to that transfer. Directing these
18 Account 105 transfers in Warsaw and Branson we
19 believe will recognize the underutilization of
20 mainline assets in those divisions and, after that,
21 require no further imputation of volumes, customer
22 levels or revenues in order to recognize the value
23 of the system that is providing service to the
24 customers in those divisions.

25 The second Public Counsel issue with

1 revenue requirement implications is its proposal
2 that Summit Natural Gas be required to book the
3 former Southern Missouri Natural Gas assets on
4 Summit's books at a merger purchase price rather
5 than the net original cost of those assets.

6 OPC attempts to support this proposal
7 in a couple of different fashions. However, the
8 bottom line is that either approach would be
9 contrary to longstanding Commission practice of
10 recording the transfer of regulated assets at their
11 net original cost.

12 Once the revenue requirement has been
13 determined, the next step is to design the rates.
14 How will the revenue requirement be collected from
15 the customers?

16 An issue regarding rate shock has
17 been listed in the list of issues. Rate shock is
18 not a defined term. However, the size of rate
19 increases is certainly something that Summit
20 Natural Gas is mindful of and something the company
21 has made proposals to address.

22 In its direct case, Summit proposed a
23 lower ROE than was recommended by its expert
24 witness. As I discussed a few moments ago, Summit
25 has further proposed certain Account 105 transfers

1 which would serve to lower the revenue requirement
2 in both the Warsaw and Branson division.

3 Summit has proposed to continue its
4 customer charge plus volumetric charge rate design
5 rather than proposing straight fixed variable as
6 the Staff originally did because Summit did not
7 believe that SFV was appropriate for it or its
8 customers given the relatively new age of Summit's
9 plant, as well as the very real competition that
10 Summit faces from other fuel sources.

11 Lastly, Summit proposed customer
12 charges and amounts less than what was called for
13 by its class cost of service study. Summit reduced
14 its requested customer charges to maintain the
15 ratio of revenues collected from fixed monthly fees
16 at approximately 12 percent of revenues.

17 Now, in terms of the rate design
18 again, there does not appear to be any party
19 proposing any reallocation of costs amongst the
20 various classes within the division. So I don't
21 think that's an issue for you.

22 However, I think that what does
23 remain for Commission decision in regard to that
24 rate design is how that any rate increase would be
25 split between the customer charge and the

1 volumetric charge.

2 As I mentioned, in its direct case
3 Summit proposed to limit the customer charges to
4 certain amounts. Staff has proposed to apply any
5 rate increase to the existing rate elements in
6 equal percentages. Summit would not object to the
7 use of the equal percentages as proposed by the
8 Staff as this case has developed.

9 You will also hear from the Missouri
10 School Boards Association concerning the increases
11 that may be seen by the schools that are a part of
12 the school aggregation program. These schools
13 purchase their own natural gas but pay Summit
14 Natural Gas for the use of its system to transport
15 the gas to the schools, as well as some of the
16 services that are related to that.

17 The subject schools are all located
18 in the old Southern Missouri Natural Gas territory.
19 These school districts were treated as transport
20 customers and paid a single discounted customer
21 charge historically or since before Summit took
22 control of Southern Missouri Natural Gas.

23 In Southern Missouri Natural Gas'
24 last rate case proceeding, amounts of revenue were
25 imputed by Staff to reflect the difference between

1 the full transport tariff rate and the discounted
2 transport tariff rate that had been given to the
3 schools. This resulted in lost revenue for the
4 company. In response, Summit began to move the
5 schools to the full transport tariff rate. Much of
6 that movement took place in the fall of 2013.

7 Additionally, it's become apparent
8 that the tariff requires the schools to be billed
9 at the companion sales rate as opposed to the
10 transport rate and to be billed at a customer
11 charge for each meter. That change has been
12 contemplated in the billing determinants and pro
13 forma revenues developed for this case by the Staff
14 and embraced by Summit.

15 Treating the schools in this fashion
16 allows the rates to be faithful to the provisions
17 of Section 393.310.5, RSMo., which is the school
18 aggregation tariff or statute which requires that
19 the tariff not have any negative financial impact
20 on the gas corporation, its other customers or
21 local taxing authorities, and that the aggregation
22 charge is sufficient to generate revenue at least
23 equal to all incremental costs caused by the
24 experimental aggregation program.

25 Past practice in regard to the

1 schools has created a negative financial impact on
2 the gas corporation. Other approaches it seems
3 would create a negative financial impact on
4 Summit's other customers.

5 This combination of taking the
6 schools to the appropriate companion sales rate and
7 of the billing by meter results in a significant
8 increase for the schools. In fact, much of the
9 increase that's going to be cited by the schools is
10 due to these factors and not the impact of the rate
11 case itself or the revenue requirement to be set at
12 the conclusion of this case.

13 Summit certainly bears no ill will
14 against the schools. However, the company is not
15 aware of a way to remain faithful to the statute
16 and avoid the impact on the schools resulting from
17 getting them onto the appropriate tariff rates.

18 The remaining issues for the
19 Commission this week will concern Summit's proposed
20 conversion program and the treatment of energy
21 efficiency programs. Summit will provide specifics
22 in regard to those issues later in the week when
23 they're heard by the Commission.

24 In conclusion, Summit Natural Gas of
25 Missouri has been instrumental in bringing natural

1 gas service to areas of the state that did not
2 previously have access to that fuel source. In
3 this case, Summit is asking the Commission to set
4 rates that will allow it to continue to provide
5 this service in a safe and adequate manner and that
6 will provide it with the incentive to continue its
7 growth in areas of the state where this fuel source
8 will be useful and desired by Missourians.

9 That's all I have, your Honor.

10 JUDGE JORDAN: Thank you. Any
11 inquiries, clarifications from the Bench?

12 All right. Thank you. The general opening
13 statement of Staff.

14 MR. BORGMEYER: Good morning. May it
15 please the Commission?

16 As you heard in the opening statement
17 of Summit Natural Gas, they're a new company in
18 Missouri, and they've been expanding their business
19 in Missouri through acquisition and investment in
20 new construction.

21 And just like with any business
22 expansion, that takes place with the hopes that the
23 customers will arrive that will make that
24 investment worthwhile. But also just like with any
25 investment, there's a risk that that won't happen.

1 And so really the big issues in this
2 case boil down to the concept of risk. Should the
3 company bear the risk of the expansion or should
4 the shareholders bear the risk? And there's been a
5 lot of testimony in this case identifying the fact
6 that in previous cases Summit has promised that
7 they would bear the risk of their financial
8 projections not coming true.

9 And so the big issues for you to
10 decide in this case is how to hold Summit to
11 that -- to those promises. And in this case,
12 Staff's case gives you a couple ways to do that in
13 a way that holds Summit to its promises and still
14 establishes just and reasonable rates for the
15 utility service that the ratepayers actually
16 consume.

17 So the big issue in this case is rate
18 of return, and Staff witness Dave Murray will be
19 here to explain his rate of return calculations.
20 And what he's done, as you've heard Summit say in
21 their opening, that the Lake of the Ozarks region
22 is not at issue in this case. And so what Staff
23 witness Dave Murray has done is attempted to create
24 a capital structure and a rate of return that
25 removes the risk of that construction from that

1 system from the rest of the case so that the
2 ratepayers in these divisions are not bearing that
3 cost.

4 And it's worth about \$3 million in
5 this case. Staff's current revenue requirement is
6 about 5.15 million. The company's around
7 8 million. So the rate of return is really the big
8 issue that I think the Commission should consider
9 when you're talking about how to apportion this
10 risk to the company and to the ratepayers.

11 Now, another way that Staff's case
12 attempts to hold Summit to its commitments about
13 risk is through capacity adjustments to the revenue
14 requirement, and those are described by Staff
15 witness Amanda McMellen.

16 And those are in the Branson and
17 Warsaw areas where Staff has determined that the
18 customer growth has not met Summit's expectations
19 in a material way, so that it would be unjust and
20 unreasonable to ask those existing customers to pay
21 for all of the existing infrastructure in the
22 Branson and Warsaw areas.

23 And so Staff has proposed a capacity
24 adjustment that removes that excess capacity, the
25 plant, the excess plant from the rate base,

1 transfers it to plant held for future use. As new
2 customers come on the system, that can be
3 reconsidered in an upcoming rate case. But for
4 purposes of this case, the adjustment will -- the
5 adjustment means that the current customers will be
6 paying for the utility service that they use and no
7 more than that.

8 And so those are two major ways that
9 the Staff is offering you to set just and
10 reasonable rates in this case and hold Summit to
11 the commitments that they made to bear the risk of
12 this expansion.

13 And I'll mention that Staff witness
14 Tom Imhoff has sponsored the class cost of service
15 study in this case, recommended Staff's rate
16 design. Staff in its testimony recommended the
17 straight fixed variable rate design.

18 As the case has progressed, the Staff
19 has agreed that -- with the company and OPC,
20 they've agreed to the two-part rate design that
21 Summit currently employs with a volumetric
22 component and a customer charge. And Staff's
23 position is that any rate increase or rate decrease
24 ordered in this case should be applied on an equal
25 percentage basis by district to all the rate

1 elements in that district.

2 As the company mentioned, the Office
3 of Public Counsel has offered testimony that
4 involves using feasibility studies from former CCN
5 cases to impute customer numbers or volumes. Staff
6 disagrees with this method of ratemaking.

7 Staff doesn't believe that this is an
8 appropriate method of ratemaking, and so Staff
9 would urge you to reject this proposed method of
10 making rates. And Staff witness Amanda McMellen
11 again will be here to describe her position to you.

12 Staff in this case is also
13 recommending that Summit be authorized to adopt an
14 energy efficiency and low-income weatherization
15 program. Currently Summit does not have one. So
16 Staff's position is that an energy efficiency
17 collaborative should be formed, that a target level
18 of funding of .5 percent of annual revenues should
19 be set for the company, and that company's
20 expenditures should ramp up to that level based on
21 discussions with the energy efficiency
22 collaborative.

23 And the Division of Energy has
24 proposed a funding mechanism that Staff is opposed
25 to, and you'll hear more about that when that issue

1 comes up for hearing later on this week.

2 So in summary, Staff's case presents
3 you with what I think is a middle -- a reasonable
4 middle ground between two -- two extremes that
5 again provides a just and reasonable rate for the
6 customers while holding Summit to its commitments
7 to bear the risk of their expansion in Missouri.

8 And I would just invite you to ask
9 the Staff witnesses any questions that you might
10 have about their positions. Thank you.

11 JUDGE JORDAN: Any inquiries from the
12 Bench of counsel? Thank you. Opening statement
13 from the Office of Public Counsel.

14 MR. POSTON: Thank you. I have a
15 handout. I don't intend to have this marked as an
16 exhibit at this time at least.

17 Good morning. May it please the
18 Commission? I'd like to begin by addressing the
19 magnitude of this rate increase request. The
20 overall size of the increase needs to be considered
21 in the context of its impact on customer rates
22 because that's what this case is about. It's about
23 establishing rates that are just and reasonable.

24 Summit's filed case requests
25 \$7.4 million. That's what customers were told the

1 company was requesting. But if you read Summit's
2 position statement, you'll see that they've added
3 an additional 800,000 to their request. If you add
4 up the revenue increases, their position statement
5 says that their request for the four districts,
6 that equals around 8.2 million.

7 And what we see when we look at the
8 proposed rates, that 8.2 million -- well, actually
9 it's -- the rates that they've calculated right now
10 are almost 7.4 million. But what we see is huge
11 rate increases for all four districts.

12 The parties agreed in our filing
13 yesterday, our partial settlement, to pro forma
14 revenues for each district. And so the increases
15 on top of that pro forma revenues are very, very
16 large. If you live in Warsaw, Summit wants you to
17 pay an additional 77 percent. A 77 percent
18 increase to the bills for ratepayers in Warsaw.
19 In the Branson district, Summit's requesting a 73
20 percent rate increase.

21 It was rate hikes like this that led
22 to the creation of this Commission and tasked it
23 with its primary duty, which is to protect
24 ratepayers, including protecting them from rate
25 increases, rate hikes that are not just and

1 reasonable.

2 In Rogersville, Summit wants a
3 54 percent increase. In Gallatin, Summit wants a
4 31 percent increase. In comparison to the
5 77 percent, 31 percent seems low, but it's not.
6 It, too, is a very high rate increase.

7 The numbers provided by Summit for
8 its customer notice that went out to all customers
9 stated that an average customer living in the
10 Branson district would see their rates rise by
11 almost \$350 per year, and that was before Summit
12 increased its request.

13 I mean, please think about that.
14 \$350 per year is a very, very large increase. For
15 a widow living month to month off of Social
16 Security income, this sort of increase could be
17 devastating.

18 Someone living on a low fixed income
19 to not have the means to pay for this, or if they
20 do, it's not without sacrificing something
21 important. Those cuts will likely be food,
22 medicine, home heat, all necessities that could
23 lead to increased health problems when they're
24 forced to go without.

25 An increase of this magnitude is a

1 threat to public health and safety, which is one of
2 the primary reasons why we urge the Commission to
3 deny this rate increase.

4 By comparison, the last time Summit's
5 predecessor, Summit Missouri Natural Gas, requested
6 a rate increase, they were granted \$1.3 million,
7 just three years ago, and that raised rates for
8 residential ratepayers by \$54 a year. That's
9 Case GR-2010-0347. Now they're asking for an
10 increase of more than six times that.

11 Compared to other LDCs of similar
12 size, Summit's request is excessive. For example,
13 in the last general rate increase of Empire
14 District Gas Company, the Commission granted Empire
15 a rate increase that raised customer bills by \$36
16 to \$72 annually. That's GR-2009-0434.

17 In Ameren's last rate case, the
18 Commission granted a rate increase that raised
19 bills by \$40 per year. That's GR-2010-0363. And
20 in Atmos Energy's last rate case, before they
21 became Liberty, the Commission granted Atmos an
22 increase of between 53 and \$115 per year. That's
23 GR-2010-0192.

24 This raises the question, why is
25 Summit requesting so much from their customers when

1 other companies only request a fraction of that?
2 Because this is a growing company, an expanding
3 company, and in the short life of this company,
4 they have simply not realized the customer levels
5 and gas volumes that they used to support their
6 Certificates of Convenience and Necessity.

7 What this rate increase amounts to is
8 an attempt by Summit to pass the risk of reaching
9 its projections on to its customers.

10 The Commission and its Staff
11 predicted that this may happen when it granted the
12 Certificates of Service Authority to Summit's
13 predecessor companies, and to protect customers,
14 the Commission put in place conditions on those
15 certificates that would protect customers well into
16 the future by placing all risk of project success
17 onto the company and no risk onto the customers.
18 We ask you to enforce those conditions.

19 And I'd like to talk for a few
20 minutes about those conditions. Summit's service
21 territory history began in 1994, as you heard from
22 Mr. Cooper, when Tartan Energy, doing business as
23 Southern Missouri Gas Company, was granted a
24 certificate to serve ten cities east of
25 Springfield, mostly along Highway 60 from

1 Mountain Grove to Mountain View, and along
2 Highway 63 from Licking down to West Plains.

3 Tartan's application for a CCN was
4 based on the company's projection that 70 percent
5 of eligible homes and businesses would take service
6 from the company.

7 In that case, the Commission Staff
8 initially recommended that the application not be
9 approved because it wasn't economically feasible.
10 But the Staff ultimately agreed to the application
11 when Tartan agreed to several conditions and an
12 imputation.

13 One condition was that all future
14 rates be set on an imputed level of volumes for the
15 communities included in those approved Certificate
16 of Service Authority areas until such time that the
17 actual volumes exceed that imputed level.

18 I've passed around a handout that
19 includes quotes from Commission Orders regarding
20 Summit's certificates to provide service, including
21 the Tartan Energy case, and I'll just walk through
22 this briefly. All I've done here with this handout
23 is I've cut and pasted sections of the Commission's
24 Orders. That's all this is. There's only -- my
25 only addition to it is I've underlined some things.

1 And so if you look on it, No. 1,
2 that's the Tartan Energy, the original certificate,
3 and you can see on page 6 to 7 of the stipulation,
4 the parties have agreed to this imputation level,
5 and Tartan also agreed that this paragraph would
6 apply to all successors and assigneds.

7 In the Commission's Order, they
8 approved that language. And on page 24 to 25 of
9 the Commission's Order, I'd like to read from that
10 Order. The Commission wrote that, the Commission's
11 of the opinion that the biggest risk facing Tartan
12 is that it may take more time than predicted to
13 obtain the necessary conversions, not that the
14 project is not viable at all. Tartan is aware of
15 the risk and has chosen to accept it. It agreed to
16 the imputed volume levels contained in the
17 stipulation, and also agreed that the provision
18 involving an imputation of volume levels be binding
19 on its successors and assigneds.

20 Tartan also conducted a sensitivity
21 analysis which showed that, in the event
22 conversions took place at a lower rate than
23 anticipated, Tartan's return on its investment
24 would be reduced to a single-digit level. Tartan
25 seems willing to accept this risk.

1 And if you look throughout this, as
2 the system -- as MGU came on and then as both
3 companies expanded, the Commission consistently
4 added a condition that the company bear all risk
5 and that customers not bear any risk.

6 The imputation from Tartan protects
7 customers by putting the risk on the company that
8 it will achieve its forecasted customer levels and
9 gas volume levels. This is done by treating
10 customers as if the forecasts were actually
11 achieved for ratemaking purposes. This ensures
12 that customers pay no more than what they would pay
13 if the project had achieved the threshold volumes.
14 Once the company achieves its projected levels, an
15 imputation disappears.

16 And we ask the Commission to
17 recognize that it used the imputation to protect
18 customers in the Tartan case, and that a similar
19 protection can be applied in this case by requiring
20 ratepayers to pay no more than what they would pay
21 if the minimum level of the projected customer
22 numbers and volumes were met. That way customers
23 do not take any of the risk of the success of the
24 expansion projects.

25 And I ask you, please ask

1 Ms. Meisenheimer. She will be testifying on this
2 subject, and please inquire of her about this.

3 Public Counsel relied on these
4 Commission-ordered conditions when we chose not to
5 oppose the certificates, and we hope the Commission
6 follows through on these important protections by
7 enforcing them. They were put in place to protect
8 ratepayers from exactly what Summit is seeking in
9 this case, which is a risk shift to ratepayers.

10 I'd like to talk for a minute about
11 the feedback received from Summit's customers, and
12 I'd like to quote from a few customers as well.
13 And I'll start with the public hearings in the
14 small community of Gallatin where we heard from
15 residential customers about the hardships that the
16 proposed increase would create in their community.

17 Mrs. Debra Warner testified, quote,
18 This is a community of single parents, elderly
19 people, disabled people. I'm a caregiver for
20 disabled people. It's a community of widows and
21 widowers. In the winter, you go into people's
22 homes and they have plastic taped over their
23 windows and doors. It's also common to go into
24 people's homes and they will ask you to step into a
25 small bedroom because it's the only thing they're

1 heating, and they're heating it with a small space
2 heater, and they and their children are living in
3 that little space. People are going without food
4 trying to keep their utilities on. Any increase in
5 this community is devastating. End quote.

6 Further south in Warsaw, the
7 Commission heard from other ratepayers, including
8 chicken farmers. Mr. Douglas Frederick testified,
9 quote, I can't understand how Summit Natural Gas
10 can put a new line in, everything was brand-new,
11 and not have the figures in front of them of what
12 their cost is and what their return is. And they
13 went after us because they told us, oh, one of your
14 chicken houses equal 50 residential homes, and so
15 we've got a lot of volume here and you're a great
16 customer. And now all of a sudden they're telling
17 us our rates are going up. End quote.

18 It's understandable why Mr. Frederick
19 is frustrated and feels he was misled when he
20 initiated service. The mains necessary to serve
21 his business have not changed, so he can't
22 understand how the cost to serve him could have
23 increased so dramatically in five years. And when
24 I say dramatic, this is Warsaw where that increase
25 would be 77 percent.

1 Down in Branson, we heard from
2 business owners in the hotel and entertainment
3 industry, which is vital to that community.
4 Branson's mayor Raeanne Presley testified, quote,
5 Before the installation -- before this installation
6 took place, the community was not given adequate
7 notification that the cost of this construction was
8 not built into the current rate structure. It was
9 not clear that the utility expected to recoup these
10 investments in future years with rate increases.

11 She goes on to say, I must say that
12 it was not made clear to our community, I think
13 neither to our citizens, nor to our businesses, nor
14 to our city staff.

15 If you haven't already, I urge you to
16 please read through the filed customer comments.
17 As of yesterday, there were 133 comments filed, and
18 as you read through them, you'll hear a consistent
19 theme of surprise and outrage.

20 As you can see from these comments,
21 the proposal to increase rates so dramatically has
22 taken everyone by surprise from the low-income
23 residential customer to the commercial customer.
24 The rate shock to customers would be severe.

25 I spent all my opening talking about

1 our primary issues, but this is not our only issue.
2 It's my understanding we'll have an opportunity to
3 provide opening remarks on those other issues, and
4 so I'll save those remarks for that time.

5 In conclusion, this is a case about a
6 company that committed to us and to you that it
7 would not shift risk to its customers. Summit has
8 the burden of coming here and proving that they
9 have satisfied those conditions, conditions placed
10 on their CCNs that apply in rate cases like this,
11 and they have not brought forth evidence that
12 proves that those conditions were met.

13 For these reasons, we ask you to
14 protect the people and businesses served by Summit
15 and deny this request. Thank you.

16 JUDGE JORDAN: Thank you, counselor.

17 COMMISSIONER W. KENNEY: Thank you.

18 I appreciate the handout. At a lot of those public
19 hearings, you have a lot of compelling testimony.

20 MR. POSTON: Yes, sir.

21 COMMISSIONER W. KENNEY: I do have
22 one question. I noticed the company's requesting
23 8.2 million in revenue increase, Staff recommends
24 5.1, and OPC is recommending zero. Does OPC
25 believe that the cost of service and revenue

1 requirements of the company have remained neutral?

2 MR. POSTON: No, I don't believe they
3 have.

4 COMMISSIONER W. KENNEY: But -- so
5 they don't equal any type of rate increase at all,
6 based on the numbers that Staff has or the company?

7 MR. POSTON: Well, for one, I'd ask
8 you to inquire with Ms. Meisenheimer about this
9 issue. But I think given the history and the
10 questionable feasibility of this expansion, that's
11 why these conditions were put in place. And I
12 think that those issues you raise need to be
13 considered in light of these conditions.

14 COMMISSIONER W. KENNEY: Okay. Thank
15 you.

16 JUDGE JORDAN: Any other inquiries of
17 counsel? Thank you, counselor.

18 The opening statement of Missouri
19 School Boards Association.

20 MR. BROWNLEE: Good morning. Richard
21 Brownlee, counsel for the Missouri School Boards
22 Association.

23 Might be a little help, and it's
24 probably maybe a touch beyond some of the evidence,
25 but to kind of explain what the School Boards

1 Association is actually doing in this case and
2 maybe a little history of that involved. I know a
3 number of you all have been involved in the
4 Legislature. I was trying to think if any of you
5 were there when some of this was passed, and I
6 think so. So you can -- you can go back with your
7 memory and try to recall.

8 In any event, the Missouri School
9 Boards Association is a not-for-profit trade
10 organization organized in 1958. Right now there's
11 about 400 public school districts, and there's
12 about 2,000 schools in Missouri that are members of
13 the Association. I think for what will be
14 described as the school transportation program,
15 there's about 260 schools involved in that.

16 Schools -- and this is critical to
17 kind of all of this, which gets back into this rate
18 shock issue. Schools budget in the spring, and
19 they have to be effectively filed by July 1 of each
20 year.

21 As all of us know, there have been --
22 the financial issues facing any public entity,
23 schools and what have you, are critical, and
24 they're critical to the counties and communities
25 that all of you have represented and that are

1 represented in this matter today, that financing is
2 a critical issue. Of course, I think in this year
3 we kind of have a special perfect storm because
4 quite a bit of the schools were affected by the
5 veto issues that are going on.

6 And I know that's kind of ancillary
7 to really what's typically before you, but that's
8 the reality of the schools' situation and their
9 finances. So who knows where that will be.

10 But in any event, the participation
11 in this case actually started in the late 1990s
12 when -- and it was a firm, and I -- you'll hear
13 later on, the principal witness for the schools is
14 a gentleman named Louie Ervin. His company is from
15 Iowa. They're Latham & Associates, and they were
16 really instrumental in developing the school
17 transportation projects throughout the nation.

18 And really what had occurred, it was
19 an idea to let the schools go together, pool their
20 buying capacity and be able to buy gas through
21 suppliers and different sources. They would
22 transport it from the gas areas in on the
23 interstate pipelines, ultimately delivered to the
24 local distribution companies, such as Summit, and
25 passed on to the schools.

1 Obviously with the ability to
2 purchase as a bulk or a large volume, there were
3 discounts and savings, and that was the genesis of
4 the plan.

5 Legislatively, it was presented to
6 the Missouri Legislature, I believe, in 2002 in
7 House Bill 1402. It passed. I think it included
8 at that time -- every gas utility, I believe,
9 pretty much signed up for these experimental
10 tariffs, I believe but for Laclede, but that's
11 another issue.

12 In any event, what it really did, it
13 allowed for aggregate purchasing of natural gas
14 supply and transport service. It allowed it for
15 the schools to go together and do that. It
16 provided that the local distribution companies
17 would resell the gas to the schools, plus the
18 transport service cost, plus transportation, plus
19 distribution cost, plus aggregation and balancing
20 fees.

21 Obviously when you're buying gas and
22 with weather changes and everything, there's a
23 fluctuation monthly that has to be balanced out,
24 and it's later on I think -- and I'm being very
25 simplistic -- called cash out. But you'll read the

1 testimony and that's part of this.

2 There was no telemetry required for
3 the schools or special metering, except for some
4 very, very large ones. Dean's correct, the tariff
5 can have no negative financial impact on the gas
6 company or other customers. That was a provision.
7 Not require schools to be eligible for pipeline
8 capacity charges for longer than large industrial
9 or commercial basic transportation charges.

10 Essentially sort of created the
11 schools as a big buyer of gas, like a -- I don't
12 want to say a Noranda, but a huge single user.
13 That's what was done, and the protections in the
14 statute were created just for that purpose.

15 In this case, we have 11 of the total
16 school districts affected in the service area of
17 the company, and there's 76 schools involved.

18 In order -- and I'd heard a little
19 bit, and I think in order to improve customer base
20 and try to attract some customers to the system,
21 the company had offered a transport flex rate to
22 the schools to change from propane to natural gas,
23 which a number of them did.

24 That is an issue that you'll hear.
25 That's the flex rate issue. It was canceled by the

1 company, I believe, unilaterally effective
2 January 1 of 2014. So when we talk about rate
3 increases to the schools, that's another factor
4 that gets added on to that basic rate increase, and
5 I'll cover those in a moment.

6 We had a number of issues involved.
7 It's not -- this is not a simple thing, and I
8 note -- and I would commend everyone that this has
9 been a real pleasurable bunch of folks to work
10 with, and it really has been. These can be real
11 difficult issues. There's not a lot of easy
12 answers for much of it, which you all know.

13 And it -- we've settled every single
14 issue but for the one that's called rate shock.
15 And I recognize there's no definition for that, but
16 when I think you'll hear the numbers, I don't think
17 it's a definition that needs to be articulated,
18 because the numbers themselves are so shocking to
19 the schools that I think it would sort of speak for
20 itself.

21 These would be total increases from
22 the 2013 contract rates. That's the numbers I'm
23 going to refer to very briefly. There's really
24 three components. One is -- and we're going to use
25 the Staff computation here for the two-part rate.

1 We didn't come up with our own. We used the Staff
2 and it's out of cost of service.

3 But for the 11 districts, and I'm
4 going to just quickly run through these, the basic
5 rate increase aside from the flex rate and then
6 what's called the cash out are like 51 percent,
7 55 percent, 52 percent, 56, 57, 49, 28, 45, 19, 59
8 and 37 percent. That's the basic rate that Staff
9 came up with.

10 When you add on the loss of the flex
11 rate, which we've averaged -- I think it varies
12 within the districts from 11 to about 31 percent,
13 we'll just average it at 20, that's another
14 increase on top of that. That gets you to -- all
15 of those 51s go to 61s, 62s and 67 percent
16 increases. And when you take off the cash out,
17 which is another adjustment that will be made as
18 part of the case, that's another percentage,
19 20 percent.

20 So really what we're ending up with
21 to the schools are rate increases of 81, 86, 82,
22 87, 89, 79, Lebanon 91 percent rate increase.
23 That's what rate shock is. And the solution, I'm
24 not to answer. I think it's a question that I
25 would hope the Commissioners would ask every

1 witness that has anything to do because it's a
2 critical issue.

3 There's been suggestions of whether
4 you could do a phase-in. There's obviously
5 suggestions from Public Counsel that the rates
6 they've requested are just too high, and if they're
7 brought down, they would be uniformly carried into
8 transportation into the schools.

9 And I don't have a good answer. I
10 just can't offer that up. But there is a solution,
11 and it's your decision to come up with that one, I
12 guess.

13 I would also urge the Commission to
14 consider the stipulations. I know they've
15 worked -- we've had a number of issues that we were
16 able to agree upon with the help of the company and
17 Public Counsel and everybody else, and I think
18 Mr. Jarrett also, he could speak to his, but he's
19 got a stipulation, too.

20 But other than that, I appreciate
21 everyone's concern, and I probably may see you a
22 little later in the week when Mr. Ervin comes in.
23 Thank you.

24 JUDGE JORDAN: Inquiries?

25 COMMISSIONER W. KENNEY: Thank you,

1 Mr. Brownlee. Could you educate me on this? You
2 said the -- when this legislation was passed in
3 2002, that was when I was there. I'm not a part of
4 that. I was gone. But --

5 MR. BROWNLEE: It's Mr. Stoll. I was
6 trying to remember.

7 COMMISSIONER W. KENNEY: Blame it on
8 him. My question was, so your member districts,
9 would the -- they group together to purchase the
10 fuel?

11 MR. BROWNLEE: The gas, right.

12 COMMISSIONER W. KENNEY: The gas.
13 And do they -- they give their -- do they give a
14 bid amount, what they need?

15 MR. BROWNLEE: There are companies
16 that do this, and you're over my head. I know that
17 there's like Mr. Erwin's companies and there's
18 companies out there that do it. And they buy gas
19 not just for schools but I think for industrial
20 groups and whoever puts gas together.

21 COMMISSIONER W. KENNEY: I understand
22 the process, but my question is this: So what is
23 the -- what is the districts and what are they
24 paying -- what do they pay Summit Natural Gas for?
25 What are their -- the fees that they pay? Do you

1 know that?

2 MR. BROWNLEE: I couldn't articulate
3 every one. It's really to use their system to
4 bring the gas in and billing and other factors that
5 come in. They're customers of the local
6 distribution company. It's just that the gas,
7 instead of -- instead of the company buying it, we
8 buy it separate and then use the pipelines to
9 transport it in. But there's -- I just --

10 COMMISSIONER W. KENNEY: Fuel is a
11 big part of that bill on a school district.

12 Mr. BROWNLEE: You bet.

13 COMMISSIONER W. KENNEY: I'm just
14 curious as how -- my perception is the school
15 district itself would not be paying certain fees
16 because they're buying gas at a reduced rate. I'm
17 just curious of how your rates would increase that
18 high, I mean your billing rate.

19 MR. BROWNLEE: I'm not a rate
20 technician for sure, and I think --

21 COMMISSIONER W. KENNEY: You're just
22 saying what they told you to say?

23 MR. BROWNLEE: Well, no, actually. I
24 mean, these are Staff figures. I would suggest
25 Mr. Imhoff maybe could -- I just don't -- I mean,

1 I --

2 COMMISSIONER W. KENNEY: Okay. I'm
3 not educated on the subject.

4 MR. BROWNLEE: It's no crime not to
5 know.

6 COMMISSIONER W. KENNEY: Thank you.

7 MR. BROWNLEE: Thank you. Anybody
8 else? Thank you.

9 JUDGE JORDAN: Thank you. Missouri
10 Division of Energy, opening statement.

11 MR. KNEE: Good morning. May it
12 please the Commission? I'm Jeremy Knee. I
13 represent the Division of Energy in this case.

14 On Friday this week, which as you've
15 heard from the parties is still a long way away,
16 we'll address issues that will significantly impact
17 the company's commitment to energy efficiency and
18 low-income weatherization.

19 As it stands today, the company has
20 no energy efficiency program and no low-income
21 weatherization program. It's essentially a blank
22 slate. So from the Division of Energy's view, this
23 is the company's chance to start on the right foot
24 by making energy savings a meaningful part of its
25 service to customers.

1 And with that, I'll leave more
2 specific remarks for Friday.

3 JUDGE JORDAN: Any inquiries from the
4 Bench?

5 COMMISSIONER W. KENNEY: No. Thank
6 you.

7 JUDGE JORDAN: Thank you, counsel.
8 The Missouri Propane Gas Association, an opening
9 statement.

10 MR. JARRETT: Good morning, Judge,
11 Commissioners. I'm Terry Jarrett, and today I'm
12 here representing the Missouri Propane Gas
13 Association.

14 The MPGA is a trade association
15 representing members who sell propane and propane
16 appliances and equipment in Missouri. It exists to
17 serve the propane industry by promoting safety,
18 education and public awareness of the uses of
19 propane.

20 The members of MPG are primarily
21 small business owners. As such, they have payrolls
22 to meet and bills to pay. Primarily they provide
23 propane products and services to their customers,
24 and they do so efficiently and safely.

25 The reason MPGA is here today is

1 because propane dealers compete with natural gas
2 for customers. In areas that are served by both
3 propane and natural gas, we're talking about space
4 heating, hot water heating, clothes dryers,
5 vent-free gas logs for fireplaces. MPGA members
6 compete with Summit in all of their divisions.

7 Quite simply, all the propane dealers
8 are asking for is the chance to fairly compete on a
9 level playing field. Since so much of the
10 competition is based on price, the propane dealers
11 I represent ask this Commission to fairly set rates
12 so that the market will operate fairly and
13 customers will be free to make informed choices as
14 to what fuel is best for them based on full
15 information and true costs.

16 Brian Brooks from Marshfield,
17 Missouri is MPGA's witness in this case. Now,
18 Brian is a fourth-generation member of his family
19 to work in the propane business. He will be
20 testifying tomorrow during the rate increase
21 portion of the hearing. I encourage you to ask him
22 questions about the propane business and how it
23 competes with natural gas.

24 Now, Brian also filed testimony on
25 appliance conversion and dual fuel issues, but we

1 have a pending stipulation on those issues, so that
2 has been taken off the issues list and he will not
3 be testifying on those. As to the stipulation, we
4 believe it is in the public interest and we would
5 ask the Commission to approve it.

6 Thank you for your attention, and I'm
7 glad to answer any questions.

8 JUDGE JORDAN: Any questions?

9 CHAIRMAN KENNEY: No questions.

10 COMMISSIONER W. KENNEY: I have one.

11 Mr. Jarrett, is this your first time before this
12 Commission?

13 MR. JARRETT: As an attorney
14 representing a client, it is. Thank you.

15 COMMISSIONER W. KENNEY: Welcome.

16 MR. JARRETT: My first question was
17 an easy question. I like that.

18 JUDGE JORDAN: Anything else?

19 COMMISSIONER W. KENNEY: Try to take
20 it easy on you.

21 MR. JARRETT: Thank you.

22 JUDGE JORDAN: That concludes opening
23 statements. The Commission will now go into the
24 issues remaining on the issue list. The first one
25 is rate of return, which will include issues of

1 return on equity, cost of debt and capital
2 structure. We'll have a more focused opening
3 statement on this issue, beginning with Summit.

4 MR. COOPER: Your Honor, we just need
5 to resort here for a second.

6 JUDGE JORDAN: Sure. Do you need a
7 recess?

8 MR. BROWNLEE: Some of us I think can
9 be excused probably, if we can just verify that.

10 JUDGE JORDAN: Yes.

11 MR. BROWNLEE: If we can take five
12 minutes or something.

13 JUDGE JORDAN: And we discussed this
14 off the record as to who would not be present
15 today. We have -- well, I've just recited the
16 issues that we have. And, Mr. Brownlee, you're
17 asking to be excused also?

18 MR. BROWNLEE: Yes.

19 JUDGE JORDAN: And who else had asked
20 to be excused, for the record? Mr. Jarrett and
21 Mr. Knee.

22 MR. KNEE: I'm going to stick around
23 for this.

24 JUDGE JORDAN: Very well. Then we
25 will go off the record and have a recess of ten

1 minutes.

2 (A BREAK WAS TAKEN.)

3 JUDGE JORDAN: We're back on the
4 record, and the Commission is ready to hear opening
5 statements as to our first issue, which deals with
6 rate of return, including return on equity, cost of
7 debt and capital structure. And the Commission
8 will now hear the opening statement on this issue
9 from Summit.

10 MR. BOUDREAU: Good morning. May it
11 please the Commission?

12 As the -- as Judge Jordan just
13 pointed out, this is an issue that has three
14 components: Return on equity, the cost of
15 long-term debt for the company and capital
16 structure. And I'll take them essentially in that
17 order in terms of the opening statement.

18 Your Staff through the testimony of
19 cost of capital witness David Murray is expected to
20 offer testimony that an appropriate cost of --
21 appropriate cost of common equity for ratemaking
22 purposes in this case is within the range of 9.8 to
23 10.8 percent. This includes a risk adjustment of
24 200 basis points. Mr. Murray's midpoint
25 recommendation is 10.3 percent. He relies

1 primarily on the discounted cash flow or DCF model.
2 Summit Natural Gas of Missouri, which
3 I'll refer to here as either Summit or the company,
4 will present the testimony of cost of capital
5 witness James Anderson on this topic. And I don't
6 mean to cast any aspersions on the many learned and
7 highly regarded academics who have previously
8 testified to this Commission in rate cases on the
9 issue of cost of capital, but Mr. Anderson brings
10 to the topic a unique expertise, and that is he's
11 highly -- he's a highly experienced broker dealer
12 who has engaged in the origination and sale of
13 securities.

14 He not only understands the
15 principles underlying the pricing of corporate debt
16 and equity, he is actually deeply experienced in
17 the corporate securities industry.

18 Other witnesses can tell you what
19 they think investors think through the use of
20 models. Mr. Anderson can actually tell you what
21 investors think because he works with them. His
22 credentials are impeccable, and his real-world
23 experience with the issues in this case and cost of
24 capital is worthy of the Commission's careful
25 consideration.

1 Mr. Anderson will testify that a
2 12 to 17.6 percent cost of equity adjusted for a
3 risk premium of 4.4 percent is justified in this
4 case. Mr. Anderson's recommendation is based on
5 three models, the capital asset pricing model, the
6 DCF model and the total return model. The midpoint
7 of Mr. Anderson's recommendation is 15 percent.

8 It should be noted, however, that the
9 company's rate proposal in this case is based only
10 on a 12 percent return on equity, as noted by
11 Mr. Cooper earlier. Summit believes that this is a
12 compromise that fairly balances the interests of
13 investors and customers and, additionally, it's a
14 recognition of some practical market forces which
15 are in play, such as the availability of
16 competitive fuels like propane.

17 Staff's primary reliance on the DCF
18 model is somewhat problematic. Just to illustrate
19 the shortcomings of putting too much emphasis on
20 the DCF model, the inputs in Staff's model assume
21 that we're dealing with a stable industry, natural
22 gas distribution.

23 As a general statement, this may be
24 true, but there's nothing much stable about the
25 character of this particular company's operations

1 in the state of Missouri at this time. Summit is
2 very much in a growth and expansion mode, as the
3 Commission is well aware.

4 Consequently, generalizations about
5 the industry misapprehend the circumstances of this
6 particular utility. Additionally, the fact that
7 the company is in a -- currently in a build-out
8 mode carries with it significant risks, such as
9 construction risk, relative lack of commercial
10 customers, high levels of investment in plant per
11 customer, and lack of a dividend payout, just to
12 name a few.

13 Mr. Murray appears to have recognized
14 generally the riskiness of the company's business
15 in that he has adjusted his ROE or return on equity
16 recommendation by 200 basis points. The company,
17 however, believes that this significantly
18 understates the actual business and financial risks
19 associated with its current status.

20 Ultimately, the high end of Staff's
21 ROE range is 10.8, as I noted earlier. The company
22 has assumed a 12 percent return as part of its
23 direct case. So the differences on this particular
24 issue are not as dramatic as one might initially
25 think. Nevertheless, an authorized return at this

1 time of 12 percent is certainly more than justified
2 by the record.

3 As an aside, Staff in a discovery
4 motion and in Mr. Murray's testimony has made much
5 about knowing the return requirements of IIF, the
6 investment fund that Mr. Cooper mentioned earlier,
7 and that this fund holds all of the capital stock
8 of Summit Utilities, which is Summit Natural Gas'
9 parent company.

10 And referring in particular to
11 Staff's Statement Describing Discovery Concern and
12 Motion for Reconsideration, paragraph 17 -- this
13 was filed June 10th. In paragraph 17 on page 7 of
14 that, in discussing some Staff DRs, DRs 132 and 139
15 through 182, Staff says, Determining a return on
16 common equity is usually based on expert witness
17 estimates of what investors require for a return.
18 These Data Requests to SNG seek to remove some of
19 the speculation from this exercise by reviewing
20 actual expectations of the investor IIF.

21 It goes on to state that it would be
22 extremely beneficial to the Commission's
23 determination of a fair return to receive and
24 review evidence directly from the sophisticated
25 private equity investor that currently wholly owns

1 SNG by reviewing returns required by IIF in its
2 investments in Summit Utilities.

3 That information has subsequently
4 been provided to Staff and, not at all
5 surprisingly, it shows that the return expectations
6 of IIF investors are much more in line with the
7 company's 12 percent ROE proposal than it is with
8 Staff's 10.3 percent.

9 So for this proposition, I direct you
10 to Mr. Anderson's surrebuttal testimony at pages 4
11 through 7. But the Commission can certainly safely
12 take Staff at its word in this matter and give
13 greater weight to evidence of Summit's actual
14 investor expectations concerning a fair return on
15 equity capital than it does on the intricate
16 formulas the cost of capital witnesses employ to
17 serve as a proxy for investor expectations.

18 On the issue of the cost of long-term
19 debt, the company's case as filed was based on its
20 actual current cost of debt at 3.21 percent. For
21 determining a weighted cost of capital in this
22 case, Mr. Murray has projected the cost of
23 long-term debt to be 5.37. I believe that number
24 started out at 5 in his direct testimony, and 5.37
25 is my understanding of what his surrebuttal

1 testimony says.

2 Now, the use of a projection of
3 Summit's embedded cost of debt is necessarily
4 derivative of Staff's proposal that the Commission
5 apply a projected capital structure of 60 percent
6 to 40 percent, 60 percent debt to 40 percent
7 equity, which is a topic I'll discuss here in a
8 moment.

9 The 5.37 percent figure itself
10 appears to be loosely based only on a sister
11 customer's embedded cost of debt of 5.37 percent,
12 and that company is another subsidiary of Summit
13 Utilities, Colorado Natural Gas.

14 Now, if the decision is made by this
15 Commission to use projected financial information
16 for determining cost of capital in this case, which
17 is something the company does not support, by the
18 way, Summit witness Jim Anderson will testify that
19 Summit would receive a bond rating of B.

20 He will further testify that the cost
21 of debt for B-rated corporations currently is 7.25
22 percent, and consequently Summit's cost of 20-year
23 debt would be something less, something in the
24 range of 6.5 to 7 percent.

25 I'll move on to the topic of capital

1 structure, which I think Mr. Borgmeyer mentioned
2 earlier is probably the key revenue requirement
3 issue in this case. The topic is somewhat involved
4 because, again, because of the unique situation in
5 which the company is positioned. Summit contends
6 that a revenue requirement should be based on its
7 actual capital structure as of September 30th,
8 2013, that is 43 to 57 debt to equity. This is
9 certainly within the realm of reasonableness.

10 Mr. Anderson's Schedule JMA-6 to his
11 direct testimony provides capital structure data
12 for Summit as well as four other Missouri gas
13 utilities, those being Ameren, Atmos, Laclede Group
14 and Southern Union.

15 The important fact here is that the
16 average debt to equity ratio for those four
17 companies is only 50/50. Only one of those
18 companies is more heavily capitalized with debt
19 than with equity.

20 Additionally, Mr. Anderson includes
21 information about the capitalization of his proxy
22 companies on Table 2 at page 44 of his direct
23 testimony, and the average for that group is
24 48 percent debt to 52 percent equity.

25 I mean, the fact of the matter is

1 that there's no evidence that is being offered that
2 would tend to show that a capital structure of
3 43 percent debt to 57 percent equity is inherently
4 unreasonable.

5 The schedules to Staff's cost of
6 service study setting out data about Staff's proxy
7 group of companies do not include any information
8 about how those companies are capitalized.
9 Certainly had the Staff thought that Summit's
10 capitalization was, to coin a phrase, off the
11 reservation, I suppose it would have provided the
12 Commission -- one would suppose it would provide
13 the Commission with data supporting that claim, and
14 it has not done so.

15 I submit that the company's actual
16 capital structure of 43 to 57 is presumptively
17 correct, and that Staff in this case should bear
18 the burden of persuading this Commission to use
19 something other than the actual capital structure.

20 Now, in that regard, let's start with
21 the observation, the Staff's recommendation that
22 the Commission apply a debt to equity ratio of
23 60/40 represents a dramatic swing. There's no
24 other way to describe it. It's a dramatic swing
25 from the actual capital structure.

1 And I would submit to you the Staff's
2 justifications for doing this are unpersuasive.
3 The rationale fits into three general categories,
4 the way I read the testimony. First, Staff asserts
5 that in 2011 the company voiced an objective of
6 achieving in the future a capital structure of
7 approximately 60/40, so it should be saddled with
8 that target now. This appears to be something in
9 the nature of gotcha ratemaking. You said you
10 wanted to get there, so this is what we're going to
11 apply to you.

12 While achieving a 60/40 mix of
13 capital deployment would be a laudable objective,
14 it remains nothing more than that, an objective.
15 Moreover, it seems to run afoul of the Commission's
16 longstanding policy against basing rates on
17 projected financial information such as the future
18 test year.

19 With respect to achieving a 60/40
20 capital structure, the company's witness Rick
21 Lawler, who will testify later this week, will
22 explain why, in light of current business and
23 financing realities, achieving a 60/40 debt to
24 equity ratio is not possible for this company in
25 the foreseeable future.

1 The bottom line here is that lenders
2 have capped the amount of long-term debt available
3 to this company based on a function of its
4 earnings, and this limitation effectively results
5 in a capital structure more heavily weighted toward
6 equity than to debt. As I've noted previously,
7 this is hardly outside the norm. This is just
8 simply the reality of the situation.

9 Secondly, Mr. Murray points again to
10 Summit's sister company, Colorado Natural Gas, or
11 CNG, claiming that CNG's capital structure is 60/40
12 and that it's reasonable to project or use that
13 capital structure for Summit as well.

14 The first observation I have about
15 this is that the capital structure of CNG is not
16 60/40. At year end 2013 it was 57.4 to 42.6 debt
17 to equity. But this is a discrepancy that's really
18 neither here nor there because there's no logical
19 parallel between the two companies that justifies
20 clothing this company in the financial garb of its
21 sister company.

22 Mr. Lawler will testify to how
23 dissimilar the two companies actually are, that at
24 a very high level CNG is a steady-state operating
25 utility with proven revenue streams. In contrast,

1 Summit is still very much in a build-out mode with
2 customer penetration numbers in some areas that are
3 currently below expectations. CNG has less debt
4 and a larger customer base. It's less risky. The
5 fact of the matter is the two companies are not at
6 all similarly situated.

7 Finally, Staff contends that but for
8 the company's build-out in the Lake of the Ozarks
9 area, its capital structure would be approximately
10 60/40. Well, this would be an interesting notion
11 if the facts were to bear it out, but the facts
12 don't bear it out.

13 Summit and its predecessor company,
14 Missouri Gas Utilities, have never achieved a ratio
15 of 60 percent debt to 40 percent equity. The
16 closest MGU ever got to that number was in 2009 at
17 57 to 43. Since its merger with Southern Missouri
18 Natural Gas in 2012, the highest level of debt for
19 the company has been 43 percent.

20 So as you can see, the Lake of the
21 Ozarks expansion has not been at all a decisive
22 factor in this. You can also back calculate to get
23 to the same location. If you back out the debt
24 associated with construction at the Lake of the
25 Ozarks division, the debt to equity ratio for the

1 four divisions in this rate case is approximately
2 42 to 58. This verifies the company's
3 pre-Lake-of-the-Ozarks actual capital structure.

4 So I refer you -- for those
5 calculations, I'll refer you to Mr. Anderson's
6 surrebuttal testimony proving up this assertion.

7 The choice of -- the choice of
8 capital structure in this case is a critical issue
9 as it bears on the calculation of revenue
10 requirement. At Staff's recommended midpoint of
11 10.3 return on equity, the company's effective rate
12 of return would only be -- using its recommended
13 capital structure, would only be 6.37 percent, a
14 return that I would submit to you is just wholly
15 inadequate.

16 Let's turn now to kind of a public
17 policy consideration that I think the Commission
18 should keep in mind as it considers this issue.
19 The Commission is dealing with unique circumstances
20 with this company, certainly a situation it has not
21 confronted in recent years. I refer to a company
22 in an ambitious buildout mode extending natural gas
23 service to large areas of the state that previously
24 had not had access to it.

25 As a division of the Department of

1 Economic Development, this Commission should not
2 follow a ratemaking policy that discourages
3 investment of private capital in infrastructure
4 that will provide an important tool for economic
5 development throughout the state of Missouri.

6 The tremendous spike in propane prices during last
7 winter's heating season is silent testament to the
8 need to provide citizens of this state with energy
9 alternatives, energy options.

10 Also, the availability of natural gas
11 can be an important factor for communities to
12 attract large commercial and industrial development
13 which might otherwise not be considered, and those
14 expand the tax base and boost employment throughout
15 the state.

16 I suggest to you that the
17 Commission's ratemaking policy should be reasonably
18 accommodating as necessary to encourage the
19 development of natural gas service with the prudent
20 deployment of private capital.

21 Again, the company's witnesses on
22 these topics are as follows: With respect to cost
23 of common equity and long-term debt, we will
24 present the testimony of Mr. Jim Anderson.
25 Mr. Anderson and Mr. Rick Lawler both will address

1 the topic of the appropriate capital structure for
2 the company. I encourage you to explore these
3 issues and facts with these gentlemen as you
4 consider these issues in the case.

5 With that, I'll complete my remarks.

6 Thank you.

7 JUDGE JORDAN: Any questions from the
8 Bench for counsel? Thank you, counsel.

9 And the opening statement of Staff.

10 MR. THOMPSON: May it please the
11 Commission? You're faced with a very difficult
12 question concerning return on equity concerning
13 cost of capital in this case. It's the only
14 remaining revenue requirement issue that separates
15 the company and the Staff. It's worth
16 approximately \$3 million.

17 You heard that the company's request
18 is \$8.2 million. Staff is willing to agree that
19 they should have an increase of \$5.1 million.
20 Taking rounding error and what have you into
21 account, the difference is the \$3 million
22 represented by this issue, or should I say this
23 collection of three issues.

24 The three issues are: What is the
25 cost of common equity, what is the cost of debt,

1 and what is the capital structure?

2 Those of you who have been following
3 Mr. Murray's recommendations for the past few years
4 are no doubt surprised to see that he recommended
5 10.3 as the return on equity in this case. That's
6 the highest return on equity recommendation I've
7 ever seen Mr. Murray make.

8 He's -- that's the midpoint of his
9 range of 9.8 to 10.8, which he calculated by adding
10 a 200 basis point upward adjustment to the range
11 that he obtained by calculating the average return
12 on equity of a proxy group of pure play local
13 distribution natural gas utilities, using well
14 accepted methods, primarily the discounted cash
15 flow model and then the capital asset pricing
16 model, as a test of reasonableness as he has
17 explained in his direct testimony in Staff's cost
18 of service report.

19 Why would Mr. Murray depart from his
20 normal practice to add 200 basis points as an
21 upward adjustment? Well, he does that because he
22 is sensitive to and recognizes the several unusual
23 features that characterize this company.

24 This company is engaged in bringing
25 natural gas service to areas of the state of

1 Missouri which Staff originally said could not
2 economically be served with natural gas. You heard
3 Mr. Poston's opening statement. You heard that
4 Staff's original recommendation for Tartan Energy
5 was, it's not economically feasible. You can't
6 bring natural gas service to small outlying
7 communities out in the countryside. But that's
8 exactly what this company is doing and what its
9 predecessors have been doing.

10 All along the Commission has
11 recognized that there is a very high and unusual
12 degree of risk, business risk, associated with this
13 endeavor, a high and unusual degree of business
14 risk. It's one thing to offer natural gas service
15 in a densely populated area like St. Louis City,
16 St. Louis County. It's another thing to take
17 natural gas service to Mountain Grove, to
18 West Plains, to Branson, to Gallatin.

19 Throughout the Commission's concern
20 has been to insulate the customers from the cost of
21 that risk. To insulate the customers from that
22 risk. Who is it that should bear the risk of a
23 speculative venture? The shareholders. The
24 shareholders. Those are the ones who decide to put
25 their money into the venture that may pay high

1 dividends or may fail because it's risky. And this
2 is risky. This is risky.

3 So when you're thinking about return
4 on equity in this case, you need to think, how much
5 of that should the ratepayers pay? How much should
6 the customers pay to reward the investors for
7 taking that risk?

8 And I suggest to you that a
9 reasonable, a reasonable reward for those investors
10 is the 10.3 percent that David Murray has
11 calculated using well-recognized, standard,
12 mainstream financial analytical tools and
13 approaches.

14 Now, capital structure and cost of
15 debt. Mr. Murray is doing something unusual in the
16 area of capital structure as well. He is urging
17 the Commission to use a hypothetical capital
18 structure, not the actual capital structure which
19 we've just heard from Mr. Boudreau is 43 percent
20 debt and 57 percent equity.

21 Mr. Murray is urging the Commission
22 to use a hypothetical capital structure of
23 60 percent debt and 40 percent equity. Why is he
24 doing that? He is doing that, again, to safeguard
25 and protect the customers from the effects of the

1 heightened risk of what this company is doing,
2 particularly now that the company is engaged in its
3 buildout in the Lake of the Ozarks district.

4 You heard there are five Missouri
5 districts, but only four of them are part of this
6 case. Why is that? Why is that? Well, it's
7 because in Lake of the Ozarks they're spending a
8 lot of money to put in infrastructure, and they
9 have very few customers.

10 They're not selling much gas there,
11 but they're spending a lot of money there, which
12 they have borrowed in order to put in
13 infrastructure hoping to have customers in the
14 future, hoping to attract customers, what they call
15 market penetration.

16 And what we've heard -- and I know
17 you've read the testimony in this case, and what
18 you've seen in that testimony is that the market
19 penetration they have achieved in at least two of
20 the other districts that are part of this case is
21 disappointing. Disappointing. They're getting
22 disappointing results. People are not converting
23 to natural gas with the level of enthusiasm that
24 these investors hoped they would.

25 But remember, I said this is a

1 speculative venture. This is a speculative
2 venture. This is something that may pay returns
3 and may not. Because maybe people out in the
4 country will be real happy to have natural gas and
5 maybe they won't. Maybe they'll stick with the
6 propane they've been buying for years.

7 In fact, the company has voluntarily
8 reduced its return on equity request from the 15
9 calculated by its expert to 12. And why would it
10 do that? To make its rates more competitive with
11 the cost of propane. To make its rates
12 competitive.

13 And you've also heard from Mr. Poston
14 that customers who showed up at local public
15 hearings expressed surprise and outrage, I think
16 those were the words, surprise and outrage to learn
17 that they've made the conversion, they're ready for
18 natural gas, and what? The cost is going up? But
19 that infrastructure is already in. What am I
20 paying for? Ah, cost is going up. It's more
21 expensive.

22 So this is a very real issue here.
23 Every time this company has come in here for an
24 application for a certificate allowing it to
25 expand, every time it has done that, it has sworn

1 and promised to this Commission that it will
2 protect the customers from the costs and the risks
3 incumbent and inherent in this expansion, and the
4 Commission has accepted those promises.

5 But where the rubber hits the road, I
6 suggest to you that the case they are presenting is
7 putting that risk on the backs of the shareholders
8 to an unreasonable and unacceptable degree.

9 So that is what Mr. Murray's
10 recommendation is designed to do, to protect the
11 customers. Yes, let's reward the shareholders for
12 a reasonable level of the risk that they have
13 undertaken, to a reasonable level, and a reasonable
14 level is 9.8 percent to 10.8 percent, midpoint
15 10.3 percent. But let's protect the shareholders
16 from unreasonable risks. Let's not reward
17 speculation on the backs of the customers who have
18 chosen to accept natural gas service.

19 So a hypothetical capital structure
20 is proposed by Staff because it is Mr. Murray's
21 best estimate of what their capital structure would
22 be if you could remove all the effects of the Lake
23 of the Ozarks expansion. If you could remove those
24 effects.

25 You'll recall, there's much talk in

1 testimony about a plan to refinance their debt that
2 was discussed in a case about 2011, and the plan
3 was to borrow \$88 million for 20 years at a rate in
4 the neighborhood of 5 percent. In the event the
5 company did not do that, in the event they borrowed
6 \$100 million for three years at 3.21 percent and
7 put at least half of that money to work expanding
8 in Lake of the Ozarks. So are we going to make the
9 customers in the other four districts pay for that
10 expansion?

11 We have to somehow separate that out.
12 And that's why a hypothetical capital structure is
13 proposed and a hypothetical cost of debt. It is
14 the best calculation Mr. Murray could achieve of
15 what their capital structure would look like, what
16 their cost of debt would be without the Lake of the
17 Ozarks expansion, which should be borne, after all,
18 by the shareholders, not by the existing
19 ratepayers.

20 The existing ratepayers should pay
21 only for the service they're getting. That's what
22 they should pay for, the cost of the service
23 they're getting. And, of course, this is a gas
24 case, so that doesn't include the cost of the gas.
25 It includes everything but the cost of the gas

1 itself. So all of those costs involved in serving
2 those four districts, that's what the customers in
3 those four districts should pay.

4 And the costs involved in expanding
5 into a fifth district, those should be borne by the
6 ratepayer -- excuse me -- by the shareholders.
7 That expansion is intended to bring profit to the
8 shareholders, and that's who should pay for that.

9 Thank you very much.

10 JUDGE JORDAN: Questions?
11 Clarifications?

12 CHAIRMAN KENNEY: No, thank you.

13 JUDGE JORDAN: Thank you, counselor.

14 Summit may begin its case in chief.

15 MR. POSTON: Judge, I do have a -- I
16 know I told you before I wouldn't have one, but if
17 you wouldn't mind, I have just like a minute
18 opening, if I could, please.

19 JUDGE JORDAN: Please.

20 MR. POSTON: May it please the
21 Commission?

22 In my general opening I drew your
23 attention to the conditional certificates issued to
24 Summit's predecessors, and in particular I pointed
25 out the recognition made by Summit or Southern

1 Missouri Gas Company that it may have to see
2 single-digit returns if these conversions don't pan
3 out. And here today I think that's when that can
4 happen, because those conversions haven't panned
5 out.

6 So one way this Commission can help
7 protect ratepayers while attempting to adhere to
8 those conditions is to keep the ROE as low as
9 possible, and I mean even below what Staff is
10 recommending in this case.

11 I don't right now have
12 cross-examination for Mr. Anderson because I don't
13 think his testimony satisfies the company's burden
14 that an increase is warranted given these
15 conditions, and I'll address that issue in my
16 post-hearing brief.

17 Thank you.

18 JUDGE JORDAN: Thank you, counselor.
19 Questions for counsel?

20 And did I correctly understand you to
21 say that you are waiving cross-examination of this
22 witness?

23 MR. POSTON: No, sir. I may have
24 recross based on questions from the Bench.

25 JUDGE JORDAN: So you may have

1 recross, but you don't plan any cross?

2 MR. POSTON: Yes, sir.

3 JUDGE JORDAN: And are we now ready
4 for Summit's case in chief? It looks like we are,
5 so you may proceed.

6 MR. BOUDREAU: Thank you. At this
7 time I'd like to call Mr. James Anderson to the
8 stand, please.

9 (Witness sworn.)

10 JUDGE JORDAN: Thank you. Counsel,
11 whenever you're ready.

12 MR. BOUDREAU: May it please the
13 Commission?

14 JAMES M. ANDERSON testified as follows:

15 DIRECT EXAMINATION BY MR. BOUDREAU:

16 Q. Would you state your name for the
17 record, please, sir.

18 A. James M. Anderson.

19 Q. By whom are you employed and in what
20 capacity, sir?

21 A. I'm employed by Municipal Capital
22 Markets, a broker dealer that is officed in Dallas
23 and in Denver.

24 Q. And on whose behalf are you
25 testifying today?

1 A. Summit Natural Gas.

2 Q. Okay. Are you the same James
3 Anderson who's caused to be prepared and filed
4 three items of testimony, those being prepared
5 direct testimony, rebuttal testimony and
6 surrebuttal testimony which have been marked
7 respectively Exhibits 1, 2 and 3, 3 having two
8 versions being nonproprietary and highly
9 confidential?

10 A. I am.

11 Q. Has that testimony been prepared by
12 you or under your direct supervision?

13 A. It has.

14 Q. Do you have any corrections that
15 you'd like to make to any of those items of
16 testimony today?

17 A. Yes. There's a couple of typos, or
18 two.

19 Q. Would you direct the Commission to
20 the first item that you'd like to address?

21 A. Yes. On Schedule JMA -- find that.

22 JUDGE JORDAN: While you're looking,
23 is this schedule part of direct or rebuttal or
24 surrebuttal?

25 THE WITNESS: Oh, this is from the

1 direct testimony, Schedule JMA-4, which reads
2 percent of revenue recovered from customer charges.
3 The word should -- there should be the word in
4 there fixed customer charges, as opposed to just
5 customer charges.

6 BY MR. BOUDREAU:

7 **Q. So the revised heading would read**
8 **how?**

9 A. Percentage of revenue recovered from
10 fixed customer charges.

11 **Q. Do you have any more corrections**
12 **you'd like to make to your direct testimony at this**
13 **time?**

14 A. There is, but I can't remember the
15 exact page.

16 **Q. Well, to your direct testimony?**

17 A. Oh, direct. No.

18 **Q. You say you have another correction**
19 **you'd like to make to another item of testimony?**

20 A. Yes. I think it's in the
21 surrebuttal.

22 **Q. I think it may be rebuttal. Let me**
23 **direct you to page 13 of your rebuttal testimony.**

24 A. Thank you.

25 **Q. See if that refreshes your memory.**

1 A. Yes. On line 19, which reads now, on
2 September 30th, 2014, that should read 2013.

3 Q. Did you say line 19 or --

4 A. Line 19 on page 13 of the rebuttal
5 testimony.

6 Q. But it would be the first line? My
7 numbering is somewhat different than yours.

8 A. It would be the first line of the
9 first response as to that question.

10 Q. So instead of 2014, it should read
11 2013; is that correct?

12 A. Yes.

13 Q. Do you have any other corrections
14 you'd like to make to your testimony at this time?

15 A. No.

16 Q. If I were to ask you the questions
17 that are contained in your prepared testimony, both
18 direct, rebuttal and surrebuttal, if I were to ask
19 you those questions today, would your answers today
20 be substantially the same?

21 A. Yes.

22 Q. Would they be true and correct to the
23 best of your information, knowledge and belief?

24 A. Yes.

25 MR. BOUDREAU: With that, I would

1 offer Exhibits 1, 2, 3NP and 3HC and tender the
2 witness for cross-examination.

3 JUDGE JORDAN: Thank you. I'm not
4 hearing any objection to any of those exhibits, so
5 they will be received into evidence.

6 (SUMMIT EXHIBIT NOS. 1, 2, 3NP AND
7 3HC WERE RECEIVED INTO EVIDENCE.)

8 MR. BOUDREAU: Very good. Thank you.

9 JUDGE JORDAN: Cross-examination from
10 Staff?

11 MR. THOMPSON: Thank you, Judge.

12 CROSS-EXAMINATION BY MR. THOMPSON:

13 Q. Good morning, Mr. Anderson.

14 A. Good morning.

15 Q. I'm looking at your direct testimony,
16 Exhibit No. 1, and this describes your experience,
17 does it not, pages 4 through 7?

18 A. Yes.

19 Q. Okay. And this is a complete
20 discussion of your experience; is that true?

21 A. I've amplified it a bit in my
22 rebuttal testimony.

23 Q. Okay. So, for example, your
24 educational background, you have a bachelor's
25 degree in business administration and accounting?

1 A. Yes.

2 Q. You don't have a master's degree, do
3 you, sir?

4 A. No.

5 Q. You're not a certified financial
6 analyst, are you, sir?

7 A. No.

8 Q. Okay. Now, as I read pages --
9 pages 5 and 6, you've testified as to cost of
10 capital three times; is that correct?

11 A. Yes.

12 Q. Okay. So you don't make your living
13 as a cost of capital expert witness, do you?

14 A. No.

15 Q. Now, are you being remunerated for
16 your testimony in this case?

17 A. I am.

18 Q. Okay. And are you otherwise employed
19 by or associated with Summit Natural Gas?

20 A. I am associated with Summit Natural
21 Gas, yes.

22 Q. How are you associated?

23 A. I'm an alternate to the board of
24 directors of Summit Utilities and Summit Natural
25 Gas of Missouri, Colorado Natural Gas and Summit

1 Natural Gas.

2 Q. So you're a member of the board of
3 directors?

4 A. No. I'm an alternative member.

5 Q. Okay. And do you have any
6 shareholder interest?

7 A. No.

8 Q. Now, you proposed, as I recall, 11
9 different risk factors that are unique to Summit
10 Natural Gas. Am I correct in my memory of that?

11 A. Yes.

12 Q. And for each of those risk factors,
13 you quantified an addition, shall we call it an
14 adder or addition to ROE based on that peculiar
15 risk; isn't that correct?

16 A. No.

17 Q. No, it's not. So how did you treat
18 those risk factors?

19 A. Well, for the first risk factor,
20 because it corresponds to all of the other risk
21 factors, which is construction of the system, I
22 didn't assign a specific risk factor to it. For
23 the other ten, I did.

24 Q. The other ten you did. Okay. And
25 how did you calculate those risk factors?

1 A. Based on my experience and the fact
2 that had the investors who purchased this system in
3 2008 simply invested in the ValueLine gas
4 distribution companies and reinvested those
5 dividends, they would have received a 12 and a half
6 percent return, which of course means their money
7 doubles every 5.8 years.

8 Here they've received no return.
9 They hadn't received any dividends. The companies
10 have lost money or made only small gains. The last
11 full year of operations of Southern it lost 3 and a
12 half million dollars.

13 And in order to entice investors to
14 invest in something like that when they can easily
15 get 12 and a half percent on market securities
16 which can be easily resold any time rather than a
17 private security that cannot be resold, they're
18 going to need a considerable inducement, over 12
19 and a half percent, to invest.

20 So by looking at those factors, we
21 can see that we easily need a 15 percent rate of
22 return. Now, keep in mind, we're assigning a rate
23 of return here for the risks that they take. As
24 you've said and other counsel have said, the
25 shareholders should bear the risk. What they're

1 asking for is a commensurate rate of return for the
2 risk that they bear. That commensurate rate of
3 return should be 15 percent.

4 Q. Okay.

5 A. And I can't think of anybody, these
6 gentlemen up here or anybody else, that would
7 invest in this company and take no return.

8 Q. Take a look at page 52 of your direct
9 testimony, if you would.

10 A. Yes.

11 Q. And that has your various risk
12 factors set out and the judgment that you propose
13 with respect to each; isn't that correct?

14 A. Yes.

15 Q. Okay. So looking, for example, at
16 line 14, which is labeled Historic Low Rate of
17 Return on Equity, you propose an adjustment of
18 .2 percent; isn't that correct?

19 A. That is correct. Although you cannot
20 look at -- past history is never an indication of
21 future events, all investors look at what has the
22 company done in the past, and it has not returned
23 any income at all. It has never paid a dividend.
24 And so at least a 2/10 of 1 percent adder should be
25 qualified there, perhaps more.

1 Q. Yes, sir. And that is a matter of
2 your professional judgment, isn't it?

3 A. It is.

4 Q. And, in fact, each of those numbers
5 there is a matter of your professional judgment;
6 isn't that correct?

7 A. Yes. Prior to the fund purchasing
8 the system, I was involved with the sale of all of
9 the equity, including to the fund. I understand
10 what investors and what they need to see to invest
11 in a highly risky, as we've discussed here,
12 investment.

13 MR. POSTON: Judge, I'm going to
14 object to the narrative responses that this witness
15 is giving to yes or no questions.

16 MR. BOUDREAU: I believe he's being
17 asked about how he went about assigning these
18 elements to his risk adjustment. I think he's just
19 being responsive.

20 JUDGE JORDAN: Well, since this is
21 cross, I'll ask you to confine your answers to the
22 question that's asked at least a little more
23 closely. Counsel can develop on redirect if
24 counsel thinks it's necessary.

25 THE WITNESS: Okay.

1 JUDGE JORDAN: Thank you.

2 MR. THOMPSON: Thank you, Judge. I
3 have no further questions. Thank you very much,
4 Mr. Anderson.

5 THE WITNESS: Thank you.

6 JUDGE JORDAN: Questions from the
7 Bench, Mr. Chairman?

8 QUESTIONS BY CHAIRMAN KENNEY:

9 Q. Mr. Anderson, good morning.

10 A. Good morning.

11 Q. I just have a couple of questions,
12 and it's really more related to your response to a
13 question from Mr. Thompson. What exactly is an
14 alternate to the board of directors?

15 A. I served on the board of directors
16 until 2010, and when the fund made a couple of
17 changes on that, they asked me to attend as an
18 alternate member; in case somebody couldn't be
19 there, I could be -- I would be an alternate
20 member. So I attend the meetings. I don't
21 normally vote unless someone is absent.

22 Q. And which entity are you an alternate
23 to the board of directors of?

24 A. Well, to all -- Summit Natural -- or
25 Summit Utilities is the parent company, and then

1 that same board is also the board of directors of
2 the other subsidiary company.

3 Q. And you were a full board member
4 until 2010?

5 A. Yes. 2011 actually.

6 Q. 2011. From what period to what
7 period?

8 A. From 1996 'til the end of 2010.

9 Q. And how were you compensated as a
10 board member from '96 to 2011?

11 A. From '96 to 2011, we received shares
12 of stock in the company.

13 Q. And in 2011 when you left the board,
14 you sold those shares?

15 A. Yes. In 2010, fall of 2010, the fund
16 bought all of the remaining shares of all the
17 minority interests.

18 CHAIRMAN KENNEY: That's all the
19 questions I have. Thanks.

20 JUDGE JORDAN: Further questions?

21 COMMISSIONER STOLL: No questions.

22 Thank you for your testimony.

23 COMMISSIONER W. KENNEY: No
24 questions.

25 COMMISSIONER RUPP: Thank you, Judge.

1 QUESTIONS BY COMMISSIONER RUPP:

2 Q. You made the statement, sir, that the
3 returns are easily gotten and publicly -- other
4 public stocks are easier to sell well in excess of
5 12 percent. How did you come up with that
6 calculation? Are you looking at historical returns
7 on indexes or --

8 A. Yes. If you'd look at my schedule to
9 my direct testimony JMA-7, JMA-7 calculates the
10 total return. Total return is a very common
11 calculation done on any site for any broker dealer.
12 They allow their customers to automatically
13 calculate the total return.

14 What the total return is, if you
15 bought a share in each one of these companies on,
16 from my calculations, the end of 2007 when IIF
17 purchased the fund -- purchased these companies
18 until the end of the test period of the companies,
19 September of 2013, and you had taken the dividends
20 each time you received a dividend and purchased
21 additional shares, at the end of that period, you
22 would have received a 12 and a half percent return
23 on your initial investment made in 2007.

24 So that is -- that's the total
25 return. So it's a reinvestment of the dividends,

1 which any financial advisor will advise you is the
2 best thing to do with your dividends is to reinvest
3 those dividends.

4 And that Schedule JMA-7 lays out in
5 detail each purchase, the initial purchase and each
6 subsequent purchase of stock and the ending value.
7 And those 11 companies, when you average them
8 together, had a 12 and a half percent rate of
9 return to the investor. So if I had invested --

10 **Q. Right. And did you -- did you --**
11 **and how did you pick these companies to put them in**
12 **there?**

13 A. These companies are the 11 proxy
14 companies I used in my direct testimony. They are
15 the 11 proxy companies from ValueLine's gas
16 distribution category.

17 Now, as the -- as Mr. Murray points
18 out, two of those companies are not pure gas
19 companies, but the rest are pure gas companies.
20 Two of them are about half propane, half gas.
21 Either way, they're gas distribution.

22 **Q. And you just started in 2007 because**
23 **that's when the company was here?**

24 A. That's correct.

25 **Q. Is there a historical average of**

1 **these ValueLine companies that goes beyond 2007?**

2 A. Yes. A person could go back to 2000
3 or pick any date. Now, those particular companies,
4 ValueLine's category changed periodically, but --
5 because of mergers and other things. But if you
6 went back further, you could have a longer period.

7 But in this case we're dealing with
8 the last rate case that MGU had up until now, which
9 is the next one they've had. So we're really
10 taking that kind of test period, if you will, from
11 the last time they had a rate increase 'til now.
12 So those are -- that's the reason we picked it.

13 I'll also point out that during that
14 period, the Dow Jones Index of Utility Companies
15 did not increase in value. It actually fell in
16 value. It hit its high point in January of '08.
17 Of course, with everything it fell in '09, but it
18 never returned to that high point. So it wasn't a
19 particularly good period for utilities in general,
20 but these 11 companies did quite well.

21 So if I'm an investor and I'm going
22 to put in, as this company has done, a quarter of a
23 million dollar investment in Missouri and I would
24 have made that quarter of a billion dollar, with a
25 B, investment in these companies, I'd have had a

1 12 and a half percent rate of return. I would have
2 doubled my money.

3 **Q. What would the industrial -- or the**
4 **utility index, Dow Index that you referenced, how**
5 **would that same investment have faired if it would**
6 **have just been a flat Dow utility fund?**

7 A. Let me find that. I've got that in
8 my direct testimony. I can't find it quickly, but
9 I will tell you that the Dow Index was roughly
10 about 500 -- this is the utility index -- at the
11 end of 2007. It hit a high point of almost 600 in
12 January of 2008, and it has never returned to that
13 high point by the time this study ended. So it
14 ended up -- and I'm just recalling from off the top
15 of my head -- at about 525, 530.

16 **Q. So on an annualized rate of return**
17 **during that period, where would you calculate that**
18 **on investment?**

19 A. I didn't go through the Dow, those
20 stocks that are in the Dow Utility Index, and they
21 include a number of electric companies, not just
22 gas companies. There's only one gas company in
23 that index. So they're not quite representative
24 here. So I didn't spend a lot of time looking at
25 what's in there, but rather looking at the

1 11 gas distribution companies or -- yes, gas
2 distribution companies that ValueLine covers and
3 doing a detailed study of that.

4 Now, I'll point out, and as my table
5 in JMA-7 points out, the actual price of the stock
6 increased slightly for those companies but didn't
7 increase much. But that dividend reinvested,
8 particularly when you're reinvesting it at a rate
9 that -- at prices that we saw in '09 when the
10 market hit a low, made a big difference.

11 But that's the type of investment.
12 Here this company pays no dividends. So their
13 shareholders have that -- don't have that
14 opportunity. They've foregone that opportunity,
15 just as they're foregoing \$35 million of rate base
16 that they're setting aside into a rate base held
17 for future use. They are taking the risk on that
18 and taking no return on it.

19 So when you consider that, 15 percent
20 is minimal. You-all should go over and shake their
21 hands and take their 12 percent deal.

22 **Q. What is the -- what is the average**
23 **dividend on the 11 ValueLine other -- what is the**
24 **average dividend that they pay?**

25 A. During that period, it ran from about

1 a 5 percent yield down to about 4 and a half. Each
2 one's a little different, but over a period of
3 time, those -- those dividend yields fell a little
4 bit during that actual period of time.

5 **Q. Thank you.**

6 A. But dividend reinvestment is a
7 powerful tool.

8 QUESTIONS BY JUDGE JORDAN:

9 **Q. I had just one question for you**
10 **because I want to clarify this on the record. I**
11 **promised myself I would do it if it came up. Can**
12 **you explain briefly, what is ValueLine?**

13 A. ValueLine is a company that puts
14 out -- follows about 2,400 common stocks, and they
15 put out once a week a survey of a portion of that
16 2,400 common stocks. And over a 30-- over a 90-day
17 period, they put out a publication on every company
18 in their -- that they survey, and they break it
19 down by categories, one of those categories being
20 the gas distribution category.

21 And so they put out a report once
22 every 90 days on those 11 companies, and they track
23 them with varying statistics and rates of return,
24 so forth, and they do a write-up on each one of the
25 companies and what their opinion is on that

1 particular company.

2 **Q. Okay. Thank you.**

3 A. It's a notable reference material for
4 the industry.

5 JUDGE JORDAN: Okay. Thank you.

6 That's helpful. Recross from the Office of Public
7 Counsel?

8 MR. POSTON: No, sir. Thank you.

9 JUDGE JORDAN: Recross from Staff?

10 MR. THOMPSON: None. Thank you,
11 Judge.

12 JUDGE JORDAN: Any redirect?

13 MR. BOUDREAU: I have none. Thank
14 you.

15 JUDGE JORDAN: Thank you. Thank you
16 for your testimony. Staff's case in chief on this
17 point.

18 MR. THOMPSON: Thank you, Judge.
19 Staff calls David Murray.

20 (Witness sworn.)

21 DAVID MURRAY testified as follows:

22 DIRECT EXAMINATION BY MR. THOMPSON:

23 **Q. Please state your name.**

24 A. David Murray.

25 **Q. Could you spell your last name for**

1 the reporter?

2 A. M-u-r-r-a-y.

3 Q. And how are you employed, Mr. Murray?

4 A. I'm employed as the Utility
5 Regulatory Manager in the Financial Analyst Unit,
6 the Utility Services Department.

7 Q. Is that a component of the Staff of
8 the Missouri Public Service Commission?

9 A. Yes, it is.

10 Q. And did you prepare or cause to be
11 prepared certain testimony today, first of all, a
12 portion of the Staff Revenue Requirement Cost of
13 Service Report?

14 A. Yes.

15 Q. And then rebuttal testimony that has
16 been, HC and NP, marked as Exhibits 118 and 119?

17 A. Yes.

18 Q. And surrebuttal testimony, HC and NP,
19 marked as Exhibits 130 and 131?

20 A. Yes.

21 Q. Do you have any corrections to those
22 pieces of testimony?

23 A. I do not.

24 Q. And if I asked you the questions
25 contained in that testimony today, would your

1 **answers be the same?**

2 A. Yes.

3 **Q. And are those answers true and**
4 **correct to the best of your knowledge and belief?**

5 A. Yes.

6 MR. THOMPSON: I would offer
7 Exhibits 118 and 119, 130 and 131.

8 JUDGE JORDAN: I haven't heard any
9 objection, so --

10 MR. BOUDREAU: No objection.

11 JUDGE JORDAN: Thank you. So those
12 exhibits will be admitted into evidence.

13 (STAFF EXHIBIT NOS. 118, 119, 130 AND
14 131 WERE RECEIVED INTO EVIDENCE.)

15 MR. THOMPSON: And I tender
16 Mr. Murray for cross-examination.

17 JUDGE JORDAN: Very good.

18 MR. BOUDREAU: If it's okay, I'd like
19 to cross-examine Mr. Murray from here. Is that all
20 right?

21 JUDGE JORDAN: That's all right.
22 My list of cross-examination had Office of Public
23 Counsel first. Am I mistaken in that?

24 MR. POSTON: I have no questions.

25 JUDGE JORDAN: You have no questions.

1 Well, then that makes it easier. Yes, you may
2 certainly cross-examine from where you're sitting.

3 MR. BOUDREAU: Thank you very much.

4 JUDGE JORDAN: Cross-examination from
5 Summit.

6 CROSS-EXAMINATION BY MR. BOUDREAU:

7 Q. Good morning, Mr. Murray.

8 A. Good morning, Mr. Boudreau.

9 Q. Your testimony states that a range of
10 9.8 to 10.8 percent would be a reasonable return on
11 equity capital in this case. That's correct, isn't
12 it?

13 A. Yes.

14 Q. And this range includes a 200 basis
15 point risk adjustment, correct?

16 A. Yes.

17 Q. So your midpoint recommendation to
18 the Commission is 10.3 percent?

19 A. Yes.

20 Q. The unadjusted range based on your
21 models is 7.8 to 8.8 percent; is that correct?

22 A. Yes.

23 Q. So if the Commission were to adopt
24 the upper end of your range of recommendations at
25 10.8 percent, that would be a reasonable outcome,

1 in your opinion?

2 A. Yes.

3 Q. Is it fair to say that your ROE
4 recommendation is based on the premise that the
5 return on equity capital needs to be sufficient to
6 attract capital and to maintain the financial
7 integrity of the company?

8 A. Yes.

9 Q. Are you aware that Mr. Anderson in
10 his rebuttal testimony has stated that your
11 10.3 percent midpoint ROE recommendation and
12 applying your recommended capital structure of
13 60/40 debt to equity, that the effective ROE would
14 be 6.37 percent?

15 A. I'm aware he stated that, yes.

16 Q. And you did not take issue with this
17 statement in your surrebuttal testimony, did you?

18 A. He included all of the equity
19 invested in the company, so I did not with Lake of
20 the Ozarks and what have you. So I don't dispute
21 his calculation.

22 Q. But you haven't done this calculation
23 on your own or, if you have, you haven't presented
24 it in your testimony, correct?

25 A. I didn't see a need to.

1 Q. Now, let's assume Mr. Anderson's
2 number is correct for this discussion. Is this
3 effective return -- well, let me put it this way:
4 This effective return is well below the lower limit
5 of your ROE recommendation of 9.8; isn't that
6 correct?

7 A. Yes.

8 Q. And, in fact, it's even below the
9 lower limit of your unadjusted ROE range at
10 7.8 percent; is that correct?

11 A. Yes.

12 Q. Now, is it your testimony that an
13 effective return of 6.37 percent on equity is
14 sufficient to allow this company to attract capital
15 and maintain the financial integrity of the
16 company?

17 A. Actually, considering IIF's
18 investment of considerable sums of money over the
19 last few years with returns, actual earned returns
20 less than 6.8 percent, I would -- my position is
21 that it has been sufficient for IIF to continue to
22 invest capital in the state of Missouri.

23 Q. You address materials concerning
24 KPMG's calculation of Summit Utilities' cost of
25 equity in your surrebuttal; is that correct?

1 A. Yes.

2 Q. And just so that we don't get our
3 entities confused here with the Commissioners,
4 Summit Utilities is Summit Natural Gas' parent
5 company; isn't that correct?

6 A. Yes, it is.

7 Q. And you have claimed that KPMG is
8 IIF's auditor; is that correct?

9 A. Auditor/evaluator. They do an annual
10 assessment of the values of IIF's individual -- of
11 their holdings, and Summit Utilities being one of
12 those holdings. It's a requirement for their --
13 under the prospectus for IIF's financial reporting.

14 Q. Let me ask you, upon what do you base
15 your statement that KPMG is IIF's auditor?

16 A. It is based on my understanding --
17 well, first of all, KPMG is one of the typical
18 auditing companies. They audited their books,
19 Summit Utilities' books, as far as financial
20 statements, not necessarily from the SEC standpoint
21 because this is a private company, but audited
22 their books to determine what a value of -- what an
23 estimated value of Summit Utilities is for IIF.

24 Q. Well, let me ask you, did you ask
25 that question in a data request?

1 A. I don't believe I did.

2 Q. Okay. Is there any authoritative
3 representation that you're basing this on that's
4 the source from IIF?

5 A. It's just my understanding of their
6 task.

7 Q. So as we're sitting here today, you
8 really can't say, can you, whether KPMG is IIF's
9 audit firm, can you?

10 A. Audit for accurate representation of
11 the financial statements, no. Evaluator/appraiser
12 of the Summit Utilities, the value of that
13 investment to IIF, yes. It's just the task of what
14 you're talking about, the scope of what they did
15 their analysis for.

16 But obviously they don't file at the
17 SEC, so they don't audit and represent to the
18 Securities and Exchange Commission that these
19 financial statements are accurate and correct.

20 Q. So you wouldn't know -- I mean, if I
21 put to you the statement that Pricewaterhouse
22 actually is IIF's audit firm, you wouldn't be able
23 to confirm or deny that?

24 A. I believe I've seen
25 PricewaterhouseCoopers information. As to whether

1 or not -- I don't know if I've seen any --
2 obviously you're aware trying to get some
3 information was difficult at times in this case.
4 And so I don't know if I ever saw anything about
5 PricewaterhouseCoopers doing an audit of the
6 accuracy and correctness of the financial
7 statements of IIF and its investments in Summit
8 Utilities.

9 Q. Was that a yes or a no answer?

10 A. I don't have any specific, no.

11 Q. Now, in order to determine a risk
12 premium to apply to the company's cost of equity,
13 you used the difference in the cost of debt based
14 on credit ratings; is that correct?

15 A. Yes.

16 Q. Now, those ratings are assigned to
17 evaluate creditworthiness for the benefit of
18 lenders; isn't that correct?

19 A. Yes.

20 Q. Okay. Would you -- and you would
21 agree, would you not, that the risks assumed by the
22 holders of debt are not the same as the risks
23 assumed by holders of equity?

24 A. There's some overlap, but yes,
25 generally there's a difference. Obviously equity

1 investors have a residual claim to cash flow.

2 Q. And so, I mean, I guess if we looked
3 at your testimony that equity investors should
4 expect a midpoint 10.3 percent return, whereas
5 5.37, which I believe is your testimony in your
6 surrebuttal testimony for long-term debt, that that
7 would be an appropriate interest rate to apply.
8 Would that 5 percent or approximately 5 percent
9 point difference in returns, does that tell the
10 Commission anything about the relative risks of
11 debt, of default on debt versus a failure to return
12 on equity?

13 A. I didn't use it in that context. I
14 used the spreads to estimate the risk.

15 Q. I understand that, but you used the
16 spreads based on credit ratings, which is basically
17 an instrument that's used to evaluate debt
18 instruments; isn't that correct?

19 A. Yes.

20 Q. Now -- but as you said, the
21 conventional wisdom is that equity is riskier than
22 debt because indebtedness has a priority claim on
23 revenues; is that correct?

24 A. Let me just clarify. Within the same
25 company, that is definitely correct. I mean, you

1 could have junk bonds that yield higher than a
2 utility stock required return on equity.

3 **Q. Fair enough. I accept that. Now, is**
4 **there any authoritative source that states that**
5 **there's an equivalence between the risk of default**
6 **on a loan to assessing the risk of getting an**
7 **inadequate return on an equity investment?**

8 A. I'm sorry. Repeat that question,
9 please.

10 **Q. Is there any authoritative source**
11 **that you're aware of that states that there's an**
12 **equivalence between the risk of a default on a loan**
13 **to assessing the risk of getting an inadequate**
14 **return on an equity investment?**

15 A. I know the spread as far as the
16 estimate for an adjustment to -- for a proxy group
17 versus a subject company. That's explained in
18 Dr. Morin's book.

19 As far as your specific question
20 about, is there anything that talks about the
21 specific spread between the debt yield and the
22 required return on equity as far as, you know, how
23 that affects, you know, what would be a typical
24 spread, I would say that I do have something in
25 direct testimony that is considered an

1 authoritative source of what a typical spread over
2 a company's cost of debt would -- what it would be
3 equivalent to for a cost of equity.

4 **Q. Well, let's -- for moving ahead,**
5 **let's assume that the use of credit ratings for**
6 **assessing the risk of default on debt is a valid**
7 **method for assessing risk on equity investments.**

8 **So my question to you is that your**
9 **analysis also is based on your opinion about how**
10 **Summit Natural Gas' creditworthiness would be**
11 **rated; isn't that correct?**

12 **A. It is, yes.**

13 **Q. So your opinion in your testimony, as**
14 **I read it, was that SNG, or Summit Natural Gas,**
15 **would be rated BA; is that correct?**

16 **A. I said -- my assessment in my direct**
17 **testimony was anywhere between a BBB and a BA. So**
18 **that's basically on the cusp as far as on the**
19 **threshold of investment grade to non-investment**
20 **grade.**

21 **Q. Bear with me a moment, please.**

22 **JUDGE JORDAN: Pardon me, counsel.**
23 **Mr. Boudreau, I don't want to interrupt your**
24 **search, but I will ask you to speak into the**
25 **microphone a little more closely.**

1 MR. BOUDREAU: I will do so. Sorry
2 if I have not.

3 JUDGE JORDAN: Thank you.

4 BY MR. BOUDREAU:

5 Q. I want to direct your attention to
6 your testimony, your surrebuttal testimony,
7 page 21.

8 A. I'm there.

9 Q. And I believe you address your view
10 of what the company's likely credit rating would
11 be, and I'm looking particularly at lines 12 and
12 13.

13 A. Yes, I see that.

14 Q. And you state that the financial
15 ratios would be consistent with a BA rating; is
16 that correct?

17 A. Yes. And may I elaborate?

18 Q. Certainly.

19 A. The BA rating, I was just commenting
20 specifically that the BA rating assumes the
21 hypothetical cap structure that I used. Is it
22 likely that, you know, that the credit rating would
23 be lower if SNG actually had the capital structure
24 that I used as a hypothetical? Okay.

25 Q. Let me ask you, sir, have you ever

1 **assisted with obtaining a credit rating for issue**
2 **of debt or bonds?**

3 A. No.

4 **Q. Mr. Anderson's opined that the**
5 **correct rating for Summit Natural Gas would be a B;**
6 **isn't that correct?**

7 A. Yes.

8 **Q. And you're aware that Mr. Anderson as**
9 **an investment banker has almost 43 years of**
10 **experience assisting municipalities, utilities and**
11 **corporations with actually obtaining credit**
12 **ratings?**

13 A. I understand there's some explanation
14 of his experience in testimony. I don't remember
15 the specifics.

16 **Q. But you have read his testimony?**

17 A. I have.

18 **Q. So would you agree that the**
19 **Commission would be justified in giving greater**
20 **weight to Mr. Anderson's opinion on this topic than**
21 **it gives to you based on his actual experience**
22 **obtaining credit ratings?**

23 A. No.

24 **Q. You would not agree with that?**

25 A. I would not agree with that.

1 **Q. What is the -- what's the definition**
2 **of an investment grade bond or a rating?**

3 A. Well, in letter terms it's anything
4 above a BBB for Standard & Poor's. It's BAA for
5 Moody's, BBB for Fitch. It's basically the
6 threshold where, you know, some institutional
7 investors, you know, they're required under their
8 investment guidelines to not go below that rating
9 level in any fixed income investments they make.

10 **Q. What's the term that's commonly used**
11 **for bonds that are not investment grade?**

12 A. A slang term or just used in the
13 press at times is a junk bond.

14 **Q. Now, is a BA rated bond investment**
15 **grade?**

16 A. It is not.

17 **Q. And that's equivalent, I believe,**
18 **that's the Moody's -- isn't that the Moody's jargon**
19 **for their rating, BA?**

20 A. It is.

21 **Q. S&P I think uses BB; is that correct?**

22 A. That is correct.

23 **Q. So your testimony, as I understand**
24 **it, is that the 200 basis point adjustment that**
25 **you've recommended is based on the average spread**

1 between an A rated bond, between A rated bond
2 yields and the average yield for a BBB bond and a
3 BB bond; is that correct?

4 A. That is correct.

5 Q. And an A rated bond is an investment
6 grade bond?

7 A. It is.

8 Q. And a BBB rated bond is also an
9 investment grade?

10 A. It is.

11 Q. So you averaged in a basis point
12 spread for an A rated bond to another investment
13 rated bond, a BBB, in order to come up with a basis
14 point spread for what you believe to be a
15 non-investment grade company; is that correct?

16 A. No. I mean, as I indicated, the
17 company as it is capitalized right now with
18 57 percent equity, I think there is debate if you
19 look at how it's capitalized now. I did a credit
20 rating assessment myself based on assuming that
21 SNG, which is Summit Natural Gas of Missouri, if it
22 had this lower amount of leverage, that -- and
23 going through the Moody's updated methodology that
24 has fairly standard assignments of rating factors,
25 that SNG, based on its current capital structure,

1 actual capital structure, could have a bond rating
2 that is investment grade.

3 So I take issue with saying that it
4 would definitely be classified as non-investment
5 grade. What I'm saying is that if I used the
6 hypothetical capital structure based on Summit
7 Utilities' and IIF's strategy of capitalizing
8 companies with 40 percent equity, 60 percent debt,
9 that would, you know, be a situation where I think
10 it would tip it over to be more entrenched in the
11 non-investment grade BA category.

12 **Q. I think we just -- I think you just**
13 **testified, and I just want -- this is just for**
14 **clarification, that the equivalent Standard &**
15 **Poor's rating compared to a BA would be a BB; is**
16 **that correct?**

17 A. Yes, that's correct.

18 **Q. Well, let me ask you this: Had you**
19 **just used the spread between the A rated yields and**
20 **a BB rated yield, the latter of which is**
21 **non-investment grade, the spread between those two**
22 **would have been 322 basis points; isn't that**
23 **correct?**

24 A. Let me refer to my testimony.

25 **Q. Let me direct you to page 13 of**

1 your --

2 A. Sure.

3 Q. -- surrebuttal, which I think is
4 where you address that.

5 A. Yes. For the period February through
6 April 2014, the average spread between an A rated
7 bond and a BB rated -- these are utility bonds. I
8 want to make sure that I clarify that. These are
9 not just general corporate bonds. These are
10 specific to utilities. It was 322 basis points.

11 Q. I appreciate that clarification.
12 Thank you. Let's turn to the topic of capital
13 structure. Your testimony is that the Commission
14 should determine Summit Natural Gas' weighted cost
15 of capital based on a debt to equity ratio of
16 60/40; is that correct?

17 A. If I could clarify some terminology
18 and the way that's characterized. Debt to equity
19 is a ratio. So if you had 50/50, that's a one.
20 When you say debt to equity of 40/60, that's a less
21 than one. So I would -- I would think it's
22 appropriately characterized as a 40 percent equity
23 to capital. Excuse me. Equity to total capital is
24 40 percent. Debt to total capital is 60 percent.
25 Debt to equity is measuring the ratio of the debt

1 and the equity to each other.

2 Q. I appreciate that. Thank you.

3 Currently, at least as filed, the company's actual
4 capital structure at the end of its test period was
5 43 percent debt to 57 percent equity; is that
6 correct?

7 A. Yes.

8 Q. Now, is it your testimony that Summit
9 Natural Gas will actually achieve a debt to equity
10 ratio of 60 to 40 during the period the new rates
11 are in effect?

12 A. I don't know how long that period's
13 going to be, so -- and I don't know if this is
14 confidential. So I can tell you, you know, what
15 I've read and what I've seen as far as strategic
16 plans, and if you want me to tell you that, I can
17 tell you that.

18 Q. Well, before we dive into that, I'm
19 just asking you, is that your testimony?

20 A. It is.

21 Q. Where does that appear in your
22 prepared testimony?

23 A. I don't know that it's in my
24 testimony. We had problems with getting
25 information from IIF. And once I got that

1 information, I mean, I got that about a week before
2 I was filing testimony, and I've had more time to
3 look at it. And as I look at the strategic plans,
4 I can tell you something, you know, if you want me
5 to.

6 Q. Well, let me just kind of get more --
7 let me just get -- in looking at your prepared
8 testimony, that's not in your prepared testimony,
9 is it?

10 A. What I'm saying is --

11 Q. Well, I know that you want to
12 supplement your testimony. The question I'm asking
13 you is, is that statement anywhere in your prepared
14 testimony?

15 A. This is a hypothetical capital
16 structure. It's not in my testimony.

17 Q. Has this company ever achieved that
18 ratio of 60 to 40?

19 A. When you say this company, this
20 company's gone through a lot of changes.

21 Q. Summit Natural Gas. Let's use the
22 company as it currently exists.

23 A. So Summit Natural Gas going back to
24 MGU, I'd have to go back and look. I don't --
25 MGU's been around since 2004, 2005. I can't tell

1 you right now off the top of my head.

2 **Q. So you don't know whether Summit**
3 **Natural Gas or any of its predecessor companies**
4 **have ever achieved a capital structure, a**
5 **hypothetical capital structure that you're**
6 **recommending?**

7 A. Yeah. I don't remember the numbers
8 over the last ten years.

9 **Q. Do you know whether any other**
10 **Missouri natural gas utility currently has a**
11 **capitalization like that?**

12 A. I'd say several small water and
13 sewers and -- not the major natural gas, like
14 Laclede or the electrics such as Ameren Missouri.

15 **Q. Do any of the proxy companies that**
16 **you've identified for your DCF model have a debt to**
17 **equity ratio of 60 to 40?**

18 A. Our schedule used to include the
19 capital structure information. I'm not seeing
20 that. So I can't tell you with certainty.

21 **Q. You said you've reviewed**
22 **Mr. Anderson's testimony?**

23 A. I have.

24 **Q. You've looked at the ValueLine**
25 **information that he provided for his proxy**

1 **companies?**

2 A. I did.

3 **Q. And are you aware that the capital**
4 **structure information for those 11 proxy companies**
5 **shows up in his testimony or his schedules?**

6 A. I believe so. Unfortunately, I just
7 have a copy of his testimony without schedules
8 here.

9 **Q. Let me ask you this: Would you have**
10 **any reason to disagree with my statement that the**
11 **average that shows up in the schedule that**
12 **Mr. Anderson presents for his 11 proxy companies is**
13 **48 to 52 debt to equity, the average?**

14 A. If you can show me the schedule, I'd
15 appreciate it.

16 **Q. Okay.**

17 A. I apologize. I printed this from
18 EFIS.

19 **Q. That's perfectly okay.**

20 MR. BOUDREAU: Is it okay if I
21 approach the witness?

22 JUDGE JORDAN: Yes.

23 BY MR. BOUDREAU:

24 **Q. This is on page 44 of Mr. Anderson's**
25 **direct testimony, Table 2.**

1 A. That is what it says. I mean, I just
2 want to provide a disclaimer. I'm not sure if the
3 debt -- if this is just long-term debt or if that
4 includes short-term debt. I don't recall.
5 Short-term debt is a big issue for gas companies.
6 It can be 10 percent of their capital structure.
7 But I don't recall.

8 MR. BOUDREAU: May I have just a
9 moment, please?

10 JUDGE JORDAN: Yes.

11 MR. BOUDREAU: I don't believe I have
12 any further questions for this witness. Thank you.

13 THE WITNESS: Thank you.

14 JUDGE JORDAN: Questions from the
15 Bench?

16 QUESTIONS BY CHAIRMAN KENNEY:

17 **Q. Good morning, Mr. Murray.**

18 A. Good morning, Mr. Chairman.

19 **Q. How are you?**

20 A. I'm pretty good. How are you doing?

21 **Q. Doing well. I just want to ask a**
22 **couple of questions about the capital, the**
23 **hypothetical capital structure. And just as a**
24 **threshold matter, what impact would it have on the**
25 **utility's revenue requirement with Staff's proposed**

1 **hypothetical capital structure as compared to the**
2 **actual capital structure?**

3 A. I'll refer you to the, you know, the
4 reconciliation that Staff filed within the case
5 recently. It says capital structure impact, and it
6 has about a million dollar -- that's what it shows,
7 about a million dollar impact for the capital
8 structure.

9 Q. Which way, up or down?

10 A. It would be down.

11 Q. Okay. And then typically the
12 Commission has in the past had a preference for
13 actual capital structures. Explain to me why
14 Staff's proposing a hypothetical capital structure.

15 A. Okay. No. This company is not at
16 all typical of what we're used to seeing with the
17 larger rate cases where they have mature service
18 territories. They are consistently capitalizing
19 themselves based on their targeted capital
20 structure. They make fairly small incremental
21 capital expenditures, and they don't have --
22 oftentimes there's not -- we don't have several
23 different districts that you're attempting to try
24 to protect from the higher costs that could occur
25 from significant capital expansion.

1 I mean, there's no doubt this company
2 has made significant investment in the state of
3 Missouri, starting out about -- when I say this
4 company, specifically the IIF investor -- starting
5 out about 40 million back in -- between Southern
6 Missouri Natural Gas and Missouri Gas Utility,
7 going up to 130 million or so just in their
8 investment. That doesn't include the debt.

9 But it's an ever-changing company,
10 and so just like with the Lake of the Ozarks right
11 now, they have made a \$90 million investment in
12 expanding Lake of the Ozarks. And so that includes
13 financing transactions that have occurred
14 specifically to allow that to happen.

15 They took out a three-year term loan
16 basically that extended a previous bridge loan that
17 they had with the intent of establishing a
18 permanent capital structure sometime the beginning
19 of 2015.

20 And so before they went into the Lake
21 of the Ozarks, we had a couple finance cases, and
22 they expressed that their intent was to try to
23 establish a permanent capital structure because
24 they
25 didn't -- they thought maybe they should hold off

1 on expanding into the Lake of the Ozarks because of
2 economic conditions.

3 And with the understanding that some
4 of these districts, called divisions by some, I
5 mean, both terms are used, do have more established
6 areas, I think the company will say they have met
7 their penetration goals. And so if you could
8 separate them and try to pull the financials out,
9 which Staff has tried to ask the company to see if
10 we can do something like that, and the company says
11 it's almost impossible to unravel this.

12 And, you know, with that
13 understanding, I know from their communication that
14 they thought appropriate capitalization of
15 established districts was about 40 percent equity,
16 60 percent debt. That's what their required rate
17 of return was based on. You know, that's what
18 their ultimate owner, IIF, would like to see.
19 That's consistent with -- I've got to be careful
20 how much I go into the IIF because that's been a
21 very sensitive area. So I'll try to avoid talking
22 about their strategy.

23 So that is what -- when they made
24 these investment decisions, these investment
25 decisions are for the long term, and when they --

1 even though I didn't have a chance to see their
2 specific models, when they -- and when I say they,
3 IIF. When they decided to build these systems in
4 the state of Missouri, you know, that inherently
5 would have had some type of discount rate with an
6 assumed capital structure.

7 And all the information I see is, you
8 know, over time and at the beginning of the case is
9 that the 40/60 is what they think they should use
10 when they make the decision to invest, and so
11 that's the minimum required return.

12 So what I'm saying is, is this is a
13 hypothetical. I mean, yes, they hope to get there
14 in the future after these expansions occur.
15 They're investing significant amounts of money in
16 mains. I mean, they have a lot of other things
17 going on with the -- the Summit Utilities, at the
18 holding company level.

19 But my position is if they -- if for
20 whatever reason they just had halted and let some
21 of these districts mature, you know, the -- you
22 know, and were able to get some of the conversions
23 and growth that they hope for specifically in
24 Branson and Warsaw, that, you know, that this --
25 this was the strategy of the company, and this is

1 what their required return was premised on. So
2 that's why.

3 Q. Because I'm not a financial analyst,
4 let me see if I can restate what you've just said
5 in a way that my obtuse brain can understand.

6 Is it because it's a more accurate
7 approximation of what IIF expected when it
8 invested, or are you trying to get to a better
9 approximation of what investment expectation is in
10 computing the overall cost of equity and debt?

11 Because I'm not really sure I
12 understand after what you just said why we would
13 use the hypothetical other than it's what the
14 company said it hoped to get to and because IIF
15 premised its investments on a 60/40 ratio.

16 A. It's what the investors' required
17 return is premised on. Just like with the weighted
18 average cost of capital for in our ratemaking
19 situations, you know, we -- for an established
20 company, their actual capital structure is usually
21 going to converge towards what they think is an
22 appropriate target of capital structure for their
23 current operations and the risk they think they can
24 bear.

25 In this situation, the -- you know,

1 when they determine whether or not they're willing
2 to -- or what type of returns they think they can
3 expect over their required return, what I'm saying
4 is they consider the 40/60 to be the appropriate
5 way to term what they require when they look at the
6 hoped-for cash flows.

7 **Q. Okay. So you're constructing the**
8 **hypothetical capital structure to get to an overall**
9 **rate of return that more accurately approximates**
10 **the investor expectations?**

11 A. Yes.

12 **Q. All right. I think I understand**
13 **now.**

14 CHAIRMAN KENNEY: That's all I have.
15 Thanks.

16 JUDGE JORDAN: Other questions from
17 the Bench?

18 COMMISSIONER STOLL: I have no
19 questions. I do appreciate that exchange, though.
20 That did clear things up in my mind. Thank you.

21 COMMISSIONER W. KENNEY: I just have
22 one question. Thank you.

23 QUESTIONS BY COMMISSIONER W. KENNEY:

24 **Q. Just to follow through on the**
25 **Chairman's, now, on the 60/40 investor expectation,**

1 are you just -- is that subjective? You're just --
2 because I look at some of their numbers in here and
3 it flows back and forth. So where's the 60/40?
4 Explain that.

5 A. It's -- to an extent it's subjective.
6 I mean, it's subjective from the company. I mean,
7 I could go into more detail. I think we'd have to
8 go into --

9 Q. I know, and I read that, but I don't
10 see -- I look at what you're saying is that's
11 just -- is that your --

12 A. It's not actual, no.

13 Q. It's your opinion?

14 A. It's based on what -- at the same
15 time when they were thinking about halting the Lake
16 of the Ozarks expansion, they were doing a
17 recapitalization of both their subsidiaries,
18 Colorado Natural Gas and -- they planned on doing a
19 recapitalization of both subsidiaries, Colorado
20 Natural Gas and Southern Missouri Natural Gas.

21 And because -- my position is because
22 they decided to go ahead and expand Lake of the
23 Ozarks, you're really never going to know for sure
24 what they could have -- what they could have
25 obtained.

1 But I do know that they were able to
2 obtain that capital structure in Colorado Natural
3 Gas consistent with what they want to do to
4 minimize their cost of capital, to achieve their
5 goals as far as how they capitalize established and
6 more mature service territories.

7 **Q. So when you said on page 9 of your**
8 **rebuttal testimony -- you don't have to go there --**
9 **just it said, At the end of the 2011 calendar year.**
10 **Consequently, it appears that if Summit Utilities**
11 **had continued with its plan of not expanding into**
12 **LOO, it would have recapitalized the current**
13 **districts with a 60/40 percent equity.**

14 A. Yes.

15 **Q. Is that taking out the numbers that**
16 **they invested to get to that number or is that --**

17 A. It's taking out any assumptions for
18 Lake of the Ozarks. It's purely hypothetical. I'm
19 not trying to back into any --

20 **Q. I'm just trying -- you say 60/40,**
21 **60/40. I had the assumption that was more of a**
22 **hypothetical.**

23 A. It is hypothetical, without a doubt.

24 COMMISSIONER W. KENNEY: All right.

25 Thank you.

1 JUDGE JORDAN: Further questions from
2 the Bench, Commissioner?

3 COMMISSIONER RUPP: Thank you, Judge.

4 QUESTIONS BY COMMISSIONER RUPP:

5 Q. I just wanted to again clarify on the
6 same subject matter. I wrote down what I thought
7 you had said was that the company should have
8 halted their investment and wait for the districts
9 to mature, and if they would have done that, then
10 they would have reached this 60/40.

11 So is your hypothetical calculations
12 based off their opinion -- your opinion that they
13 should not have invested in the Lake of the Ozarks
14 and, therefore, they would have reached this
15 capital structure?

16 A. I'm not taking an opinion as to
17 whether or not they should or shouldn't have
18 invested in Lake of the Ozarks. What I'm saying is
19 that if this was a standalone company without
20 having all these other expansions occur, which
21 obviously increase the risk and increase the amount
22 of capital deployed and increases the amount of
23 equity they have to put into the system, my -- my
24 opinion is that, if they let things play out,
25 whether it was this year, next year, what have you,

1 that they wanted to capitalize it at 60/40, and
2 they were able to do it at CNG and it was at the
3 same time.

4 So -- but in the meantime, they
5 decided to go ahead and basically extend a bridge
6 loan that they had for 43, 44 million and just
7 extend it for three years. I mean, that's why -- I
8 didn't even recommend the 3 percent cost of debt
9 because that's no representation of a permanent
10 capital structure. That does not represent how
11 they want to be capitalized going forward.

12 And so my point was, yeah, they
13 just -- there was -- it's impossible to know
14 exactly how things would have played out. I'm just
15 trying to look at proxies, bottom line, within the
16 same family.

17 **Q. And then looking at page 23 of your**
18 **surrebuttal testimony, in the question and answers**
19 **where you're commenting on Mr. Anderson's**
20 **calculations, can you just walk -- I read it a few**
21 **times. I just -- what is the -- can you walk me**
22 **through what's the disparatement (sic) between his**
23 **rate of return on the ValueLine proxy group versus**
24 **I think you said there was only a 40 percent in**
25 **that proxy group when you did your analysis.**

1 **What's the large difference between that proxy**
2 **group's rate of return for equity investors?**

3 A. If Mr. Anderson were to use the Dow
4 Jones Utility Average as a proxy for the cost of
5 capital using the total return method as to what
6 these gas companies should receive, he's -- I take
7 issue with just comparing two different proxies to
8 try to draw any type of inference.

9 But, you know, if the total return
10 for the Dow Jones Utility Average is, say,
11 3 percent over this time period, because there was
12 capital losses but there might be some dividends,
13 the companies in Dow Jones Utility Average are
14 riskier than the gas companies. I mean, they're
15 power companies. They're pipeline companies.
16 They're very diverse. There's maybe six pure play
17 regulated electrics in there.

18 It's really a basic violation of the
19 risk and return to say just because a company
20 received a market return of 3 percent or an index,
21 Dow Jones Utility Average, which I'm not sure what
22 the date is, but I can assure you it's higher than
23 gas. To equate that to the cost of equity is
24 just -- it violates the basic tenets of risk and
25 return.

1 Just like a bond, you know, obviously
2 the bond yields and bond returns, with the low
3 interest rate environment and as interest rates
4 decline, bond capital gains increased, and so you
5 actually had bonds outperforming stocks. And to
6 indicate that that means once the yield drops down
7 to 3 percent, that I expect the bond -- that I
8 think the cost of debt should be 7 or 8 percent
9 because I've got that capital gain, it's just a
10 complete violation of the basic tenets of risk and
11 return.

12 My point is that his natural gas
13 proxy group, even with the two that I disagreed
14 with, did have significant capital gains, and the
15 reason why they had those significant capital gains
16 is because of the flight to quality, the attraction
17 to dividend yield. You've got a low interest rate
18 environment.

19 I mean, this really isn't even
20 controversial in mainstream financial, you know,
21 media is that, you know, the valuation levels of
22 regulated utility companies is at an all-time high
23 because we are in a low interest rate environment,
24 and it's not -- nobody -- I don't want to say
25 people don't invest in utility companies for

1 growth, but they invest into it for a dividend
2 yield.

3 And so the price appreciation has not
4 been because the cost of capital is going up. It's
5 actually because the cost of capital is coming
6 down.

7 **Q. And so looking at the -- you differed**
8 **on two of the members of the ValueLine group.**
9 **Taking into consideration this is, again, very**
10 **hypothetical, you know, take out the flight to**
11 **quality. Take out the low interest rate**
12 **environment. What is a reasonable historic average**
13 **on utility investments, gas utility equity**
14 **investments historically?**

15 A. I mean, I can just look at the -- you
16 know, the S&P 500, let's say, is 9 or 10 percent.
17 You look at the beta of utilities about .7, so
18 about 30 percent less, so 7 percent. I mean, I
19 don't have any data in my testimony to
20 specifically --

21 **Q. Would that -- would that calculate**
22 **the reinvestment of dividends through that time or**
23 **is that --**

24 A. It would be total return. Any time
25 you look at the averages over a period of time,

1 it's total return. It assumes reinvestment of
2 dividends.

3 COMMISSIONER RUPP: I think that's
4 all I have, Judge.

5 JUDGE JORDAN: Very good. I have no
6 questions for you. Recross from Office of Public
7 Counsel?

8 MR. POSTON: No, sir. Thank you.

9 JUDGE JORDAN: Recross from Summit?

10 MR. BOUDREAU: Yes. Thank you.

11 RECROSS-EXAMINATION BY MR. BOUDREAU:

12 **Q. Mr. Murray, you referred to, I think,**
13 **in response to a question from Commissioner Kenney,**
14 **about the reconciliation in this case. Do you have**
15 **a copy of that with you?**

16 A. I do.

17 **Q. Unless you've got your own personal**
18 **notes on it, would I be able to take a look at that**
19 **document?**

20 A. Sure.

21 MR. BOUDREAU: Thank you. If I could
22 just have a moment to consult?

23 JUDGE JORDAN: You may.

24 MR. BOUDREAU: May I approach the
25 witness, please?

1 JUDGE JORDAN: You may.

2 BY MR. BOUDREAU:

3 Q. I'm going to have to do this just
4 looking at these numbers. And I want to get back,
5 there was a question that you got from
6 Chairman Kenney about the revenue impact of the
7 capital structure issue, and I think your testimony
8 was roughly a million dollars. And this is what
9 you were referring to; is that correct?

10 A. Yes.

11 Q. Now, let me ask you this: If we
12 look -- and I'm going back to the opening statement
13 from your counsel that said that the cost of
14 capital issues is the big revenue requirement
15 difference between the companies, which is
16 approximately \$3 million.

17 I'm trying to reconcile what he said
18 with what you said in terms of how does that
19 \$1 million play into the total \$3 million number.
20 And let me -- so that leads to my question. My
21 question is, is your testimony then we have -- we
22 have rate of return and capital structure, which
23 are broken into three different elements, the total
24 of which on the reconciliation is just a little bit
25 north of 3 million?

1 A. That's correct, yes.

2 Q. So what you were looking at, capital
3 structure -- let me ask you that. Of these three
4 line items, is this the -- is this middle line item
5 the one that you were looking at?

6 A. The second -- yes, the middle one.

7 Q. Let me ask you, then, this: The line
8 right below that deals with return on equity. Does
9 that return on equity, is that number based on the
10 capital structure recommendation that Staff is
11 making? I mean, I'm just trying to figure out how
12 all these numbers come together.

13 A. That's a good question, and I really
14 probably should defer to auditing for further
15 clarification on that --

16 Q. Okay. Fair enough.

17 A. -- as far as which one they --
18 because you have to hold, you know, variables
19 constant to be able to reconcile.

20 JUDGE JORDAN: Counsel, for
21 clarification, were you referring to the
22 reconciliation filed on August 14th?

23 MR. THOMPSON: Yes, Judge.

24 MR. BOUDREAU: That must be the
25 document, yes.

1 BY MR. BOUDREAU:

2 Q. I won't -- apparently I'm just as
3 ignorant about how these numbers play out as
4 anybody else, but I wanted to -- I just kind of
5 wanted some clarification on that point. I don't
6 think I can take it much further than this at this
7 point, so I'm just going to drop it.

8 Maybe one question. Is it possible,
9 sir, that in response to Mr. Kenney's -- or
10 Commissioner Kenney's question to you about the
11 revenue impact of the capital structure issue, that
12 it could be a good deal more than just the
13 \$1 million that you identified?

14 A. I don't know why it would be much
15 more, but like I said, I'm going to defer to
16 Staff's auditing department just to make sure.

17 Q. Let me ask you this: If we were to
18 put that question to one of the Staff witnesses,
19 one of the Staff auditors, who would that be best
20 asked of?

21 A. Amanda McMellen.

22 Q. Okay. We'll just leave it at that.
23 Thank you. Kind of defer that issue to if and when
24 she takes the stand.

25 JUDGE JORDAN: Okay. Redirect from

1 Staff?

2 MR. BOUDREAU: Actually, I may have
3 one or more -- a few more questions.

4 JUDGE JORDAN: I'm sorry. I thought
5 you were done.

6 BY MR. BOUDREAU:

7 Q. In response to some questions, I
8 think, from Commissioner -- I hate to say it --
9 Rupp or Rupp?

10 COMMISSIONER RUPP: It's Rupp, but I
11 don't care.

12 MR. BOUDREAU: Rupp. I apologize for
13 that.

14 BY MR. BOUDREAU:

15 Q. You were talking about the Dow Jones
16 Utility Index testimony in Mr. Anderson's
17 testimony.

18 A. Yes.

19 Q. Can I direct you to -- do you have
20 his testimony with you?

21 A. I do.

22 Q. Can I direct you to page 25 of
23 Mr. Anderson's surrebuttal testimony?

24 A. Yes.

25 Q. Okay. And between approximately

1 lines 10 and 19 of that testimony, is this the area
2 of testimony that you were referring to in that
3 exchange?

4 A. No. I think we were referring to my
5 testimony.

6 Q. Okay. Well, looking at
7 Mr. Anderson's testimony, he gives some testimony
8 here about the Dow Jones Utility Index numbers at
9 different times; is that correct?

10 A. Yes.

11 Q. And so would you agree with me that
12 if you look at the time periods that he identifies
13 and the numbers, the index itself, that most of
14 the -- most of that change has happened actually
15 fairly recently?

16 A. I think -- well, let's just say
17 specific dates. January 31st, 2008 through
18 December 31st, 2013, and I think he went all the
19 way to June 30th, 2014.

20 Q. So it's all occurred since
21 December -- so it's all occurred between
22 December -- between December 31, 2013 and June 30th
23 of 2014; is that correct?

24 A. You're going to have to clarify.
25 What's all occurred? I don't know what you're

1 talking about.

2 Q. Okay. At December 31 of 2013, the
3 index closed at 490.57; is that correct?

4 A. Yes.

5 Q. And then at June 30th of 2014, it
6 closed at 576.98?

7 A. That is correct.

8 MR. BOUDREAU: Check my notes. I
9 believe that's all I have.

10 JUDGE JORDAN: Take your time. I
11 don't want to cut you off again.

12 MR. BOUDREAU: I don't believe I have
13 any more questions for this witness. Thank you.

14 JUDGE JORDAN: Redirect from Staff?

15 MR. THOMPSON: Thank you, Judge.

16 REDIRECT EXAMINATION BY MR. THOMPSON:

17 Q. Let's pick right up with the Dow
18 Jones Utility Index because otherwise I'll forget
19 it. Your problem with the Dow Jones Utility Index
20 that's used by Mr. Anderson is that it was a
21 comparison of apples to oranges; is that correct?

22 A. Yes. They're two different indexes.

23 Q. And so conclusions drawn from
24 comparing these two dissimilar indexes would be
25 essentially false and unreliable?

1 MR. BOUDREAU: I'll object to the
2 question on the grounds that it's leading.

3 BY MR. THOMPSON:

4 Q. Would there be problems with
5 conclusions drawn from the comparison of these two
6 dissimilar indexes?

7 A. Yes.

8 Q. What would those problems be?

9 A. Well, to the extent that you have,
10 you know, power companies, energy companies,
11 diversified electric companies in the Dow Jones
12 Utility Average that are much more susceptible to
13 swings in economic cycles, such as decline in
14 demand and the power markets, merchant generation,
15 those companies have, you know, obviously had a bit
16 of volatility, taken some pretty big declines in
17 their stock prices. That just doesn't -- hasn't
18 happened with the natural gas distribution proxy
19 group actually.

20 Like I said, to me, it's more of an
21 indication of the higher cost of capital for the
22 diversified companies and the lower cost of capital
23 for the gas companies. So if there's any analysis
24 that should have been done, that's the comparison
25 that should have been made.

1 **Q. Okay. And there was some questions**
2 **about where you got the 60/40 figure. Do you**
3 **recall those questions?**

4 A. Yes.

5 **Q. You didn't make that up, did you?**

6 A. No.

7 **Q. Where did you find that figure 60/40?**

8 A. The 60/40 was actually filed in a
9 finance case in 2011-2012, and that's -- we asked
10 the company what their -- what their intent was,
11 and it was an intent to capitalize the companies as
12 is without expanding it into the Lake of the Ozarks
13 and their desire within that -- within that case,
14 they said they were planning to issue
15 88 million of debt with a goal of achieving a
16 60 percent debt/40 percent equity ratio.

17 And like I said, because Colorado
18 Natural Gas recapitalized at the same time, but
19 Colorado Natural Gas did not make the same -- did
20 not change its plans of making significant capital
21 investment. Lake of the Ozarks was the biggest
22 capital investment of Summit Utilities' history,
23 until Maine. Now they're embarking on their next
24 largest expansion.

25 But -- so, yes, that 60/40 was trying

1 to, you know, trying to help set the rates based on
2 what, you know, what the best estimate would be for
3 the capitalization of the districts for the
4 ratepayers that should not be affected by the Lake
5 of the Ozarks expansion.

6 Q. So the 60/40 came from the company?

7 A. Yes.

8 Q. And the Chairman was asking you why
9 you recommended the use of the hypothetical capital
10 structure. Do you recall that?

11 A. Yes.

12 Q. And was that to protect the existing
13 ratepayers or was it to approximate investor
14 expectations?

15 A. Both.

16 Q. Both. Okay. Now, you referred to
17 some strategic plans. Do you recall that?

18 A. Yes.

19 Q. Should we go in-camera so you can
20 explain what you learned from those strategic
21 plans?

22 A. Yes, I think it would be very
23 helpful.

24 MR. THOMPSON: Can we go in-camera,
25 Judge?

1 JUDGE JORDAN: Yes. And I will
2 explain what that means to members of the audience
3 who are not familiar with that. What we're going
4 to be doing is discussing some hypothetical
5 information -- not hypothetical. I'm sorry.
6 Highly confidential. It starts with the same
7 letter of the alphabet -- highly confidential
8 information, and so persons who are not necessary
9 for that, who are not parties, will leave the
10 hearing room. We will also mute the broadcast of
11 this on the Internet. We will continue to make a
12 record of it, but that portion of the record will
13 be closed. I think that pretty much sums it up.

14 MR. THOMPSON: Thank you, Judge.

15 JUDGE JORDAN: All right. Then we
16 will go in-camera, and I'm also muting now.

17 (REPORTER'S NOTE: At this point, an
18 in-camera session was held, which is contained in
19 Volume 11, pages 199 through 209 of the
20 transcript.)

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1 JUDGE JORDAN: We're out of our
2 in-camera examination and cross-examination, Bench
3 questions, recross and redirect. Does Staff have
4 any further redirect for this witness?

5 MR. THOMPSON: Yes, Judge. Thank
6 you.

7 BY MR. THOMPSON:

8 Q. Now, Mr. Boudreau asked you some
9 questions about how you calculated your upward
10 adjustment of 200 basis points. Do you recall
11 that?

12 A. Yes.

13 Q. And he -- he implied that it was
14 improper to use a credit rating based calculation
15 to adjust for basically an equity risk issue. Do
16 you recall that?

17 A. Yes.

18 Q. Would it be better to just make
19 numbers up, as Mr. Anderson did?

20 MR. BOUDREAU: I object to the
21 question. That's an inappropriate question.

22 MR. THOMPSON: I don't withdraw it,
23 Judge.

24 MR. BOUDREAU: We have expert
25 witnesses giving their opinions. To characterize

1 it as making stuff up I think is inappropriate.

2 JUDGE JORDAN: Well, insofar as it
3 does not constitute testimony, I'll overrule the
4 objection and have the witness answer.

5 THE WITNESS: I think it's important
6 to have some quantifiable basis based on market
7 factors, and I did that based on factors that are
8 observable, that are yields that, you know, that
9 are published and available to investors.

10 So while he may have experience, I
11 really have no idea why 100 basis points makes
12 sense and 200 basis points makes sense for someone
13 else. I have no idea.

14 JUDGE JORDAN: I will interject a
15 question here just to clarify your answer to Staff
16 counsel's question. Is your answer based on the
17 premise that Mr. Anderson's testimony, as
18 described, consists of making numbers up?

19 THE WITNESS: It's based on his
20 experience. I don't know how he made them up. So
21 based on experience, if, you know, I have no -- I
22 have no basis to understand how he came up with
23 those numbers.

24 JUDGE JORDAN: That answers my
25 question.

1 BY MR. THOMPSON:

2 Q. Mr. Boudreau also indicated that he
3 believed you had changed your cost of debt figure
4 in your surrebuttal. Is that the case?

5 A. No.

6 Q. So your figure is still 5.0?

7 A. Yes. I just provided alternatives
8 for the Commission to be aware of.

9 Q. There was some questioning from
10 Mr. Boudreau about who was IIF's auditor, whether
11 it was KPMG or Pricewaterhouse. Do you recall
12 that?

13 A. Yes.

14 Q. And does that make any difference to
15 any of your recommendations?

16 A. No.

17 MR. THOMPSON: I have no further
18 redirect. Thank you very much, Judge.

19 JUDGE JORDAN: That concludes the
20 examination for this witness, who is our last
21 witness scheduled for today. Are there any other
22 matters that the parties want to take care of
23 before we go off the record and before we adjourn?

24 (No response.)

25 JUDGE JORDAN: I am not hearing any,

1 and so, with that, we will go off the record and we
2 will be adjourned 'til tomorrow. Tomorrow's
3 schedule looks fairly ambitious, I note. I see 13
4 witnesses scheduled and 20 rounds of examination.
5 We've also scheduled Thursday to deal with the
6 overflow of that copious testimony.

7 And with that, we will adjourn and we
8 will go off the record.

9 (WHEREUPON, the hearing was adjourned
10 at 12:26 p.m.)

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12
13
14
15
16
17
18
19
20
21
22
23
24
25

1	I N D E X	
2	Opening Statement by Mr. Cooper	65
	Opening Statement by Mr. Borgmeyer	78
3	Opening Statement by Mr. Poston	83
	Opening Statement by Mr. Brownlee	95
4	Opening Statement by Mr. Knee	105
	Opening Statement by Mr. Jarrett	106
5		
	RATE OF RETURN ISSUES	
6		
	Opening Statement by Mr. Boudreau	110
7	Opening Statement by Mr. Thompson	124
	Opening Statement by Mr. Poston	132
8		
9	SUMMIT'S EVIDENCE:	
10	JAMES ANDERSON	
	Direct Examination by Mr. Boudreau	134
11	Cross-Examination by Mr. Thompson	138
	Questions by Chairman Kenney	144
12	Questions by Commissioner Rupp	146
	Questions by Judge Jordan	151
13		
	STAFF'S EVIDENCE:	
14		
	DAVID MURRAY	
15	Direct Examination by Mr. Thompson	152
	Cross-Examination by Mr. Boudreau	153
16	Questions by Chairman Kenney	174
	Questions by Commissioner W. Kenney	180
17	Questions by Commissioner Rupp	183
	Recross-Examination by Mr. Boudreau	188
18	Redirect Examination by Mr. Thompson	194
19	DAVID MURRAY (In-Camera Session - Volume 11)	
	Redirect Examination by Mr. Thompson	202
20	Further Questions by Commissioner Rupp	205
	Recross-Examination by Mr. Poston	208
21		
22		
23		
24		
25		

	EXHIBITS INDEX	MARKED	REC'D
	SUMMIT'S EXHIBITS		
1			
2			
3	EXHIBIT NO. 1		
4	Direct Testimony of James M. Anderson	62	138
5			
6	EXHIBIT NO. 2		
7	Rebuttal Testimony of James M. Anderson	62	138
8			
9	EXHIBIT NOS. 3NP/3HC		
10	Surrebuttal Testimony of James M. Anderson	62	138
11			
12	EXHIBIT NO. 4		
13	Direct Testimony of Michelle A. Moorman	62	
14			
15	EXHIBIT NO. 5		
16	Rebuttal Testimony of Timothy R. Johnston	62	
17			
18	EXHIBIT NO. 6		
19	Surrebuttal Testimony of Timothy R. Johnston	62	
20			
21	EXHIBIT NO. 7		
22	Rebuttal Testimony of Rick H. Lawler	62	
23			
24	EXHIBIT NO. 8		
25	Surrebuttal Testimony of Rick H. Lawler	62	
26			
27	EXHIBIT NO. 9		
28	Surrebuttal Testimony of David Moody	62	
29			
30	EXHIBIT NO. 10		
31	Rebuttal Testimony of Renato Nitura, Jr.	62	
32			
33	EXHIBIT NO. 11		
34	Surrebuttal Testimony of Renato Nitura, Jr.	62	
35			

1	SUMMIT'S EXHIBITS		
	(Continued)		
2		MARKED	REC'D
3	EXHIBIT NO. 12		
	Direct Testimony of Alicia L.		
4	Picard	62	
5	EXHIBIT NO. 13		
	Direct Testimony of Tyson Porter	62	
6			
	EXHIBIT NOS. 14NP/14HC		
7	Rebuttal Testimony of Tyson Porter	62	
8	EXHIBIT NO. 15		
	Surrebuttal Testimony of Tyson		
9	Porter	62	
10	EXHIBIT NO. 16		
	Direct Testimony of Kent Taylor	62	
11			
	EXHIBIT NO. 17		
12	Rebuttal Testimony of Kent Taylor	62	
13	EXHIBIT NO. 18		
	Direct Testimony of Martha R.		
14	Wankum	62	
15	EXHIBIT NO. 19		
	Rebuttal Testimony of Martha R.		
16	Wankum	62	
17	EXHIBIT NO. 20		
	Surrebuttal Testimony of Martha R.		
18	Wankum	62	
19	STAFF'S EXHIBITS		
20	EXHIBIT NO. 100		
	Direct Testimony of Thomas M.		
21	Imhoff	62	
22	EXHIBIT NO. 102		
	Direct Testimony of Amanda		
23	McMellen	62	
24	EXHIBIT NO. 103HC		
	Staff Report - Cost of Service	62	
25			

1	STAFF'S EXHIBITS		
	(Continued)		
2		MARKED	REC'D
3	EXHIBIT NO. 104		
	Staff Report - Cost of Service	62	
4			
	EXHIBIT NO. 105		
5	Staff Report - Cost of Service		
	Appendices	62	
6			
	EXHIBIT NO. 106		
7	Staff Accounting Schedules	62	
8	EXHIBIT NO. 107		
	Direct Testimony of Thomas M.		
9	Imhoff	62	
10	EXHIBIT NO. 108		
	Staff Report - Class Cost of		
11	Service Rate Design	62	
12	EXHIBIT NO. 109		
	Rebuttal Testimony of Michelle		
13	Bocklage	62	
14	EXHIBIT NO. 110		
	Rebuttal Testimony of Kory		
15	Boustead	62	
16	EXHIBIT NO. 111		
	Rebuttal Testimony of Kim Cox	62	
17			
	EXHIBIT NO. 112		
18	Rebuttal Testimony of Michael J.		
	Ensrud	62	
19			
	EXHIBIT NO. 13HC		
20	Rebuttal Testimony of Lesa Jenkins	62	
21	EXHIBIT NO. 114		
	Rebuttal Testimony of Lesa Jenkins	62	
22			
	EXHIBIT NO. 115		
23	Rebuttal Testimony of Robin		
	Kliethermes	62	
24			
	EXHIBIT NO. 116		
25	Rebuttal Testimony of Phil Lock	62	

		MARKED	REC'D
1	STAFF'S EXHIBITS (Continued)		
2			
3	EXHIBIT NO. 117 Rebuttal Testimony of Amanda McMellen	62	
4			
5	EXHIBIT NO. 118HC Rebuttal Testimony of David Murray	62	154
6			
7	EXHIBIT NO. 119 Rebuttal Testimony of David Murray	62	154
8	EXHIBIT NO. 120 Rebuttal Testimony of John A. Robinett	62	
9			
10	EXHIBIT NO. 121 Rebuttal Testimony of Seoung Joun Won, Ph.D.	62	
11			
12	EXHIBIT NO. 122 Surrebuttal Testimony of Michelle Bocklage	62	
13			
14	EXHIBIT NO. 123 Surrebuttal Testimony of Kory Boustead	62	
15			
16	EXHIBIT NO. 124 Surrebuttal Testimony of Michael Ensrud	62	
17			
18	EXHIBIT NO. 125 Surrebuttal Testimony of Thomas M. Imhoff	62	
19			
20	EXHIBIT NO. 126 Surrebuttal Testimony of Lesa Jenkins	62	
21			
22	EXHIBIT NO. 127 Surrebuttal Testimony of Phil Lock	62	
23			
24	EXHIBIT NO. 128 Surrebuttal Testimony of Amanda McMellen	62	
25			

		MARKED	REC'D
1	STAFF'S EXHIBITS		
	(Continued)		
2			
3	EXHIBIT NO. 129		
	Surrebuttal Testimony of Joel		
4	McNutt	62	
5	EXHIBIT NO. 130HC		
	Surrebuttal Testimony of David		
6	Murray	62	154
7	EXHIBIT NO. 131		
	Surrebuttal Testimony of David		
8	Murray	62	154
9	EXHIBIT NO. 132		
	Surrebuttal Testimony of Henry E.		
10	Warren	62	
11	EXHIBIT NO. 133		
	Reconciliation	62	
12			
	EXHIBIT NO. 134		
13	Final Staff Reconciliation	62	
14	EXHIBIT NO. 135		
	Branson District Final Staff		
15	Accounting Schedules	62	
16	EXHIBIT NO. 136		
	Gallatin District Final Staff		
17	Accounting Schedules	62	
18	EXHIBIT NO. 137		
	Rogersville District Final Staff		
19	Accounting Schedules	62	
20	EXHIBIT NO. 138		
	Warsaw District Final Staff		
21	Accounting Schedules	62	
22	OPC'S EXHIBITS		
23	EXHIBIT NO. 200		
	Rebuttal Testimony of Keri Roth	62	
24			
	EXHIBIT NO. 201		
25	Surrebuttal Testimony of Keri Roth	62	

1	OPC'S EXHIBITS		
	(Continued)		
2		MARKED	REC'D
3	EXHIBIT NO. 202		
	Rebuttal Testimony of Barbara		
4	Meisenheimer	62	
5	EXHIBIT NO. 203		
	Surrebuttal Testimony of Barbara		
6	Meisenheimer	62	
7	EXHIBIT NO. 204		
	Rebuttal Testimony of Geoff Marke	62	
8			
	EXHIBIT NO. 205		
9	Surrebuttal Testimony of Geoff		
	Marke	62	
10			
	MSBA'S EXHIBITS		
11			
	EXHIBIT NO. 400		
12	Direct Testimony of Louie R.		
	Ervin, Sr.	62	
13			
	EXHIBIT NO. 401		
14	Rebuttal Testimony of Louie R.		
	Ervin, Sr.	62	
15			
	EXHIBIT NO. 402		
16	Surrebuttal Testimony of Louie R.		
	Ervin, Sr.	62	
17			
	DIVISION OF ENERGY'S EXHIBITS		
18			
	EXHIBIT NO. 500		
19	Direct Testimony of John Buchanan	62	
20	EXHIBIT NO. 501		
	Rebuttal Testimony of John		
21	Buchanan	62	
22	EXHIBIT NO. 502		
	Surrebuttal Testimony of John		
23	Buchanan	62	
24	EXHIBIT NO. 503		
	Rebuttal Testimony of Joe Gassner	62	
25			

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

DIVISION OF ENERGY'S EXHIBITS
(Continued)

MARKED REC'D

EXHIBIT NO. 504

Surrebuttal Testimony of Joe

Gassner

62

MPGA'S EXHIBITS

EXHIBIT NO. 600

Rebuttal Testimony of Brian T.

Brooks

62

EXHIBIT NO. 601HC

Rebuttal Testimony of Brian T.

Brooks

62

A	118:19,25 122:3 127:18 150:5 151:4 157:19 165:21 168:1 170:3 175:2,13 179:20 181:12	166:24 210:10 adjustments 72:16 80:13 administration 138:25 admitted 154:12 adopt 82:13 155:23 advise 147:1 advisor 147:1 affirmatively 70:3 afoul 119:15 afternoon 69:25 age 74:8 aggregate 98:13 aggregation 75:12 76:18,21 76:24 98:19 ago 73:24 86:7 agree 102:16 124:18 160:21 165:18,24,25 193:11 agreed 66:8 81:19,20 84:12 88:10,11 89:4,5 89:15,17 agrees 70:21 72:16 Ah 129:20 ahead 163:4 181:22 184:5 Akayla 61:7 63:10 Alicia 216:3 alleged 71:9 allow 78:4 146:12 157:14 176:14 allowed 98:13,14 allowing 129:24 allows 76:16 all-time 186:22 alphabet 198:7 alternate 139:23 144:14,18,19	144:22 alternative 71:12 140:4 alternatives 123:9 212:7 Amanda 80:15 82:10 191:21 216:22 218:3 218:24 ambitious 122:22 213:3 Ameren 117:13 172:14 Ameren's 86:17 amount 70:12 103:14 120:2 167:22 183:21 183:22 amounts 74:12 75:4,24 87:7 178:15 amplified 138:21 analysis 89:21 159:15 163:9 184:25 195:23 analyst 139:6 153:5 179:3 analytical 127:12 ancillary 97:6 Anderson 65:9 111:5,9,20 112:1 116:18 117:20 123:24 123:25 133:12 134:7,14,18 135:3 138:13 144:4,9 156:9 165:8 173:12 185:3 194:20 210:19 214:10 215:4,6,8 Anderson's 112:4,7 115:10 117:10 122:5 157:1 165:4,20 172:22 173:24 184:19 192:16	192:23 193:7 211:17 annual 59:12 62:14 82:18 158:9 annualized 149:16 annually 86:16 answer 101:24 102:9 108:7 160:9 211:4,15 211:16 answers 100:12 137:19 143:21 154:1,3 184:18 211:24 anticipated 89:23 anybody 105:7 142:5,6 191:4 apologize 173:17 192:12 apparent 76:7 apparently 191:2 appear 63:4 65:9 74:18 170:21 appearance 62:24 65:11 APPEARANC... 60:1 appearing 63:9 63:16 64:5 appears 113:13 116:10 119:8 182:10 Appendices 217:5 apples 194:21 appliance 107:25 appliances 106:16 Applicant 62:25 application 68:6 88:3,8,10 129:24 applied 81:24 90:19
----------	---	--	---	---

apply 75:4 89:6 94:10 116:5 118:22 119:11 160:12 161:7	71:16 78:1,7 80:17,22 88:16 97:22 107:2 121:2 122:23 125:25 177:6	71:9 113:19 121:24 126:12 139:19,20,22	auditor 158:8,15 212:10	165:5
applying 156:12	arrive 78:23	Associates 97:15	auditors 191:19	BA 163:15,17 164:15,19,20 166:14,19 168:11,15
apportion 80:9	articulate 104:2	association 60:12 60:18 63:19,21 64:4,6 75:10	Auditor/evalua... 158:9	BAA 166:4
appreciate 94:18 102:20 169:11 170:2 173:15 180:19	articulated 100:17	95:19,22 96:1,9 96:13 106:8,13 106:14	August 59:7 62:9 190:22	bachelor's 138:24
appreciation 187:3	aside 101:5 114:3 150:16	assume 112:20 157:1 163:5	authoritative 159:2 162:4,10 163:1	back 96:6,17 110:3 121:22 121:23 148:2,6 171:23,24 176:5 181:3 182:19 189:4 189:12
approach 73:8 173:21 188:24	asked 72:11 109:19 143:17 143:22 144:17	assumed 113:22 160:21,23 178:6	authorities 76:21	background 138:24
approaches 77:2 127:13	153:24 191:20 196:9 210:8	assumes 164:20 188:1	authority 67:5 87:12 88:16	backs 130:7,17
appropriate 74:7 77:6,17 82:8 110:20,21 124:1 161:7 177:14 179:22 180:4	asking 62:18 70:24 78:3 86:9 107:8 109:17 142:1 170:19 171:12 197:8	assuming 167:20	authorized 82:13 113:25	balanced 98:23
appropriately 169:22	assertion 122:6	assumption 182:21	automatically 146:12	balances 112:12
approval 69:6	asserts 119:4	assumptions 182:17	availability 112:15 123:10	balancing 98:19
approve 108:5	assessing 162:6 162:13 163:6,7	assure 185:22	available 66:23 67:6 120:2 211:9	banker 165:9
approved 68:6 88:9,15 89:8	assessment 158:10 163:16 167:20	Atmos 86:20,21 117:13	average 85:9 101:13 117:16 117:23 125:11 147:7,25 150:22,24 166:25 167:2 169:6 173:11 173:13 179:18 185:4,10,13,21 187:12 195:12	banks 67:1
approximate 197:13	asset 112:5 125:15	attempt 87:8	averaged 101:11 167:11	Barbara 220:3,5
approximately 65:23 67:12 70:9 74:16 119:7 121:9 122:1 124:16 161:8 189:16 192:25	assets 66:16 72:10,20 73:3,5 73:10	attempted 79:23	averages 187:25	base 80:25 99:19 121:4 123:14 150:15,16 158:14
approximates 180:9	assign 140:22	attempting 133:7 175:23	avoid 77:16 177:21	based 82:20 88:4 95:6 107:10,14 112:4,9 114:16 115:19 116:10 117:6 120:3 133:24 140:14 141:1 155:20 156:4 158:16 160:13 161:16 163:9 165:21 166:25 167:20 167:25 168:6 169:15 175:19 177:17 181:14 183:12 190:9 197:1 210:14 211:6,7,16,19 211:21
approximation 179:7,9	assigned 62:16 160:16	attempts 73:6 80:12	aware 77:15 89:14 113:3 156:9,15 160:2 162:11 165:8 173:3 212:8	basic 99:9 100:4
April 169:6	assigns 89:6 89:19	attend 144:17,20	awareness 106:18	
area 66:7 99:16 121:9 126:15 127:16 177:21 193:1	assigning 141:22 143:17	attention 108:6 132:23 164:5	B	
areas 69:21	assignments 167:24	attorney 60:2,2,3 60:8,13 108:13	B 116:19 148:25	
	assisted 165:1	attract 99:20 123:12 128:14 156:6 157:14		
	assisting 165:10	attraction 186:16		
	Associate 60:19	audience 198:2		
	associated 69:18	audit 159:9,10,17 159:22 160:5		
		audited 158:18 158:21		
		auditing 158:18 190:14 191:16		

101:4,8 185:18 185:24 186:10 basically 161:16 163:18 166:5 176:16 184:5 210:15 basing 119:16 159:3 basis 81:25 110:24 113:16 125:10,20 155:14 166:24 167:11,13 168:22 169:10 210:10 211:6 211:11,12,22 BB 166:21 167:3 168:15,20 169:7 BBB 163:17 166:4,5 167:2,8 167:13 bear 79:3,4,7 81:11 83:7 90:4 90:5 118:17 121:11,12 126:22 141:25 142:2 163:21 179:24 bearing 80:2 bears 77:13 122:9 bedroom 91:25 began 67:10 76:4 87:21 beginning 109:3 176:18 178:8 behalf 63:4,9,21 64:6 134:24 belief 137:23 154:4 believe 65:8 71:21 72:19 74:7 82:7 94:25 95:2 98:6,8,10 100:1 108:4 115:23 143:16	159:1,24 161:5 164:9 166:17 167:14 173:6 174:11 194:9 194:12 believed 212:3 believes 70:6 71:14 112:11 113:17 Bench 78:11 83:12 106:4 124:8 133:24 144:7 174:15 180:17 183:2 210:2 beneficial 114:22 benefit 160:17 Benton 67:20 best 107:14 130:21 131:14 137:23 147:2 154:4 191:19 197:2 bet 104:12 beta 187:17 better 179:8 210:18 beyond 95:24 148:1 bid 103:14 big 70:20 79:1,9 79:17 80:7 99:11 104:11 150:10 174:5 189:14 195:16 biggest 89:11 196:21 bill 98:7 104:11 billed 76:8,10 billing 76:12 77:7 104:4,18 billion 148:24 bills 84:18 86:15 86:19 106:22 binding 89:18 bit 97:4 99:19 138:21 151:4	189:24 195:15 Blame 103:7 blank 105:21 board 139:23 140:2 144:14 144:15,23 145:1,1,3,10,13 Boards 60:17 63:19,21 75:10 95:19,21,25 96:9 Bocklage 217:13 218:13 boil 79:2 bond 116:19 166:2,13,14 167:1,1,2,3,5,6 167:8,12,13 168:1 169:7 186:1,2,2,4,7 bonds 162:1 165:2 166:11 169:7,9 186:5 book 73:2 162:18 books 72:1 73:4 158:18,19,22 boost 123:14 Borgmeyer 61:6 63:8,10 65:4 78:14 117:1 214:2 borne 131:17 132:5 borrow 131:3 borrowed 128:12 131:5 bottom 73:8 120:1 184:15 Boudreau 60:2 63:2 65:19 71:4 110:10 127:19 134:6,12,15 136:6 137:25 138:8 143:16 152:13 154:10 154:18 155:3,6 155:8 163:23	164:1,4 173:20 173:23 174:8 174:11 188:10 188:11,21,24 189:2 190:24 191:1 192:2,6 192:12,14 194:8,12 195:1 210:8,20,24 212:2,10 214:6 214:10,15,17 bought 145:16 146:15 Boustead 217:15 218:15 Box 60:4,21 61:2 61:8 brain 179:5 brand-new 92:10 Branson 66:2 67:25 68:16 72:8,18 74:2 80:16,22 84:19 85:10 93:1 126:18 178:24 219:14 Branson's 93:4 break 110:2 151:18 Brian 107:16,18 107:24 221:6,8 bridge 176:16 184:5 brief 133:16 briefly 88:22 100:23 151:12 bring 104:4 126:6 132:7 bringing 77:25 125:24 brings 111:9 broadcast 198:10 broken 189:23 broker 111:11 134:22 146:11 Brooks 107:16 221:7,9	brought 71:25 94:11 102:7 Brownlee 60:13 63:20,20 95:20 95:21 103:1,5 103:11,15 104:2,12,19,23 105:4,7 109:8 109:11,16,18 214:3 Brydon 60:3 63:3 Buchanan 220:19,21,23 budget 96:18 build 178:3 Building 60:20 buildout 122:22 128:3 build-out 113:7 121:1,8 built 67:15 93:8 bulk 98:2 bunch 100:9 burden 94:8 118:18 133:13 business 68:2 78:18,21 87:22 92:21 93:2 106:21 107:19 107:22 113:14 113:18 119:22 126:12,13 138:25 businesses 88:5 93:13 94:14 buy 97:20 103:18 104:8 buyer 99:11 buying 97:20 98:21 104:7,16 129:6 B-rated 116:21
C				
C 60:3 62:1 222:2,2				

<p>calculate 121:22 140:25 146:13 149:17 187:21 calculated 84:9 125:9 127:11 129:9 210:9 calculates 146:9 calculating 125:11 calculation 70:22 122:9 131:14 146:6,11 156:21,22 157:24 210:14 calculations 79:19 122:5 146:16 183:11 184:20 Caldwell 67:20 calendar 182:9 call 70:19 128:14 134:7 140:13 called 66:17 74:12 98:25 100:14 101:6 177:4 calling 62:11 calls 152:19 Camden 67:21 canceled 99:25 cap 164:21 capacity 80:13 80:23,24 97:20 99:8 134:20 capital 71:3 79:24 109:1 110:7,15,19 111:4,9,24 112:5 114:7 115:15,16,21 116:5,16,25 117:7,11 118:2 118:16,19,25 119:6,13,20 120:5,11,13,15 121:9 122:3,8 122:13 123:3</p>	<p>123:20 124:1 124:13 125:1 125:15 127:14 127:16,17,18 127:22 130:19 130:21 131:12 131:15 134:21 139:10,13 155:11 156:5,6 156:12 157:14 157:22 164:23 167:25 168:1,6 169:12,15,23 169:23,24 170:4 171:15 172:4,5,19 173:3 174:6,22 174:23 175:1,2 175:5,7,13,14 175:19,21,25 176:18,23 178:6 179:18 179:20,22 180:8 182:2,4 183:15,22 184:10 185:5 185:12 186:4,9 186:14,15 187:4,5 189:7 189:14,22 190:2,10 191:11 195:21 195:22 196:20 196:22 197:9 capitalization 117:21 118:10 172:11 177:14 197:3 capitalize 182:5 184:1 196:11 capitalized 117:18 118:8 167:17,19 184:11 capitalizing 168:7 175:18 Capitol 60:4</p>	<p>capped 120:2 caption 222:10 care 192:11 212:22 careful 111:24 177:19 caregiver 91:19 carried 102:7 carries 113:8 Carter 60:3 63:2 65:19 case 59:11 66:3 68:18 69:19,21 71:1 73:22 75:2 75:8,24 76:13 77:11,12 78:3 79:2,5,10,11,12 79:17,22 80:1,5 80:11 81:3,4,10 81:15,18,24 82:12 83:2,22 83:24 86:9,17 86:20 88:7,21 90:18,19 91:9 94:5 96:1 97:11 99:15 101:18 105:13 107:17 110:22 111:23 112:4,9 113:23 115:19,22 116:16 117:3 118:17 122:1,8 124:4,13 125:5 127:4 128:6,17 128:20 130:6 131:2,24 132:14 133:10 134:4 139:16 144:18 148:7,8 152:16 155:11 160:3 175:4 178:8 188:14 196:9,13 212:4 cases 70:16 79:6 82:5 94:10 111:8 175:17 176:21</p>	<p>cash 98:25 101:6 101:16 111:1 125:14 161:1 180:6 cast 111:6 categories 119:3 151:19,19 category 147:16 148:4 151:20 168:11 cause 153:10 222:9 caused 76:23 135:3 CCN 82:4 88:3 CCNs 94:10 CCR 59:22 222:21 cease 66:24 cell 62:18,19 certain 68:5 73:25 75:4 104:15 153:11 certainly 73:19 77:13 114:1 115:11 117:9 118:9 122:20 155:2 164:18 certainty 172:20 certificate 66:7 68:4,6 87:24 88:15 89:2 129:24 certificates 66:25 67:2 87:6,12,15 88:20 91:5 132:23 certified 139:5 222:5 certify 222:7 Chairman 59:16 108:9 132:12 144:7,8 145:18 174:16,18 180:14 189:6 197:8 214:11 214:16</p>	<p>Chairman's 180:25 chance 105:23 107:8 178:1 change 76:11 99:22 193:14 196:20 changed 69:8 92:21 148:4 212:3 changes 98:22 144:17 171:20 character 112:25 characterize 125:23 210:25 characterized 169:18,22 charge 74:4,4,25 75:1,21 76:11 76:22 81:22 charges 74:12,14 75:3 99:8,9 136:2,4,5,10 Check 194:8 checked 64:15 chicken 92:8,14 chief 61:6 132:14 134:4 152:16 children 92:2 choice 122:7,7 choices 107:13 chose 91:4 chosen 89:15 130:18 circumstances 113:5 122:19 cited 77:9 cities 87:24 citizens 93:13 123:8 city 59:8 60:5,10 60:15,21 61:3,9 93:14 126:15 222:15 claim 118:13 161:1,22 claimed 158:7</p>
---	---	---	---	---

claiming 120:11	190:12	Commissioner	87:13 90:3	124:2,15
clarification	comes 64:25 83:1	94:17,21 95:4	97:24 98:16	125:23,24
168:14 169:11	102:22	95:14 102:25	103:15,17,18	126:8 128:1,2
190:15,21	coming 79:8 94:8	103:7,12,21	117:17,18,22	129:7,23 131:5
191:5	187:5	104:10,13,21	118:7,8 120:19	133:1 142:7,22
clarifications	commend 100:8	105:2,6 106:5	120:23 121:5	144:25 145:2
78:11 132:11	commensurate	108:10,15,19	141:4,9 146:15	145:12 147:23
clarify 151:10	142:1,2	145:21,23,25	146:17,18	148:22 149:22
161:24 169:8	commenting	146:1 180:18	147:7,11,13,14	150:12 151:13
169:17 183:5	164:19 184:19	180:21,23	147:15,18,19	151:17 152:1
193:24 211:15	comments 93:16	182:24 183:2,3	147:19 148:1,3	156:7,19
class 74:13 81:14	93:17,20	183:4 188:3,13	148:14,20,25	157:14,16
217:10	commercial	191:10 192:8	149:21,22	158:5,21
classes 74:20	93:23 99:9	192:10 214:12	150:1,2,6	161:25 162:17
classified 168:4	113:9 123:12	214:16,17,20	151:22,25	167:15,17
clear 93:9,12	Commission	Commissioners	158:18 168:8	171:17,19,22
180:20	59:2 61:7,11	59:19 101:25	172:3,15 173:1	175:15 176:1,4
client 108:14	62:10 63:7,9	106:11 158:3	173:4,12 174:5	176:9 177:6,9
closed 67:8 194:3	65:15 70:2,11	Commission's	185:6,13,14,15	177:10 178:18
194:6 198:13	70:14,16,18	69:5 88:23 89:7	185:15 186:22	178:25 179:14
closely 143:23	72:11 73:9	89:9,10 111:24	186:25 189:15	179:20 181:6
163:25	74:23 77:19,23	114:22 119:15	195:10,10,11	183:7,19
closest 121:16	78:3,15 80:8	123:17 126:19	195:15,22,23	185:19 196:10
clothes 107:4	83:18 84:22	Commission-o...	196:11	197:6
clothing 120:20	86:2,14,18,21	91:4	companion 76:9	company's 72:1
CNG 120:11,15	87:10,14 88:7	commitment	77:6	80:6 82:19 88:4
120:24 121:3	88:19 89:10	105:17	company 68:3,10	94:22 105:17
184:2	90:3,16 91:5	commitments	68:17 71:14,21	105:23 112:9
CNG's 120:11	92:7 102:13	80:12 81:11	73:20 76:4	112:25 113:14
coin 118:10	105:12 107:11	83:6	77:14 78:17	115:7,19
Cole 222:4,16	108:5,12,23	committed 94:6	79:3 80:10	118:15 119:20
collaborative	110:4,7,11	common 91:23	81:19 82:2,19	121:8 122:2,11
82:17,22	111:8 113:3	110:21 114:16	84:1 86:14 87:2	123:21 124:17
collected 73:14	115:11 116:4	123:23 124:25	87:3,3,17,23	133:13 160:12
74:15	116:15 118:12	146:10 151:14	88:6 90:4,7,14	163:2 164:10
collection 124:23	118:13,18,22	151:16	94:6 95:1,6	170:3 171:20
Colorado 116:13	122:17,19	commonly	97:14 99:6,17	compared 86:11
120:10 139:25	123:1 124:11	166:10	99:21 100:1	168:15 175:1
181:18,19	126:10 127:17	communication	102:16 104:6,7	comparing 185:7
182:2 196:17	127:21 130:1,4	177:13	105:19 110:15	194:24
196:19	132:21 133:6	communities	111:3 113:7,16	comparison 85:4
combination	134:13 135:19	88:15 96:24	113:21 114:9	86:4 194:21
77:5	153:8 155:18	123:11 126:7	116:12,17	195:5,24
come 70:24 81:2	155:23 159:18	community	117:5 119:5,24	compelling 94:19
101:1 102:11	161:10 165:19	91:14,16,18,20	120:3,10,20,21	compensated
104:5 129:23	169:13 175:12	92:5 93:3,6,12	121:13,19	145:9
146:5 167:13	212:8	companies 87:1	122:20,21	compete 107:1,6

107:8 competes 107:23 competition 74:9 107:10 competitive 112:16 129:10 129:12 complete 124:5 138:19 186:10 completed 69:3 complex 68:1 component 81:22 153:7 components 100:24 110:14 compromise 112:12 computation 100:25 computing 179:10 concept 79:2 concern 77:19 102:21 114:11 126:19 concerning 75:10 115:14 124:12 124:12 157:23 concludes 108:22 212:19 conclusion 77:12 77:24 94:5 conclusions 194:23 195:5 condition 88:13 90:4 conditional 132:23 conditions 87:14 87:18,20 88:11 91:4 94:9,9,12 95:11,13 133:8 133:15 177:2 conducted 89:20 confidential 135:9 170:14 198:6,7	confine 143:21 confirm 159:23 confronted 122:21 confused 158:3 consequently 113:4 116:22 182:10 consider 80:8 102:14 124:4 150:19 180:4 considerable 141:18 157:18 consideration 111:25 122:17 187:9 considered 70:1 83:20 95:13 123:13 162:25 considering 157:17 considers 122:18 consist 64:10,24 consistent 93:18 164:15 177:19 182:3 consistently 90:3 175:18 consists 71:24 211:18 constant 190:19 constitute 70:7 211:3 constructed 69:15 constructing 180:7 construction 72:2 78:20 79:25 93:7 113:9 121:24 140:21 consult 188:22 consume 79:16 contact 64:7 contained 89:16 137:17 153:25	198:18 contemplated 76:12 contends 117:5 121:7 context 83:21 161:13 continue 74:3 78:4,6 157:21 198:11 continued 182:11 216:1 217:1 218:1 219:1 220:1 221:1 contract 100:22 contrary 73:9 contrast 120:25 control 69:12 75:22 controversial 186:20 Convenience 68:4 87:6 conventional 161:21 converge 179:21 conversion 77:20 107:25 129:17 conversions 89:13,22 133:2 133:4 178:22 converting 128:22 Cooper 60:2 63:1 63:2 65:5,13,17 65:18 87:22 109:4 112:11 114:6 214:2 copious 213:6 copy 64:13 173:7 188:15 corporate 66:13 111:15,17 169:9 corporation 65:23 76:20 77:2	corporations 116:21 165:11 correct 64:18 65:3,5,12,13 99:4 118:17 137:11,22 139:10 140:10 140:15 142:13 142:18,19 143:6 147:24 154:4 155:11 155:15,21 156:24 157:2,6 157:10,25 158:5,8 159:19 160:14,18 161:18,23,25 163:11,15 164:16 165:5,6 166:21,22 167:3,4,15 168:16,17,23 169:16 170:6 189:9 190:1 193:9,23 194:3 194:7,21 222:12 correction 136:18 corrections 135:14 136:11 137:13 153:21 correctly 133:20 correctness 160:6 corresponds 140:20 cost 71:1 73:5,11 74:13 80:3 81:14 92:12,22 93:7 94:25 98:18,19 101:2 109:1 110:6,14 110:19,20,21 111:4,9,23 112:2 115:16 115:18,20,21	115:22 116:3 116:11,16,20 116:22 118:5 123:22 124:13 124:25,25 125:17 126:20 127:14 129:11 129:18,20 131:13,16,22 131:24,25 139:9,13 153:12 157:24 160:12,13 163:2,3 169:14 179:10,18 182:4 184:8 185:4,23 186:8 187:4,5 189:13 195:21,22 212:3 216:24 217:3,5,10 costs 72:2 74:19 76:23 107:15 130:2 132:1,4 175:24 councils 66:24 counsel 60:19 61:1,1,4,6,7 63:14,17 71:10 72:25 82:3 83:12,13 91:3 95:17,21 102:5 102:17 106:7 124:8,8 133:19 134:10 141:24 143:23,24 152:7 154:23 163:22 188:7 189:13 190:20 counselor 94:16 95:17 132:13 133:18 counsel's 71:8 211:16 Counsel/Gas 61:6 count 70:9
---	---	---	--	--

<p>counties 67:19,21 68:13 96:24 country 129:4 countryside 126:7 County 126:16 222:4,16 couple 73:7 79:12 135:17 144:11,16 174:22 176:21 course 97:2 131:23 141:6 148:17 court 63:5,11 64:8 cover 100:5 covers 150:2 Cox 217:16 create 77:3 79:23 91:16 created 77:1 99:10,14 creation 84:22 credentials 111:22 credit 160:14 161:16 163:5 164:10,22 165:1,11,22 167:19 210:14 creditworthiness 160:17 163:10 crime 105:4 critical 96:16,23 96:24 97:2 102:2 122:8 cross 134:1 143:21 cross-examinat... 133:12,21 138:2,9,12 154:16,22 155:4,6 210:2 214:11,15 cross-examine 154:19 155:2</p>	<p>CSR 59:22 222:21 curious 104:14 104:17 current 66:13 67:21 69:11 80:5 81:5 93:8 113:19 115:20 119:22 167:25 179:23 182:12 currently 81:21 82:15 113:7 114:25 116:21 121:3 170:3 171:22 172:10 culp 163:18 customer 72:21 74:4,11,14,25 75:3,20 76:10 80:18 81:22 82:5 83:21 85:8 85:9 86:15 87:4 90:8,21 92:16 93:16,23,23 99:19 113:11 121:2,4 136:2,4 136:5,10 customers 65:24 66:15 67:7,13 71:13 72:3,4,24 73:15 74:8 75:20 76:20 77:4 78:23 80:20 81:2,5 83:6,25 85:8 86:25 87:9,13 87:15,17 90:5,7 90:10,12,18,22 91:11,12,15 93:24 94:7 99:6 99:20 104:5 105:25 106:23 107:2,13 112:13 113:10 126:20,21 127:6,25 128:9 128:13,14</p>	<p>129:14 130:2 130:11,17 131:9 132:2 146:12 customer's 116:11 cut 70:12 88:23 194:11 cuts 85:21 cycles 195:13</p> <hr/> <p style="text-align: center;">D</p> <hr/> <p>D 60:19 61:1 62:1 214:1 Dallas 134:22 Daniel 59:15,18 62:15 data 114:18 117:11 118:6 118:13 158:25 187:19 date 148:3 185:22 dates 193:17 Dave 79:18,23 David 110:19 127:10 152:19 152:21,24 214:14,19 215:20 218:5,7 219:5,7 Davies 67:20 day 65:1 days 151:22 DCF 111:1 112:6 112:17,20 172:16 Dcooper@bry... 60:6 deal 150:21 191:12 213:5 dealer 111:11 134:22 146:11 dealers 107:1,7 107:10 dealing 112:21 122:19 148:7</p>	<p>deals 110:5 190:8 Dean 60:2 63:2 65:18 Dean's 99:4 debate 167:18 Debra 91:17 debt 71:2 109:1 110:7,15 111:15 115:19 115:20,23 116:3,6,11,21 116:23 117:8 117:16,18,24 118:3,22 119:23 120:2,6 120:16 121:3 121:15,18,23 121:25 123:23 124:25 127:15 127:20,23 131:1,13,16 156:13 160:13 160:22 161:6 161:11,11,17 161:22 162:21 163:2,6 165:2 168:8 169:15 169:18,20,24 169:25,25 170:5,9 172:16 173:13 174:3,3 174:4,5 176:8 177:16 179:10 184:8 186:8 196:15 212:3 debt/40 196:16 December 66:10 67:7 193:18,21 193:22,22 194:2 decide 79:10 126:24 decided 178:3 181:22 184:5 decision 70:18 74:23 102:11 116:14 178:10</p>	<p>decisions 177:24 177:25 decisive 121:21 decline 186:4 195:13 declines 195:16 decrease 81:23 deeply 111:16 default 161:11 162:5,12 163:6 defer 190:14 191:15,23 deferred 65:11 defined 73:18 definitely 161:25 168:4 definition 100:15 100:17 166:1 degree 126:12,13 130:8 138:25 139:2 delivered 97:23 demand 195:14 densely 126:15 Denver 134:23 deny 86:3 94:15 159:23 depart 125:19 department 60:19 122:25 153:6 191:16 deployed 183:22 deployment 119:13 123:20 Deputy 61:6 derivative 116:4 describe 82:11 118:24 described 71:23 80:14 96:14 211:18 describes 138:16 Describing 114:11 design 73:13 74:4,17,24 81:16,17,20</p>
--	---	--	--	---

<p>217:11 designed 130:10 desire 196:13 desired 78:8 detail 71:5 147:5 181:7 detailed 150:3 determinants 76:12 determination 114:23 determine 158:22 160:11 169:14 180:1 determined 73:13 80:17 determining 114:15 115:21 116:16 devastating 85:17 92:5 develop 143:23 developed 75:8 76:13 developing 97:16 development 60:19 66:6 123:1,5,12,19 devices 62:19 Diana 60:3 63:2 65:19 differed 187:7 difference 75:25 124:21 150:10 160:13,25 161:9 185:1 189:15 212:14 differences 113:23 different 68:1 73:7 97:21 137:7 140:9 151:2 175:23 185:7 189:23 193:9 194:22 difficult 100:11 124:11 160:3</p>	<p>direct 72:11 73:22 75:2 113:23 115:9 115:24 117:11 117:22 125:17 134:15 135:5 135:12,19,23 136:1,12,16,17 136:23 137:18 138:15 142:8 146:9 147:14 149:8 152:22 162:25 163:16 164:5 168:25 173:25 192:19 192:22 214:10 214:15 215:4 215:10 216:3,5 216:10,13,20 216:22 217:8 220:12,19 Directing 72:17 directly 114:24 directors 139:24 140:3 144:14 144:15,23 145:1 disabled 91:19 91:20 disagree 173:10 disagreed 186:13 disagrees 82:6 disappears 90:15 disappointing 128:21,21,22 disclaimer 174:2 discount 178:5 discounted 75:20 76:1 111:1 125:14 discounts 98:3 discourages 123:2 discovery 114:3 114:11 discrepancy 120:17</p>	<p>discuss 64:19 116:7 discussed 73:24 109:13 131:2 143:11 discussing 114:14 198:4 discussion 138:20 157:2 discussions 82:21 disparatement 184:22 dispute 156:20 dissimilar 120:23 194:24 195:6 distribution 67:19 97:24 98:16,19 104:6 112:22 125:13 141:4 147:16 147:21 150:1,2 151:20 195:18 district 81:25 82:1 84:14,19 85:10 86:14 104:11,15 128:3 132:5 219:14,16,18 219:20 districts 75:19 84:5,11 96:11 99:16 101:3,12 103:8,23 128:5 128:20 131:9 132:2,3 175:23 177:4,15 178:21 182:13 183:8 197:3 dive 170:18 diverse 185:16 diversified 195:11,22 dividend 113:11 142:23 146:20 150:7,23,24 151:3,6 186:17 187:1</p>	<p>dividends 127:1 141:5,9 146:19 146:25 147:2,3 150:12 185:12 187:22 188:2 division 60:23 63:24,25 66:5,5 66:9 71:17 72:2 72:5,7 74:2,20 82:23 105:10 105:13,22 121:25 122:25 220:17 221:1 divisions 65:25 66:1,4 67:22,25 68:16 70:23,25 71:12 72:9,13 72:20,24 80:2 107:6 122:1 177:4 document 188:19 190:25 DOE 62:5 doing 64:23 65:1 68:2 87:22 96:1 119:2 126:8,9 127:15,24,24 128:1 150:3 160:5 174:20 174:21 181:16 181:18 198:4 dollar 148:23,24 175:6,7 dollars 141:12 189:8 doors 91:23 doubled 149:2 doubles 141:7 doubt 125:4 176:1 182:23 Douglas 68:14 92:8 Dow 148:14 149:4,6,9,19,20 185:3,10,13,21 192:15 193:8 194:17,19</p>	<p>195:11 Dr 162:18 dramatic 92:24 113:24 118:23 118:24 dramatically 92:23 93:21 draw 185:8 drawn 194:23 195:5 drew 132:22 drop 191:7 drops 186:6 DRs 114:14,14 dryers 107:4 dual 107:25 due 77:10 duty 84:23</p> <hr/> <p style="text-align: center;">E</p> <hr/> <p>E 62:1,1 214:1 219:9 222:2,2 earlier 67:23 71:24 72:4 112:11 113:21 114:6 117:2 earned 157:19 earnings 120:4 easier 146:4 155:1 easily 141:14,16 141:21 146:3 east 60:4,9 87:24 easy 100:11 108:17,20 economic 60:19 123:1,4 177:2 195:13 economically 88:9 126:2,5 educate 103:1 educated 105:3 education 106:18 educational 138:24 effect 66:10 170:11</p>
---	--	--	---	--

<p>effective 100:1 122:11 156:13 157:3,4,13 effectively 96:19 120:4 effects 127:25 130:22,24 efficiency 77:21 82:14,16,21 105:17,20 efficiently 106:24 EFIS 173:18 either 70:2 73:8 111:3 147:21 elaborate 164:17 elderly 91:18 elected 66:24 electric 149:21 195:11 electrics 172:14 185:17 elements 70:17 75:5 82:1 143:18 189:23 eligible 88:5 99:7 embarking 196:23 embedded 116:3 116:11 embraced 76:14 emphasis 112:19 Empire 86:13,14 employ 115:16 employed 134:19 134:21 139:18 153:3,4 employment 123:14 employs 81:21 encourage 107:21 123:18 124:2 endeavor 126:13 ended 149:13,14 energy 60:23 63:24 64:1 68:2 77:20 82:14,16</p>	<p>82:21,23 87:22 88:21 89:2 105:10,13,17 105:20,24 123:8,9 126:4 195:10 Energy's 86:20 105:22 220:17 221:1 enforce 87:18 enforcing 91:7 engaged 111:12 125:24 128:2 England 60:3 63:3 Ensrud 217:18 218:17 ensures 90:11 entertainment 93:2 enthusiasm 128:23 entice 141:13 entities 158:3 entity 66:13 68:1 68:7,19,20 96:22 144:22 entrenched 168:10 entries 62:24 environment 186:3,18,23 187:12 equal 75:6,7 76:23 81:24 92:14 95:5 equals 84:6 equate 185:23 equipment 106:16 equity 71:2 109:1 110:6,14,21 111:16 112:2 112:10 113:15 114:16,25 115:15 116:7 117:8,16,19,24</p>	<p>118:3,22 119:24 120:6 120:17 121:15 121:25 122:11 123:23 124:12 124:25 125:5,6 125:12 127:4 127:20,23 129:8 142:17 143:9 155:11 156:5,13,18 157:13,25 160:12,23,25 161:3,12,21 162:2,7,14,22 163:3,7 167:18 168:8 169:15 169:18,20,22 169:23,25 170:1,5,9 172:17 173:13 177:15 179:10 182:13 183:23 185:2,23 187:13 190:8,9 196:16 210:15 equivalence 162:5,12 equivalent 163:3 166:17 168:14 error 124:20 Ervin 97:14 102:22 220:12 220:14,16 Erwin's 103:17 essentially 99:10 105:21 110:16 194:25 establish 176:23 established 177:5 177:15 179:19 182:5 establishes 79:14 establishing 83:23 176:17 estimate 130:21 161:14 162:16</p>	<p>197:2 estimated 158:23 estimates 114:17 evaluate 160:17 161:17 Evaluator/app... 159:11 event 89:21 96:8 97:10 98:12 131:4,5 events 142:21 everybody 102:17 everyone's 102:21 ever-changing 176:9 evidence 71:18 94:11 95:24 114:24 115:13 118:1 138:5,7 154:12,14 214:9,13 evidentiary 59:6 62:17 exact 136:15 exactly 91:8 126:8 144:13 184:14 examination 134:15 152:22 194:16 210:2 212:20 213:4 214:10,15,18 214:19 example 86:12 138:23 142:15 exceed 88:17 exception 71:1 excess 80:24,25 146:4 excessive 86:12 exchange 159:18 180:19 193:3 excuse 132:6 169:23 excused 109:9,17</p>	<p>109:20 exercise 114:19 exhibit 62:2,3,4,4 62:5,6 83:16 138:6,16 154:13 215:3,5 215:7,9,11,13 215:15,17,19 215:21,23 216:3,5,6,8,10 216:11,13,15 216:17,20,22 216:24 217:3,4 217:6,8,10,12 217:14,16,17 217:19,21,22 217:24 218:3,5 218:6,8,10,12 218:14,16,18 218:20,22,23 219:3,5,7,9,11 219:12,14,16 219:18,20,23 219:24 220:3,5 220:7,8,11,13 220:15,18,20 220:22,24 221:3,6,8 exhibits 64:10,12 135:7 138:1,4 153:16,19 154:7,12 215:1 215:2 216:1,19 217:1 218:1 219:1,22 220:1 220:10,17 221:1,5 existing 75:5 80:20,21 131:18,20 197:12 exists 69:20 106:16 171:22 expand 123:14 129:25 181:22 expanded 67:14 90:3</p>
---	--	---	--	---

expanding 78:18 87:2 131:7 132:4 176:12 177:1 182:11 196:12	151:12 175:13 181:4 197:20 198:2	fairly 107:8,11 107:12 112:12 167:24 175:20 193:15 213:3	175:4 190:22 196:8	flat 149:6
explained 125:17 162:17	explained 125:17 162:17	faithful 76:16 77:15	filing 59:11 62:13 84:12 171:2	flex 99:21,25 101:5,10
expansion 78:22 79:3 81:12 83:7 90:24 95:10 113:2 121:21 130:3,23 131:10,17 132:7 175:25 181:16 196:24 197:5	explanation 165:13	fall 68:7 76:6 145:15	Final 219:13,14 219:16,18,20	flight 186:16 187:10
expansions 178:14 183:20	explore 124:2	false 194:25	Finally 121:7	flow 111:1 125:15 161:1
expect 161:4 180:3 186:7	expressed 129:15 176:22	familiar 198:3	finance 67:1 176:21 196:9	flows 180:6 181:3
expectation 179:9 180:25	extend 184:5,7	family 107:18 184:16	finances 97:9	fluctuation 98:23
expectations 80:18 114:20 115:5,14,17 121:3 180:10 197:14	extended 176:16	far 158:19 162:15,19,22 163:18 170:15 182:5 190:17	financial 76:19 77:1,3 79:7 96:22 99:5 113:18 116:15 119:17 120:20 127:12 139:5 147:1 153:5 156:6 157:15 158:13,19 159:11,19 160:6 164:14 179:3 186:20	focused 65:1 109:2
expected 93:9 110:19 179:7	extending 122:22	farmers 92:8	financials 177:8	folks 100:9
expenditures 82:20 175:21	extent 181:5 195:9	fashion 76:15	financing 97:1 119:23 176:13	follow 123:2 180:24
expenses 69:17	extremes 83:4	fashions 73:7	find 135:21 149:7,8 196:7	following 125:2
expensive 129:21	<hr/> F <hr/>	feasibility 71:15 82:4 95:10	fireplaces 107:5	follows 91:6 123:22 134:14 151:14 152:21
experience 111:23 138:16 138:20 141:1 165:10,14,21 211:10,20,21	fact 77:8 79:5 113:6 117:15 117:25 121:5 129:7 141:1 143:4 157:8	features 125:23	firm 63:3 97:12 159:9,22 222:6	food 85:21 92:3
experienced 69:16 111:11 111:16	facing 89:11 96:22	February 169:5	first 68:24 69:19 71:10 108:11 108:16,24 110:5 119:4 120:14 135:20 137:6,8,9 140:19 153:11 154:23 158:17	foot 105:23
experimental 76:24 98:9	fact 77:8 79:5 113:6 117:15 117:25 121:5 129:7 141:1 143:4 157:8	Feddersen 59:22 222:5,21	forecasts 90:10	forced 85:24
expert 73:23 114:16 129:9 139:13 210:24	fact 77:8 79:5 113:6 117:15 117:25 121:5 129:7 141:1 143:4 157:8	feedback 91:11	foreclosed 67:3	forces 112:14
expertise 111:10	fact 77:8 79:5 113:6 117:15 117:25 121:5 129:7 141:1 143:4 157:8	feels 92:19	foregoing 150:15 222:12	foreseeable 119:25
explain 79:19 95:25 119:22	fact 77:8 79:5 113:6 117:15 117:25 121:5 129:7 141:1 143:4 157:8	fees 74:15 98:20 103:25 104:15	foregone 150:14	forget 194:18
	factor 100:3 121:22 123:11 140:19,22	fell 148:15,17 151:3	foremost 150:14	formation 66:20
	factors 77:10 104:4 140:9,12 140:18,21,25 141:20 142:12 167:24 211:7,7	field 107:9	former 73:3 82:4	formed 66:14 82:17
	facts 121:11,11 124:3	fifth 132:5	formerly 66:13	formulas 115:16
	fail 127:1	figure 116:9 190:11 196:2,7 212:3,6	forth 94:11 151:24 181:3 222:10	forward 184:11
	failure 161:11	figures 92:11 104:24	found 71:15	four 70:25 84:5 84:11 117:12
	fair 114:23 115:14 156:3 162:3 190:16	file 62:11 64:7,17 159:16		
	faired 149:5	filed 68:3 69:25 83:24 93:16,17 96:19 107:24 114:13 115:19 135:3 170:3		

117:16 122:1 128:5 131:9 132:2,3 fourth-generat... 107:18 fraction 87:1 Frederick 92:8 92:18 free 107:13 Friday 65:11 105:14 106:2 fromthe 97:22 front 92:11 frustrated 92:19 fuel 74:10 78:2,7 103:10 104:10 107:14,25 fuels 112:16 full 69:12 76:1,5 107:14 141:11 145:3 222:12 function 120:3 fund 68:20,20 114:6,7 143:7,9 144:16 145:15 146:17 149:6 funding 82:18,24 further 72:21 73:25 92:6 116:20 144:3 145:20 148:6 174:12 183:1 190:14 191:6 210:4 212:17 214:20 future 72:14 81:1 87:16 88:13 93:10 119:6,17 119:25 128:14 142:21 150:17 178:14	Gallatin 66:1,22 66:23 67:10,15 67:22 71:23 85:3 91:14 126:18 219:16 Gallery 60:14 garb 120:20 gas 59:10,12 60:7 60:12 62:12,14 63:4 64:4,6 65:16,20,22,23 66:8,12,14,20 66:21 67:6,7,18 68:3,11,12,13 68:22 69:3,4,6 69:7,8,9,13,16 69:19 73:2,3,20 75:13,14,15,18 75:22,23 76:20 77:2,24 78:1,17 86:5,14 87:5,23 90:9 92:9 97:20 97:22 98:8,13 98:17,21 99:5 99:11,22 103:11,12,18 103:20,24 104:4,6,16 106:8,12 107:1 107:3,5,23 111:2 112:22 114:8 116:13 117:12 120:10 121:14,18 122:22 123:10 123:19 125:13 125:25 126:2,6 126:14,17 128:10,23 129:4,18 130:18 131:23 131:24,25 133:1 135:1 139:19,21,25 139:25 140:1 140:10 141:3 147:15,18,19	147:20,21 149:22,22 150:1,1 151:20 158:4 163:10 163:14 165:5 167:21 169:14 170:9 171:21 171:23 172:3 172:10,13 174:5 176:6,6 181:18,20,20 182:3 185:6,14 185:23 186:12 187:13 195:18 195:23 196:18 196:19 Gassner 220:24 221:4 general 60:19 64:24 78:12 86:13 112:23 119:3 132:22 148:19 169:9 generalizations 113:4 generally 113:14 160:25 generate 76:22 generation 195:14 genesis 98:3 gentleman 97:14 gentlemen 124:3 142:6 Geoff 220:7,9 getting 77:17 128:21 131:21 131:23 162:6 162:13 170:24 give 64:13 103:13 103:13 115:12 given 74:8 76:2 93:6 95:9 133:14 222:15 gives 79:12 165:21 193:7 giving 143:15	165:19 210:25 glad 108:7 go 85:24 91:21 91:23 96:6 97:19 98:15 101:15 108:23 109:25 148:2 149:19 150:20 166:8 171:24 177:20 181:7,8 181:22 182:8 184:5 197:19 197:24 198:16 212:23 213:1,8 goal 196:15 goals 177:7 182:5 goes 93:11 114:21 148:1 going 62:20 77:9 92:3,17 97:5 100:23,24 101:4 109:22 119:10 129:18 129:20 131:8 141:18 143:13 148:21 167:23 170:13 171:23 176:7 178:17 179:21 181:23 184:11 187:4 189:3,12 191:7 191:15 193:24 198:3 good 62:8 64:3 65:7 69:24 78:14 83:17 95:20 102:9 105:11 106:10 110:10 138:8 138:13,14 144:9,10 148:19 154:17 155:7,8 174:17 174:18,20 188:5 190:13 191:12 gotcha 119:9	gotten 146:3 grade 163:19,20 166:2,11,15 167:6,9,15 168:2,5,11,21 grant 66:7 granted 86:6,14 86:18,21 87:11 87:23 great 92:15 greater 115:13 165:19 Greene 68:13 ground 83:4 grounds 195:2 group 66:18 103:9 117:13 117:23 118:7 125:12 162:16 184:23,25 186:13 187:8 195:19 groups 103:20 group's 185:2 Grove 88:1 126:17 growing 87:2 grown 72:3 growth 78:7 80:18 113:2 178:23 187:1 GR-2009-0434 86:16 GR-2010-0192 86:23 GR-2010-0347 86:9 GR-2010-0363 86:19 GR-2014-0086 59:11 62:11 guess 102:12 161:2 guidelines 166:8
<hr/> G <hr/>				<hr/> H <hr/>
G 62:1 gain 186:9 gains 141:10 186:4,14,15				H 215:16,18

<p>half 131:7 141:5 141:12,15,19 146:22 147:8 147:20,20 149:1 151:1 HALL 59:18 halted 178:20 183:8 halting 181:15 Hamilton 66:22 66:24 67:11,15 handout 83:15 88:18,22 94:18 hands 150:21 happen 78:25 87:11 133:4 176:14 happened 193:14 195:18 happy 129:4 hardships 91:15 Harrison 67:20 Harry 60:20 hate 192:8 HC 153:16,18 head 103:16 149:15 172:1 heading 136:7 health 85:23 86:1 Healy 60:9,9 hear 65:15 68:18 75:9 82:25 93:18 97:12 99:24 100:16 110:4,8 heard 77:23 78:16 79:20 87:21 91:14 92:7 93:1 99:18 105:15 124:17 126:2,3 127:19 128:4,16 129:13 154:8 hearing 59:6 62:17 65:21 70:11 71:6 83:1 107:21 138:4</p>	<p>198:10 212:25 213:9 hearings 70:5 91:13 94:19 129:15 heat 85:22 heater 92:2 heating 92:1,1 107:4,4 123:7 heavily 117:18 120:5 heightened 128:1 held 72:14 81:1 150:16 198:18 help 95:23 102:16 133:6 197:1 helpful 152:6 197:23 Henry 219:9 high 60:9,20 85:6 102:6 104:18 113:10,20 120:24 126:11 126:13,25 148:16,18 149:11,13 186:22 higher 162:1 175:24 185:22 195:21 highest 121:18 125:6 highly 111:7,11 111:11 135:8 143:11 198:6,7 Highway 87:25 88:2 hikes 84:21,25 historic 142:16 187:12 historical 146:6 147:25 historically 75:21 187:14 history 68:9 87:21 95:9 96:2</p>	<p>142:20 196:22 hit 148:16 149:11 150:10 hits 130:5 hold 79:10 80:12 81:10 176:25 190:18 holders 67:2 160:22,23 holding 83:6 178:18 holdings 68:21 68:21 158:11 158:12 holds 79:13 114:7 home 85:22 homes 88:5 91:22 91:24 92:14 Honor 63:1,9 65:4,6,17 78:9 109:4 hope 91:5 101:25 178:13,23 hoped 128:24 179:14 hoped-for 180:6 hopes 78:22 hoping 128:13,14 hot 107:4 hotel 93:2 House 98:7 houses 92:14 Howell 68:14 huge 84:10 99:12 hypothetical 127:17,22 130:19 131:12 131:13 164:21 164:24 168:6 171:15 172:5 174:23 175:1 175:14 178:13 179:13 180:8 182:18,22,23 183:11 187:10 197:9 198:4,5</p>	<p style="text-align: center;">I</p> <p>idea 97:19 211:11,13 IDENTIFICA... 62:7 identified 172:16 191:13 identifies 193:12 identifying 79:5 ignorant 191:3 IIF 68:19,20,24 68:25 69:1 114:5,20 115:1 115:6 146:16 157:21 158:23 159:4,13 160:7 170:25 176:4 177:18,20 178:3 179:7,14 IIF's 157:17 158:8,10,13,15 159:8,22 168:7 212:10 ill 77:13 illustrate 112:18 Imhoff 81:14 104:25 216:21 217:9 218:19 impact 76:19 77:1,3,10,16 83:21 99:5 105:16 174:24 175:5,7 189:6 191:11 impeccable 111:22 implications 73:1 implied 210:13 important 85:21 91:6 117:15 123:4,11 211:5 impossible 177:11 184:13 improper 210:14 improve 99:19 imputation 72:6 72:21 88:12</p>	<p>89:4,18 90:6,15 90:17 imputations 71:12 impute 82:5 imputed 75:25 88:14,17 89:16 inadequate 122:15 162:7 162:13 inappropriate 210:21 211:1 incentive 78:6 include 108:25 118:7 131:24 149:21 172:18 176:8 included 88:15 98:7 156:18 includes 88:19 110:23 117:20 131:25 155:14 174:4 176:12 including 69:17 84:24 88:20 92:7 110:6 143:9 income 85:16,18 142:23 166:9 Incorporated 65:16 incorrect 71:19 increase 59:11 62:13 71:11 74:24 75:5 77:8 77:9 81:23 83:19,20 84:18 84:20 85:3,4,6 85:14,16,25 86:3,6,10,13,15 86:18,22 87:7 91:16 92:4,24 93:21 94:23 95:5 100:4 101:5,14,22 104:17 107:20 124:19 133:14</p>
---	---	--	--	---

148:11,15	116:15 117:21	186:17,23	114:25 115:14	issued 132:23
150:7 183:21	118:7 119:17	187:11	115:17 147:9	issues 65:2,10
183:21	137:23 159:25	interesting	148:21 176:4	69:23 70:5,8,10
increased 69:16	160:3 170:25	121:10	180:10,25	70:11,15,20,20
69:17 85:12,23	171:1 172:19	interests 112:12	197:13	71:2,5,7,9
92:23 150:6	172:25 173:4	145:17	investors 66:18	73:17 77:18,22
186:4	178:7 198:5,8	interject 211:14	111:19,21	79:1,9 94:1,3
increases 73:19	informed 107:13	Internet 198:11	112:13 114:17	95:12 96:22
75:10 84:4,11	infrastructure	interrupt 62:23	115:6 127:6,9	97:5 100:6,11
84:14,25 93:10	68:19 80:21	163:23	128:24 141:2	102:15 105:16
100:3,21	123:3 128:8,13	interstate 97:23	141:13 142:21	107:25 108:1,2
101:16,21	129:19	intricate 115:15	143:10 161:1,3	108:24,25
183:22	inherent 130:3	invest 141:14,19	166:7 179:16	109:16 111:23
incremental	inherently 118:3	142:7 143:10	185:2 211:9	124:3,4,23,24
76:23 175:20	178:4	157:22 178:10	invite 83:8	189:14 214:5
incumbent 130:3	initial 146:23	186:25 187:1	involved 96:2,3	item 135:20
indebtedness	147:5	invested 68:24	96:15 99:17	136:19 190:4
161:22	initially 88:8	141:3 147:9	100:6 117:3	items 135:4,15
index 148:14	113:24	156:19 179:8	132:1,4 143:8	190:4
149:4,4,9,10,20	initiated 92:20	182:16 183:13	involves 66:3	I-70 67:16
149:23 185:20	inputs 112:20	183:18	82:4	
192:16 193:8	inquire 91:2 95:8	investing 178:15	involving 89:18	J
193:13 194:3	inquiries 78:11	investment 68:20	in-camera	J 217:18
194:18,19	83:11 95:16	78:19,24,25	197:19,24	James 111:5
215:1	102:24 106:3	89:23 113:10	198:16,18	134:7,14,18
indexes 146:7	insofar 211:2	114:6 123:3	210:2 214:19	135:2 214:10
194:22,24	installation 93:5	143:12 146:23	Iowa 97:15	215:4,6,8
195:6	93:5	148:23,25	issue 64:25 70:25	January 67:11
indicate 186:6	institutional	149:5,18	71:2 72:25	69:7 100:2
indicated 167:16	166:6	150:11 157:18	73:16 74:21	148:16 149:12
212:2	instrument	159:13 162:7	79:17,22 80:8	193:17
indication	161:17	162:14 163:19	82:25 94:1 95:9	jargon 166:18
142:20 195:21	instrumental	165:9 166:2,8	96:18 97:2	Jarrett 60:8 64:5
individual	77:25 97:16	166:11,14	98:11 99:24,25	64:5 102:18
158:10	instruments	167:5,9,12	100:14 102:2	106:10,11
inducement	161:18	168:2 176:2,8	108:24 109:3	108:11,13,16
141:18	insulate 126:20	176:11 177:24	110:5,8,13	108:21 109:20
industrial 99:8	126:21	177:24 179:9	111:9 113:24	214:4
103:19 123:12	integrity 156:7	183:8 196:21	115:18 117:3	Jefferson 59:8
149:3	157:15	196:22	122:8,18	60:5,10,15,21
industry 93:3	intend 83:15	investments	124:14,22	61:3,9 222:16
106:17 111:17	intended 132:7	72:12 93:10	129:22 133:15	Jenkins 218:21
112:21 113:5	intent 176:17,22	115:2 160:7	156:16 165:1	Jenkins 217:20
152:4	196:10,11	163:7 166:9	168:3 174:5	217:21
inference 185:8	interest 69:2	179:15 187:13	185:7 189:7	Jeremy 60:19
information 64:7	108:4 140:6	187:14	191:11,23	64:1 105:12
107:15 115:3	161:7 186:3,3	investor 114:20	196:14 210:15	jeremy.knee@...

60:22	190:20 191:25	212:18,19,25	191:4,23	lack 113:9,11
Jim 116:18	192:4 194:10	214:12	Kliethermes	Laclede 68:14
123:24	194:14 198:1	judgment 142:12	217:23	98:10 117:13
JMA 135:21	198:15 210:1	143:2,5	Knee 60:19 63:25	172:14
JMA-4 136:1	211:2,14,24	July 96:19	64:1 105:11,12	Lake 66:2,4,5,10
JMA-6 117:10	212:19,25	June 114:13	109:21,22	67:22 79:21
JMA-7 146:9,9	214:12	193:19,22	214:4	121:8,20,24
147:4 150:5	Joun 218:11	194:5	know 96:2,21	128:3,7 130:22
Joe 220:24 221:3	Jr 215:22,24	junk 162:1	97:6 100:12	131:8,16
Joel 219:3	Judge 59:16 62:8	166:13	102:14 103:16	156:19 176:10
John 61:6 63:10	62:16 63:6,13	justification 72:5	104:1 105:5	176:12,20
218:8 220:19	63:15,18,23	justifications	128:16 132:16	177:1 181:15
220:20,22	64:3,9,22 65:7	119:2	159:20 160:1,4	181:22 182:18
Johnston 215:12	65:14 78:10	justified 112:3	162:15,22,23	183:13,18
215:14	83:11 94:16	114:1 165:19	164:22 166:6,7	196:12,21
Jones 61:7 63:11	95:16 102:24	justifies 120:19	168:9 170:12	197:4
148:14 185:4	105:9 106:3,7		170:13,14,23	language 89:8
185:10,13,21	106:10 108:8	K	171:4,11 172:2	large 66:18 71:9
192:15 193:8	108:18,22	K 59:22 222:5,21	172:9 175:3	84:16 85:14
194:18,19	109:6,10,13,19	keep 92:4 122:18	177:12,13,17	98:2 99:4,8
195:11	109:24 110:3	133:8 141:22	178:4,8,21,22	122:23 123:12
Jordan 59:15	110:12 124:7	Kellene 59:22	178:24 179:19	185:1
62:8,15 63:6,13	132:10,13,15	222:5,21	179:25 181:9	larger 121:4
63:18,23 64:3,9	132:19 133:18	Kenney 59:16,17	181:23 182:1	175:17
64:22 65:7,14	133:25 134:3	94:17,21 95:4	184:13 185:9	largest 196:24
78:10 83:11	134:10 135:22	95:14 102:25	186:1,20,21	Lastly 74:11
94:16 95:16	138:3,9,11	103:7,12,21	187:10,16	late 97:11
102:24 105:9	143:13,20	104:10,13,21	190:18 191:14	Latham 97:15
106:3,7 108:8	144:1,2,6	105:2,6 106:5	193:25 195:10	laudable 119:13
108:18,22	145:20,25	108:9,10,15,19	195:15 197:1,2	law 59:16 60:2,2
109:6,10,13,19	151:8 152:5,9	132:12 144:8	211:8,20,21	60:3,8,13 62:16
109:24 110:3	152:11,12,15	145:18,23	knowing 114:5	63:3
110:12 124:7	152:18 154:8	174:16 180:14	knowledge	Lawler 65:10
132:10,13,19	154:11,17,21	180:21,23	137:23 154:4	119:21 120:22
133:18,25	154:25 155:4	182:24 188:13	known 66:1,13	123:25 215:16
134:3,10	163:22 164:3	189:6 214:11	68:10	215:18
135:22 138:3,9	173:22 174:10	214:16,16	knows 97:9	lays 147:4
143:20 144:1,6	174:14 180:16	Kenney's 191:9	Kory 217:14	LDCs 86:11
145:20 151:8	183:1,3 188:4,5	191:10	218:14	lead 85:23
152:5,9,12,15	188:9,23 189:1	Kent 216:10,12	KPMG 158:7,15	leading 195:2
154:8,11,17,21	190:20,23	Keri 219:23,25	158:17 159:8	leads 189:20
154:25 155:4	191:25 192:4	Kevin 61:6 63:10	212:11	learn 129:16
163:22 164:3	194:10,14,15	key 117:2	KPMG's 157:24	learned 111:6
173:22 174:10	197:25 198:1	Kim 217:16		197:20
174:14 180:16	198:14,15	kind 95:25 96:17	L	leave 106:1
183:1 188:5,9	210:1,5,23	97:3,6 122:16	L 60:2 216:3	191:22 198:9
188:23 189:1	211:2,14,24	148:10 171:6	labeled 142:16	Lebanon 101:22

left 145:13	lines 164:11	187:17,25	Madison 60:15	62:12 97:1
legacy 67:18	193:1	188:18 189:12	61:2,8	115:12 117:25
Legal 61:7	list 70:10 73:17	193:12	magnitude 83:19	121:5 143:1,5
legislation 103:2	108:2,24	looked 161:2	85:25	174:24 183:6
Legislatively	154:22	172:24	Maine 196:23	matters 64:16
98:5	listed 70:10	looking 135:22	mainline 72:12	212:22
Legislature 96:4	73:17	138:15 141:20	72:20	mature 175:17
98:6	Litigation 59:22	142:15 146:6	mains 92:20	178:21 182:6
lenders 120:1	222:7	149:24,25	178:16	183:9
160:18	little 92:3 95:23	164:11 171:7	mainstream	mayor 93:4
Lesa 217:20,21	96:2 99:18	184:17 187:7	127:12 186:20	McMellen 80:15
218:20	102:22 143:22	189:4 190:2,5	maintain 74:14	82:10 191:21
letter 166:3	151:2,3 163:25	193:6	156:6 157:15	216:23 218:4
198:7	189:24	looks 134:4	major 81:8	218:24
let's 62:24 118:20	live 84:16	213:3	172:13	McNutt 219:4
122:16 130:11	living 85:9,15,18	loosely 116:10	majority 69:2	mean 85:13
130:15,16	92:2 139:12	loss 101:10	making 82:10	104:18,24,25
157:1 163:4,5	LLC 60:14	losses 185:12	105:24 190:11	111:6 117:25
169:12 171:21	loan 162:6,12	lost 76:3 141:10	196:20 211:1	133:9 159:20
187:16 193:16	176:15,16	141:11	211:18	161:2,25
194:17	184:6	lot 79:5 92:15	Manager 153:5	167:16 171:1
level 60:14 72:9	local 76:21 97:24	94:18,19	manner 78:5	174:1 176:1
82:17,20 88:14	98:16 104:5	100:11 128:8	Marc 61:1 63:15	177:5 178:13
88:17 89:4,24	125:12 129:14	128:11 149:24	Marke 220:7,9	178:16 181:6,6
90:21 107:9	located 75:17	171:20 178:16	marked 62:6	184:7 185:14
120:24 121:18	location 121:23	Louie 97:14	64:10 83:15	186:19 187:15
128:23 130:12	Lock 217:25	220:12,14,16	135:6 153:16	187:18 190:11
130:13,14	218:22	Louis 126:15,16	153:19 215:2	meaningful
166:9 178:18	logical 120:18	low 85:5,18	216:2 217:2	105:24
levels 72:22 87:4	logs 107:5	133:8 142:16	218:2 219:2	means 81:5 85:19
89:16,18 90:8,9	long 105:15	150:10 186:2	220:2 221:2	141:6 186:6
90:14 113:10	170:12 177:25	186:17,23	market 107:12	198:2
186:21	longer 99:8 148:6	187:11	112:14 128:15	measuring
leverage 167:22	longstanding	lower 72:1 73:23	128:18 141:15	169:25
Liberty 86:21	73:9 119:16	74:1 89:22	150:10 185:20	mechanism
Licking 88:2	long-term 110:15	157:4,9 164:23	211:6	82:24
life 87:3	115:18,23	167:22 195:22	markets 134:22	media 186:21
light 95:13	120:2 123:23	low-income	195:14	medicine 85:22
119:22	161:6 174:3	82:14 93:22	Marshfield	meet 106:22
limit 75:3 157:4	LOO 182:12	105:18,20	107:16	meetings 144:20
157:9	look 84:7 89:1		Martha 216:13	Meisenheimer
limitation 120:4	90:1 131:15		216:15,17	91:1 95:8 220:4
line 73:8 92:10	142:8,20,21	M	master's 139:2	220:6
115:6 120:1	146:8 167:19	M 59:17 60:8	material 80:19	member 103:8
137:1,3,4,6,8	171:3,3,24	134:14,18	152:3	107:18 140:2,4
142:16 184:15	180:5 181:2,10	215:4,6,8	materials 157:23	144:18,20
190:4,4,7	184:15 187:15	216:20 217:8	matter 59:10	145:3,10
		218:19		

<p>members 96:12 106:15,20 107:5 187:8 198:2</p> <p>memory 96:7 136:25 140:10</p> <p>mention 81:13</p> <p>mentioned 67:23 68:18 72:3 75:2 82:2 114:6 117:1</p> <p>merchant 195:14</p> <p>merged 69:6</p> <p>merger 69:14,20 73:4 121:17</p> <p>mergers 148:5</p> <p>met 71:19,21 80:18 90:22 94:12 177:6</p> <p>meter 76:11 77:7</p> <p>metering 99:3</p> <p>method 82:6,8,9 163:7 185:5</p> <p>methodology 167:23</p> <p>methods 125:14</p> <p>MGU 66:14 67:4 67:7,10,14,18 90:2 121:16 148:8 171:24</p> <p>MGU's 66:16 171:25</p> <p>Michael 217:18 218:16</p> <p>Michelle 215:10 217:12 218:13</p> <p>microphone 163:25</p> <p>middle 83:3,4 190:4,6</p> <p>midpoint 110:24 112:6 122:10 125:8 130:14 155:17 156:11 161:4</p> <p>Midwest 59:22 222:6</p>	<p>Miller 67:21</p> <p>million 80:4,6,7 83:25 84:6,8,10 86:6 94:23 124:16,18,19 124:21 131:3,6 141:12 148:23 150:15 175:6,7 176:5,7,11 184:6 189:8,16 189:19,19,25 191:13 196:15</p> <p>mind 122:18 132:17 141:22 180:20</p> <p>mindful 73:20</p> <p>mine 62:20</p> <p>minimal 150:20</p> <p>minimize 182:4</p> <p>minimum 90:21 178:11</p> <p>minority 145:17</p> <p>minute 91:10 132:17</p> <p>minutes 87:20 109:12 110:1</p> <p>minutia 70:17</p> <p>misapprehend 113:5</p> <p>misled 92:19</p> <p>Missouri 59:1,8 59:10 60:7,12 60:17 61:7,10 62:10 63:5,18 63:21,24 64:4,6 65:16,20,22,25 66:12,14,20,22 67:13 68:3,5,11 68:12,23 69:2,4 69:6,7,8,9,12 73:3 75:9,18,22 75:23 77:25 78:18,19 83:7 86:5 87:23 95:18,21 96:8 96:12 98:6 105:9 106:8,12</p>	<p>106:16 107:17 111:2 113:1 117:12 121:14 121:17 123:5 126:1 128:4 133:1 139:25 148:23 153:8 157:22 167:21 172:10,14 176:3,6,6 178:4 181:20 222:3 222:16</p> <p>Missourians 78:8</p> <p>Missouri's 62:13</p> <p>mistaken 154:23</p> <p>mix 119:12</p> <p>MO 60:5,10,15 60:21 61:3,9</p> <p>mode 113:2,8 121:1 122:22</p> <p>model 111:1 112:5,6,6,18,20 112:20 125:15 125:16 172:16</p> <p>models 111:20 112:5 155:21 178:2</p> <p>moment 100:5 116:8 163:21 174:9 188:22</p> <p>moments 73:24</p> <p>money 71:1 126:25 128:8 128:11 131:7 141:6,10 149:2 157:18 178:15</p> <p>month 85:15,15</p> <p>monthly 74:15 98:23</p> <p>Moody 215:20</p> <p>Moody's 166:5 166:18,18 167:23</p> <p>Moorman 215:10</p> <p>moratorium 66:8 66:9</p>	<p>Morgan 67:20</p> <p>Morin's 162:18</p> <p>morning 62:8 64:24 78:14 83:17 95:20 105:11 106:10 110:10 138:13 138:14 144:9 144:10 155:7,8 174:17,18</p> <p>motion 114:4,12</p> <p>motions 64:18</p> <p>Mountain 88:1,1 126:17</p> <p>move 71:6 76:4 116:25</p> <p>movement 76:6</p> <p>moving 163:4</p> <p>MPG 106:20</p> <p>MPGA 62:6 106:14,25 107:5</p> <p>MPGA's 107:17 221:5</p> <p>MSBA 62:4</p> <p>MSBA'S 220:10</p> <p>multiple 68:8</p> <p>municipal 66:21 66:22 71:25 134:21</p> <p>municipalities 165:10</p> <p>Murray 65:9 79:18,23 110:19 113:13 115:22 120:9 125:7,19 127:10,15,21 131:14 147:17 152:19,21,24 153:3 154:16 154:19 155:7 174:17 188:12 214:14,19 218:5,7 219:6,8</p> <p>Murray's 110:24 114:4 125:3</p>	<p>130:9,20</p> <p>mute 198:10</p> <p>muting 198:16</p> <p>M-u-r-r-a-y 153:2</p> <hr/> <p style="text-align: center;">N</p> <hr/> <p>N 62:1 214:1</p> <p>name 62:15 65:18 66:13 68:2,19 69:9,10 113:12 134:16 152:23,25</p> <p>named 97:14</p> <p>narrative 143:14</p> <p>nation 97:17</p> <p>natural 59:10,12 60:7 62:12,14 63:4 65:16,20 65:22,23 66:8 66:12 67:18 68:11,12,12,22 69:3,4,6,9,13 69:19 73:2,3,20 75:13,14,18,22 75:23 77:24,25 78:17 86:5 92:9 98:13 99:22 103:24 107:1,3 107:23 111:2 112:21 114:8 116:13 120:10 121:18 122:22 123:10,19 125:13,25 126:2,6,14,17 128:23 129:4 129:18 130:18 135:1 139:19 139:20,24,25 140:1,10 144:24 158:4 163:10,14 165:5 167:21 169:14 170:9 171:21,23 172:3,10,13</p>
---	---	--	---	---

176:6 181:18 181:20,20 182:2 186:12 195:18 196:18 196:19 nature 119:9 near 67:16 nearly 68:9 necessarily 116:3 158:20 necessary 89:13 92:20 123:18 143:24 198:8 necessities 85:22 Necessity 68:4 87:6 need 70:13 95:12 103:14 109:4,6 123:8 127:4 141:18,21 143:10 156:25 needs 83:20 100:17 156:5 negative 76:19 77:1,3 99:5 negotiated 67:4 neighborhood 131:4 neither 93:13 120:18 net 73:5,11 neutral 95:1 never 121:14 142:20,23 148:18 149:12 181:23 Nevertheless 113:25 new 67:15 69:16 69:18 74:8 78:17,20 81:1 92:10 170:10 news 69:24 Nitura 215:22,24 nonproprietary 135:8 non-investment	163:19 167:15 168:4,11,21 Noranda 99:12 norm 120:7 normal 125:20 normally 144:21 north 189:25 NOS 62:2,3,4,4,5 62:6 138:6 154:13 215:7 216:6 notable 152:3 note 100:8 198:17 213:3 noted 112:8,10 113:21 120:6 notes 188:18 194:8 222:13 notice 85:8 noticed 94:22 notification 93:7 notion 121:10 not-for-profit 96:9 NP 153:16,18 number 96:3 99:23 100:6 102:15 115:23 121:16 149:21 157:2 182:16 189:19 190:9 numbering 137:7 numbers 82:5 85:7 90:22 95:6 100:16,18,22 121:2 143:4 172:7 181:2 182:15 189:4 190:12 191:3 193:8,13 210:19 211:18 211:23 <hr/> O <hr/> O 62:1 object 75:6 143:14 195:1	210:20 objection 138:4 154:9,10 211:4 objective 119:5 119:13,14 observable 211:8 observation 118:21 120:14 obtain 89:13 182:2 obtained 67:5 69:2 71:14 125:11 181:25 obtaining 165:1 165:11,22 obtuse 179:5 obviously 98:1 98:21 102:4 159:16 160:2 160:25 183:21 186:1 195:15 occur 175:24 178:14 183:20 occurred 97:18 176:13 193:20 193:21,25 October 66:15 offer 102:10 110:20 126:14 138:1 154:6 offered 82:3 99:21 118:1 offering 64:12 81:9 office 60:20 61:1 61:4 63:14,16 71:8 82:2 83:13 152:6 154:22 188:6 222:15 officed 134:22 oftentimes 175:22 oh 92:13 135:25 136:17 okay 64:22 95:14 105:2 135:2 138:19,23	139:8,12,18 140:5,24 142:4 142:15 143:25 152:2,5 154:18 159:2 160:20 164:24 173:16 173:19,20 175:11,15 180:7 190:16 191:22,25 192:25 193:6 194:2 196:1 197:16 old 71:20 75:18 once 73:12 90:14 151:15,21 170:25 186:6 ones 99:4 126:24 one's 151:2 OPC 62:3 71:14 73:6 81:19 94:24,24 OPC'S 219:22 220:1 opening 64:17,24 65:1,15 78:12 78:16 79:21 83:12 93:25 94:3 95:18 105:10 106:8 108:22 109:2 110:4,8,17 124:9 126:3 132:18,22 189:12 214:2,2 214:3,3,4,4,6,7 214:7 operate 107:12 operating 65:24 66:1 67:25 69:17 70:23 120:24 operation 67:10 operations 69:13 112:25 141:11 179:23 opined 165:4	opinion 89:11 151:25 156:1 163:9,13 165:20 181:13 183:12,12,16 183:24 opinions 210:25 opportunity 94:2 150:14,14 oppose 70:4 91:5 opposed 76:9 82:24 136:4 options 123:9 oranges 194:21 order 72:22 89:7 89:9,10 99:18 99:19 110:17 128:12 141:13 160:11 167:13 ordered 81:24 Orders 88:19,24 organization 96:10 organized 96:10 original 67:1 70:10 71:15 72:2 73:5,11 89:2 126:4 originally 66:17 74:6 126:1 origination 111:12 origins 67:24 outcome 155:25 outlying 126:6 outperforming 186:5 outrage 93:19 129:15,16 outside 120:7 overall 83:20 179:10 180:8 overflow 213:6 overlap 160:24 overrule 211:3 owned 66:17,18 owner 177:18
--	---	---	--	--

<p>owners 68:8 93:2 106:21 owns 114:25 Ozarks 66:2,4,5 66:10 67:22 79:21 121:8,21 121:25 128:3,7 130:23 131:8 131:17 156:20 176:10,12,21 177:1 181:16 181:23 182:18 183:13,18 196:12,21 197:5</p> <hr/> <p style="text-align: center;">P</p> <p>P 62:1 page 89:3,8 114:13 117:22 136:15,23 137:4 142:8 164:7 168:25 173:24 182:7 184:17 192:22 pages 115:10 138:17 139:8,9 198:19 paid 75:20 142:23 pan 133:2 panned 133:4 paragraph 89:5 114:12,13 parallel 120:19 Pardon 163:22 parent 66:16 68:22 69:11 114:9 144:25 158:4 parents 91:18 part 66:7 68:15 75:11 99:1 101:18 103:3 104:11 105:24 113:22 128:5 128:20 135:23</p>	<p>partial 84:13 participation 66:25 97:10 particular 112:25 113:6 113:23 114:10 132:24 148:3 152:1 particularly 128:2 148:19 150:8 164:11 parties 64:13 69:24 70:2 84:12 89:4 105:15 198:9 212:22 partner 71:4 partners 65:18 parts 68:5 party 74:18 pass 87:8 passed 88:18 96:5 97:25 98:7 103:2 pasted 88:23 Paul 60:2 63:2 65:19 71:4 paulb@brydo... 60:6 pay 75:13 80:20 84:17 85:19 90:12,12,20,20 103:24,25 106:22 126:25 127:5,6 129:2 131:9,20,22 132:3,8 150:24 paying 81:6 103:24 104:15 129:20 payments 66:25 payout 113:11 payrolls 106:21 pays 150:12 peculiar 140:14 pending 64:18 108:1</p>	<p>penetration 121:2 128:15 128:19 177:7 people 91:19,19 91:20 92:3 94:14 128:22 129:3 186:25 people's 91:21,24 percent 66:19 74:16 82:18 84:17,17,20 85:3,4,5,5 88:4 92:25 101:6,7,7 101:8,12,15,19 101:22 110:23 110:25 112:2,3 112:7,10 113:22 114:1 115:7,8,20 116:5,6,6,6,9 116:11,22,24 117:24,24 118:3,3 121:15 121:15,19 122:13 127:10 127:19,20,23 127:23 130:14 130:14,15 131:4,6 136:2 141:6,15,19,21 142:3,18,24 146:5,22 147:8 149:1 150:19 150:21 151:1 155:10,18,21 155:25 156:11 156:14 157:10 157:13,20 161:4,8,8 167:18 168:8,8 169:22,24,24 170:5,5 174:6 177:15,16 182:13 184:8 184:24 185:11 185:20 186:7,8 187:16,18,18</p>	<p>196:16,16 percentage 81:25 101:18 136:9 percentages 75:6 75:7 perception 104:14 perfect 97:3 perfectly 173:19 period 145:6,7 146:18,21 148:6,10,14,19 149:17 150:25 151:2,4,17 169:5 170:4,10 185:11 187:25 periodically 148:4 periods 193:12 period's 170:12 permanent 176:18,23 184:9 person 148:2 personal 188:17 personally 222:8 persons 198:8 persuading 118:18 Pettis 67:20 phase-in 102:4 Phil 217:25 218:22 phones 62:18,19 phrase 118:10 Ph.D 218:11 Picard 216:4 pick 147:11 148:3 194:17 picked 148:12 pieces 153:22 pipeline 99:7 185:15 pipelines 97:23 104:8 place 76:6 78:22 87:14 89:22</p>	<p>91:7 93:6 95:11 222:9,14 placed 94:9 placing 87:16 Plains 88:2 126:18 plan 98:4 131:1,2 134:1 182:11 planned 181:18 planning 196:14 plans 170:16 171:3 196:20 197:17,21 plant 72:14 74:9 80:25,25 81:1 113:10 plastic 91:22 play 112:15 125:12 183:24 185:16 189:19 191:3 played 184:14 playing 107:9 please 78:15 83:17 85:13 90:25 91:2 93:16 105:12 110:11 124:10 132:18,19,20 134:8,12,17 152:23 162:9 163:21 174:9 188:25 pleasurable 100:9 plus 74:4 98:17 98:18,18,19 point 125:10 148:13,16,18 149:11,13 150:4 152:17 155:15 161:9 166:24 167:11 167:14 184:12 186:12 191:5,7 198:17 pointed 110:13</p>
--	---	---	---	---

132:24	practice 73:9	122:3	82:15 96:14	174:25
points 110:24	76:25 125:20	price 73:4 107:10	105:20,21	proposing 74:5
113:16 120:9	predecessor 86:5	150:5 187:3	programs 77:21	74:19 175:14
125:20 147:17	87:13 121:13	prices 123:6	progressed 81:18	proposition
150:5 168:22	172:3	150:9 195:17	project 87:16	115:9
169:10 210:10	predecessors	Pricewaterhouse	89:14 90:13	prospectus
211:11,12	126:9 132:24	159:21 212:11	120:12	158:13
policy 119:16	predicted 87:11	Pricewaterhou...	projected 90:14	protect 84:23
122:17 123:2	89:12	159:25 160:5	90:21 115:22	87:13,15 90:17
123:17	preference	pricing 111:15	116:5,15	91:7 94:14
pool 97:19	175:12	112:5 125:15	119:17	127:25 130:2
Poor's 166:4	prefiled 64:10	primarily 106:20	projection 88:4	130:10,15
168:15	preliminary	106:22 111:1	116:2	133:7 175:24
populated	64:16	125:14	projections	197:12
126:15	premise 156:4	primary 84:23	71:15 79:8 87:9	protecting 84:24
Porter 216:5,7,9	211:17	86:2 94:1	projects 90:24	protection 90:19
portion 72:12	premised 179:1	112:17	97:17	protections 91:6
107:21 151:15	179:15,17	principal 97:13	promised 79:6	99:13
153:12 198:12	premium 112:3	principles 111:15	130:1 151:11	protects 90:6
position 71:5	160:12	printed 173:17	promises 79:11	proven 120:25
81:23 82:11,16	prepare 153:10	Prior 143:7	79:13 130:4	proves 94:12
84:2,4 157:20	prepared 135:3,4	priority 161:22	promoting	provide 67:18
178:19 181:21	135:11 137:17	private 68:20	106:17	71:4 77:21 78:4
positioned 117:5	153:11 170:22	114:25 123:3	propane 60:12	78:6 88:20 94:3
positions 83:10	171:7,8,13	123:20 141:17	64:4,6 99:22	106:22 118:12
possible 119:24	present 71:18	158:21	106:8,12,15,15	123:4,8 174:2
133:9 191:8	109:14 111:4	pro 76:12 84:13	106:17,19,23	provided 68:12
post 69:20	123:24 222:8	84:15	107:1,3,7,10,19	85:7 98:16
Poston 61:1	presented 98:5	probably 95:24	107:22 112:16	115:4 118:11
63:15,16 83:14	156:23	102:21 109:9	123:6 129:6,11	172:25 212:7
94:20 95:2,7	presenting 130:6	117:2 190:14	147:20	provides 83:5
129:13 132:15	presents 83:2	problem 194:19	properties 69:13	117:11
132:20 133:23	173:12	problematic	property 69:17	providing 72:23
134:2 143:13	Presiding 59:15	112:18	proposal 72:15	proving 94:8
152:8 154:24	Presley 93:4	problems 85:23	73:1,6 93:21	122:6
188:8 214:3,7	press 166:13	170:24 195:4,8	112:9 115:7	provision 89:17
214:20	presumptively	proceed 134:5	116:4	99:6
Poston's 126:3	118:16	proceeding 75:24	proposals 73:21	provisions 76:16
post-constructi...	pretty 98:9	proceedings 59:5	propose 142:12	proxies 184:15
69:20	174:20 195:16	62:23 222:8,11	142:17	185:7
post-hearing	198:13	process 103:22	proposed 72:16	proxy 115:17
133:16	previous 79:6	products 106:23	73:22,25 74:3	117:21 118:6
power 185:15	176:16	professional	74:11 75:3,4,7	125:12 147:13
195:10,14	previously 78:2	143:2,5	77:19 80:23	147:15 162:16
powerful 151:7	111:7 120:6	profit 132:7	82:9,24 84:8	172:15,25
practical 112:14	122:23	program 75:12	91:16 130:20	173:4,12
practically 66:16	pre-Lake-of-th...	76:24 77:20	131:13 140:8	184:23,25

<p>185:1,4 186:13 195:18 prudent 123:19 PSC 67:5 public 59:2 61:1 61:1,4,5,7,10 62:10 63:7,14 63:16,17 68:4 71:8,10 72:25 82:3 83:13 86:1 91:3,13 94:18 96:11,22 102:5 102:17 106:18 108:4 122:16 129:14 146:4 152:6 153:8 154:22 188:6 publication 151:17 publicly 146:3 published 211:9 pull 177:8 purchase 67:5 69:3 73:4 75:13 98:2 103:9 147:5,5,6 purchased 67:7 68:25 141:2 146:17,17,20 purchasing 98:13 143:7 pure 125:12 147:18,19 185:16 purely 182:18 purpose 99:14 purposes 81:4 90:11 110:22 put 87:14 91:7 92:10 95:11 126:24 128:8 128:12 131:7 147:11 148:22 151:15,17,21 157:3 159:21 183:23 191:18 puts 103:20</p>	<p>151:13 putting 90:7 112:19 130:7 P.C 60:3 63:3 p.m 213:10 P.O 60:4,21 61:2 61:8 <hr/>Q<hr/>qualified 142:25 quality 186:16 187:11 quantifiable 211:6 quantified 140:13 quarter 148:22 148:24 question 86:24 94:22 101:24 103:8,22 108:16,17 124:12 137:9 143:22 144:13 151:9 158:25 162:8,19 163:8 171:12 180:22 184:18 188:13 189:5,20,21 190:13 191:8 191:10,18 195:2 210:21 210:21 211:15 211:16,25 questionable 95:10 questioning 212:9 questions 83:9 107:22 108:7,8 108:9 124:7 132:10 133:19 133:24 137:16 137:19 143:15 144:3,6,8,11 145:19,20,21 145:24 146:1</p>	<p>151:8 153:24 154:24,25 174:12,14,16 174:22 180:16 180:19,23 183:1,4 188:6 192:3,7 194:13 196:1,3 210:3,9 214:11,12,12 214:16,16,17 214:20 quickly 101:4 149:8 quite 67:25 97:4 107:7 148:20 149:23 quote 91:12,17 92:5,9,17 93:4 quotes 88:19 <hr/>R<hr/>R 62:1 215:12,14 216:13,15,17 220:12,14,16 222:2 Raeanne 93:4 raise 95:12 raised 86:7,15,18 raises 86:24 ramp 82:20 ran 150:25 range 110:22 113:21 116:24 125:9,10 155:9 155:14,20,24 157:9 rate 66:3,8,9 69:19,21 70:16 73:16,17,18 74:4,17,24,24 75:5,5,24 76:1 76:2,5,9,10 77:6,10 79:17 79:19,24 80:7 80:25 81:3,15 81:17,20,23,23 81:25 83:5,19</p>	<p>84:11,20,21,24 84:25 85:6 86:3 86:6,13,15,17 86:18,20 87:7 89:22 93:8,10 93:24 94:10 95:5 96:17 99:21,25 100:2 100:4,14,25 101:5,5,8,11,21 101:22,23 104:16,18,19 107:20 108:25 110:6 111:8 112:9 122:1,11 131:3 141:21 141:22 142:1,2 142:16 147:8 148:8,11 149:1 149:16 150:8 150:15,16 161:7 175:17 177:16 178:5 180:9 184:23 185:2 186:3,17 186:23 187:11 189:22 214:5 217:11 rated 163:11,15 166:14 167:1,1 167:5,8,12,13 168:19,20 169:6,7 ratemaking 82:6 82:8 90:11 110:21 119:9 123:2,17 179:18 ratepayer 132:6 ratepayers 79:15 80:2,10 84:18 84:24 86:8 90:20 91:8,9 92:7 127:5 131:19,20 133:7 197:4,13 rates 73:13 76:16</p>	<p>77:17 78:4 79:14 81:10 82:10 83:21,23 84:8,9 85:10 86:7 88:14 92:17 93:21 100:22 102:5 104:17 107:11 119:16 129:10 129:11 151:23 170:10 186:3 197:1 rating 116:19 164:10,15,19 164:20,22 165:1,5 166:2,8 166:19 167:20 167:24 168:1 168:15 210:14 ratings 160:14,16 161:16 163:5 165:12,22 ratio 74:15 117:16 118:22 119:24 121:14 121:25 169:15 169:19,25 170:10 171:18 172:17 179:15 196:16 rationale 119:3 ratios 164:15 rbrownlee@rs... 60:16 reached 183:10 183:14 reaching 87:8 read 84:1 89:9 93:16,18 98:25 119:4 128:17 136:7 137:2,10 139:8 163:14 165:16 170:15 181:9 184:20 reads 136:1 137:1 ready 110:4</p>
---	---	--	---	---

129:17 134:3 134:11 real 74:9 100:9 100:10 129:4 129:22 realities 119:23 reality 97:8 120:8 realized 87:4 reallocation 74:19 really 79:1 80:7 97:7,16,18 98:12 100:10 100:23 101:20 104:3 120:17 144:12 148:9 159:8 179:11 181:23 185:18 186:19 190:13 211:11 realm 117:9 real-world 111:22 reason 106:25 148:12 173:10 178:20 186:15 reasonable 70:7 79:14 81:10 83:3,5,23 85:1 120:12 127:9,9 130:12,13,13 155:10,25 187:12 reasonableness 117:9 125:16 reasonably 123:17 reasons 86:2 94:13 rebuttal 135:5,23 136:22,23 137:4,18 138:22 153:15 156:10 182:8 215:6,12,16,22 216:7,12,15	217:12,14,16 217:18,20,21 217:23,25 218:3,5,7,8,10 219:23 220:3,7 220:14,20,24 221:6,8 recall 96:7 130:25 140:8 174:4,7 196:3 197:10,17 210:10,16 212:11 recalling 149:14 recapitalization 181:17,19 recapitalized 182:12 196:18 receive 114:23 116:19 185:6 received 91:11 138:5,7 141:5,8 141:9 145:11 146:20,22 154:14 185:20 receiving 69:5 recess 109:7,25 recited 109:15 recognition 112:14 132:25 recognize 72:9 72:19,22 90:17 100:15 recognized 113:13 126:11 recognizes 125:22 recommend 184:8 recommendation 110:25 112:4,7 113:16 118:21 125:6 126:4 130:10 155:17 156:4,11 157:5 190:10 recommendati...	125:3 155:24 212:15 recommended 73:23 81:15,16 88:8 122:10,12 125:4 156:12 166:25 197:9 recommending 82:13 94:24 133:10 172:6 recommends 94:23 reconcile 189:17 190:19 reconciliation 175:4 188:14 189:24 190:22 219:11,13 Reconsideration 114:12 reconsidered 81:3 record 64:11,20 109:14,20,25 110:4 114:2 134:17 151:10 198:12,12 212:23 213:1,8 recording 73:10 recoup 93:9 recovered 136:2 136:9 recross 133:24 134:1 152:6,9 188:6,9 210:3 Recross-Exami... 188:11 214:17 214:20 REC'D 215:2 216:2 217:2 218:2 219:2 220:2 221:2 redirect 143:23 152:12 191:25 194:14,16 210:3,4 212:18 214:18,19	reduced 74:13 89:24 104:16 129:8 refer 100:23 111:3 122:4,5 122:21 168:24 175:3 reference 152:3 referenced 149:4 referred 67:17 188:12 197:16 referring 114:10 189:9 190:21 193:2,4 refinance 131:1 reflect 75:25 refreshes 136:25 regard 69:23 72:17 74:23 76:25 77:22 118:20 regarded 111:7 regarding 73:16 88:19 region 79:21 regulated 73:10 185:17 186:22 Regulatory 59:16 62:16 153:5 reinvest 147:2 reinvested 141:4 150:7 reinvesting 150:8 reinvestment 146:25 151:6 187:22 188:1 reject 82:9 related 71:2 75:16 144:12 relating 65:2 relative 113:9 161:10 relatively 74:8 reliance 112:17 relied 91:3 relies 110:25	remain 66:10 70:15 74:23 77:15 remained 95:1 remaining 69:1 77:18 108:24 124:14 145:16 remains 119:14 remarks 94:3,4 106:2 124:5 remember 103:6 128:25 136:14 165:14 172:7 remind 64:12 remove 70:9 114:18 130:22 130:23 removes 79:25 80:24 remunerated 139:15 Renato 215:22 215:24 reorganizations 68:8 Repeat 162:8 report 125:18 151:21 153:13 216:24 217:3,5 217:10 REPORTED 59:21 reporter 63:5,11 63:22 64:1,8,13 153:1 222:6 REPORTER'S 198:17 reporting 158:13 represent 105:13 107:11 159:17 184:10 representation 159:3,10 184:9 representative 149:23 represented 96:25 97:1
---	--	--	---	--

<p>124:22 representing 65:20 67:2 106:12,15 108:14 represents 118:23 request 70:4 83:19 84:3,5 85:12 86:12 87:1 94:15 124:17 129:8 158:25 requested 74:14 86:5 102:6 requesting 84:1 84:19 86:25 94:22 requests 83:24 114:18 require 72:21 99:7 114:17 180:5 required 73:2 99:2 115:1 162:2,22 166:7 177:16 178:11 179:1,16 180:3 requirement 70:17,20,22 71:10 72:7 73:1 73:12,14 74:1 77:11 80:5,14 117:2,6 122:10 124:14 153:12 158:12 174:25 189:14 requirements 70:24 95:1 114:5 requires 76:8,18 requiring 90:19 resell 98:17 reservation 118:11 residential 86:8 91:15 92:14</p>	<p>93:23 residual 161:1 resold 141:16,17 resolution 70:7 resort 109:5 respect 119:19 123:22 142:13 respectively 135:7 response 64:21 76:4 137:9 144:12 188:13 191:9 192:7 212:24 responses 143:14 responsive 143:19 rest 80:1 147:19 restate 179:4 resulted 76:3 resulting 77:16 results 77:7 120:4 128:22 return 71:2 79:18,19,24 80:7 89:23 92:12 108:25 109:1 110:6,6 110:14 112:6 112:10 113:15 113:22,25 114:5,15,17,23 115:5,14 122:11,12,14 124:12 125:5,6 125:11 127:3 129:8 141:6,8 141:22,23 142:1,3,7,17 146:10,10,13 146:14,22,25 147:9 149:1,16 150:18 151:23 155:10 156:5 157:3,4,13 161:4,11 162:2 162:7,14,22</p>	<p>177:17 178:11 179:1,17 180:3 180:9 184:23 185:2,5,9,19,20 185:25 186:11 187:24 188:1 189:22 190:8,9 214:5 returned 142:22 148:18 149:12 returns 115:1 129:2 133:2 146:3,6 157:19 157:19 161:9 180:2 186:2 revenue 70:17,19 70:22,24 71:10 72:7 73:1,12,14 74:1 75:24 76:3 76:22 77:11 80:5,13 84:4 94:23,25 117:2 117:6 120:25 122:9 124:14 136:2,9 153:12 174:25 189:6 189:14 191:11 revenues 59:12 62:14 71:13 72:22 74:15,16 76:13 82:18 84:14,15 161:23 review 114:24 reviewed 172:21 reviewing 114:19 115:1 revised 59:11 62:13 136:7 reward 127:6,9 130:11,16 Richard 60:13 63:20 95:20 Rick 119:20 123:25 215:16 215:18 right 62:20 65:14</p>	<p>78:12 84:9 96:10 103:11 105:23 133:11 147:10 154:20 154:21 167:17 172:1 176:10 180:12 182:24 190:8 194:17 198:15 ring 62:22 rise 85:10 risk 78:25 79:2,3 79:4,7,25 80:10 80:13 81:11 83:7 87:8,16,17 89:11,15,25 90:4,5,7,23 91:9 94:7 110:23 112:3 113:9 126:12 126:12,14,21 126:22,22 127:7 128:1 130:7,12 140:9 140:12,15,18 140:19,20,22 140:25 141:25 142:2,11 143:18 150:17 155:15 160:11 161:14 162:5,6 162:12,13 163:6,7 179:23 183:21 185:19 185:24 186:10 210:15 riskier 161:21 185:14 riskiness 113:14 risks 113:8,18 130:2,16 141:23 160:21 160:22 161:10 risky 121:4 127:1 127:2,2 143:11 road 130:5 ROBERT 59:16</p>	<p>Robin 217:23 Robinett 218:9 ROE 73:23 113:15,21 115:7 133:8 140:14 156:3 156:11,13 157:5,9 Rogersville 66:2 67:24 68:16 71:17 85:2 219:18 room 198:10 Roth 219:23,25 roughly 149:9 189:8 rounding 124:20 rounds 213:4 RPR 59:22 222:21 RSBIII 60:14 RSMo 76:17 rubber 130:5 rule 70:2 run 101:4 119:15 Rupp 59:18 145:25 146:1 183:3,4 188:3 192:9,9,10,10 192:12 214:12 214:17,20 R.E 59:15</p> <hr/> <p style="text-align: center;">S</p> <p>s 59:11,16 60:13 60:20 62:1 sacrificing 85:20 saddled 119:7 safe 78:5 safeguard 127:24 safely 106:24 115:11 safety 86:1 106:17 sale 111:12 143:8 sales 76:9 77:6 satisfied 94:9</p>
--	--	---	--	---

satisfies 133:13	159:17	94:14 107:2	130:7,11,15	107:7 120:8
save 94:4	second 72:25	126:2 144:15	131:18 132:6,8	141:3
savings 98:3	109:5 190:6	service 59:2,12	141:25 150:13	single 75:20
105:24	Secondly 120:9	61:7,11 62:10	shares 69:1	91:18 99:12
saw 150:9 160:4	Section 76:17	63:7 67:18	145:11,14,16	100:13
saying 104:22	sections 88:23	68:13 69:21	146:21	single-digit 89:24
168:3,5 171:10	securities 111:13	72:23 74:13	sheet 222:10	133:2
178:12 180:3	111:17 141:15	78:1,5 79:15	shift 91:9 94:7	sir 94:20 133:23
181:10 183:18	159:18	81:6,14 87:12	shock 73:16,17	134:2,17,20
says 84:5 114:15	security 85:16	87:20 88:5,16	93:24 96:18	139:3,6 143:1
116:1 174:1	141:17	88:20 92:20	100:14 101:23	146:2 152:8
175:5 177:10	Sedalia 67:16	94:25 98:14,18	shocking 100:18	164:25 188:8
schedule 117:10	see 84:2,7,10	99:16 101:2	short 87:3	191:9
135:21,23	85:10 89:3	105:25 118:6	shortcomings	sister 116:10
136:1 146:8	93:20 102:21	122:23 123:19	112:19	120:10,21
147:4 172:18	121:20 125:4	125:18,25	Shorthand 222:6	site 146:11
173:11,14	133:1 136:25	126:6,14,17	shortly 66:20	sitting 155:2
213:3	141:21 143:10	130:18 131:21	71:6	159:7
scheduled 65:8	156:25 164:13	131:22 153:8	short-term 174:4	situated 121:6
212:21 213:4,5	177:9,18 178:1	153:13 175:17	174:5	situation 97:8
schedules 118:5	178:7 179:4	182:6 216:24	show 118:2	117:4 120:8
173:5,7 217:7	181:10 213:3	217:3,5,11	173:14	122:20 168:9
219:15,17,19	seeing 64:22	services 59:22	showed 89:21	179:25
219:21	172:19 175:16	62:14 75:16	129:14	situations 179:19
school 60:17	seek 114:18	106:23 153:6	shows 64:17	six 86:10 185:16
63:19,21 75:10	seeking 91:8	222:7	115:5 173:5,11	size 73:18 83:20
75:12,19 76:17	seen 75:11 125:7	serving 132:1	175:6	86:12
95:19,21,25	128:18 159:24	session 198:18	sic 184:22	slang 166:12
96:8,11,14	160:1 170:15	214:19	signatories 70:3	slate 105:22
97:16 99:16	sell 106:15 146:4	set 77:11 78:3	signed 98:9	slightly 150:6
104:11,14	selling 128:10	81:9 82:19	significant 69:15	small 71:24
schools 75:11,12	Senior 59:16	88:14 107:11	77:7 113:8	91:14,25 92:1
75:15,17 76:3,5	61:1	142:12 197:1	175:25 176:2	106:21 126:6
76:8,15 77:1,6	sense 211:12,12	222:9	178:15 186:14	141:10 172:12
77:8,9,14,16	sensitive 125:22	setting 118:6	186:15 196:20	175:20
96:12,15,16,18	177:21	150:16	significantly	SNG 114:18
96:23 97:4,8,13	sensitivity 89:20	settled 100:13	105:16 113:17	115:1 163:14
97:19,25 98:15	Seoung 218:10	settlement 84:13	silence 62:18,19	164:23 167:21
98:17 99:3,7,11	separate 104:8	severe 93:24	silenced 62:21	167:25
99:17,22 100:3	131:11 177:8	sewers 172:13	silent 123:7	Social 85:15
100:19 101:21	separates 124:14	SFV 74:7	similar 62:19	sold 145:14
102:8 103:19	September 117:7	shake 150:20	72:15 86:11	solution 101:23
scope 159:14	137:2 146:19	share 146:15	90:18	102:10
SCOTT 59:18	serve 67:6 74:1	shareholder	similarly 121:6	somebody
search 163:24	87:24 92:20,22	140:6	simple 100:7	144:18
season 123:7	106:17 115:17	shareholders	simplistic 98:25	somewhat
SEC 158:20	served 65:24	79:4 126:23,24	simply 87:4	112:18 117:3

137:7 sophisticated 114:24 sorry 162:8 164:1 192:4 198:5 sort 85:16 99:10 100:19 source 78:2,7 159:4 162:4,10 163:1 sources 74:10 97:21 south 67:16 92:6 southern 68:3,5 68:11,11 69:2,4 69:6,12 73:3 75:18,22,23 87:23 117:14 121:17 132:25 141:11 176:5 181:20 space 92:1,3 107:3 speak 100:19 102:18 163:24 special 97:3 99:3 specific 106:2 140:22 160:10 162:19,21 169:10 178:2 193:17 specifically 164:20 176:4 176:14 178:23 187:20 specifics 77:21 165:15 speculation 114:19 130:17 speculative 126:23 129:1,1 spell 152:25 spend 149:24 spending 128:7 128:11 spent 93:25	spike 123:6 split 74:25 sponsored 81:14 spread 162:15,21 162:24 163:1 166:25 167:12 167:14 168:19 168:21 169:6 spreads 161:14 161:16 spring 96:18 Springfield 87:25 Sr 220:12,14,16 ss 222:3 St 126:15,16 stable 112:21,24 staff 61:6,10 62:3 63:7,10 72:15 72:17 74:6 75:4 75:8,25 76:13 78:13 79:18,22 80:14,17,23 81:9,13,16,18 82:5,7,8,10,12 82:24 83:9 87:10 88:7,10 93:14 94:23 95:6 100:25 101:1,8 104:24 110:18 114:3 114:14,15 115:4,12 118:9 118:17 119:4 121:7 124:9,15 124:18 126:1 130:20 133:9 138:10 152:9 152:19 153:7 153:12 154:13 175:4 177:9 190:10 191:18 191:19 192:1 194:14 210:3 211:15 216:24 217:3,5,7,10 219:13,14,16	219:18,20 Staff's 70:21 79:12 80:5,11 81:15,22 82:16 83:2 112:17,20 113:20 114:11 115:8 116:4 118:5,6,21 119:1 122:10 125:17 126:4 152:16 174:25 175:14 191:16 214:13 216:19 217:1 218:1 219:1 stand 134:8 191:24 standalone 183:19 standard 127:11 166:4 167:24 168:14 standpoint 158:20 stands 105:19 start 69:23 91:13 105:23 118:20 started 97:11 115:24 147:22 starting 176:3,4 starts 198:6 state 59:1 60:20 65:25 67:13 78:1,7 113:1 114:21 122:23 123:5,8,15 125:25 134:16 152:23 157:22 164:14 176:2 178:4 222:3,16 stated 70:3 85:9 156:10,15 statement 65:15 78:13,16 83:12 84:2,4 95:18 105:10 106:9 109:3 110:8,17	112:23 114:11 124:9 126:3 146:2 156:17 158:15 159:21 171:13 173:10 189:12 214:2,2 214:3,3,4,4,6,7 214:7 statements 64:17 64:25 65:2 108:23 110:5 158:20 159:11 159:19 160:7 states 155:9 162:4,11 statistics 151:23 status 113:19 statute 76:18 77:15 99:14 steady-state 120:24 Stenotype 222:11 222:13 step 73:13 91:24 STEPHEN 59:17 stick 109:22 129:5 stipulation 89:3 89:17 102:19 108:1,3 stipulations 69:25 70:1,4,6 70:8,9 102:14 stock 114:7 145:12 147:6 150:5 162:2 195:17 stocks 146:4 149:20 151:14 151:16 186:5 Stoll 59:17 103:5 145:21 180:18 Stone 68:14 storm 97:3 straight 74:5 81:17 strategic 170:15	171:3 197:17 197:20 strategy 168:7 177:22 178:25 streams 120:25 Street 60:9,20 61:2,8 structure 71:3 79:24 93:8 109:2 110:7,16 116:5 117:1,7 117:11 118:2 118:16,19,25 119:6,20 120:5 120:11,13,15 121:9 122:3,8 122:13 124:1 125:1 127:14 127:16,18,18 127:22 130:19 130:21 131:12 131:15 156:12 164:21,23 167:25 168:1,6 169:13 170:4 171:16 172:4,5 172:19 173:4 174:6,23 175:1 175:2,5,8,14,20 176:18,23 178:6 179:20 179:22 180:8 182:2 183:15 184:10 189:7 189:22 190:3 190:10 191:11 197:10 structures 175:13 studies 71:16 82:4 study 74:13 81:15 118:6 149:13 150:3 stuff 211:1 subject 75:17 91:2 105:3
---	---	--	--	--

162:17 183:6	81:10,21 82:13	171:12	system 66:6 67:1	targets 71:19,20
subjective 181:1	82:15 83:6	suppliers 97:21	71:19,24 72:13	71:20,22
181:5,6	84:16 85:2,3,7	supply 67:6	72:23 75:14	tariff 76:1,2,5,8
submit 118:15	85:11 86:5,25	98:14	80:1 81:2 90:2	76:18,19 77:17
119:1 122:14	87:8 91:8 92:9	support 73:6	99:20 104:3	99:4
subsequent	94:7,14 97:24	87:5 116:17	140:21 141:2	tariffs 59:11
147:6	103:24 107:6	supporting	143:8 183:23	62:13 98:10
subsequently	109:3 110:9	118:13	systems 66:23	Tartan 68:2
67:14 115:3	111:2,3 112:11	suppose 118:11	67:5,8,11,15,16	87:22 88:11,21
subsidiaries	113:1 114:8,8	118:12	67:18 68:15	89:2,5,11,14,20
181:17,19	115:2 116:12	sure 62:20,22	71:25 178:3	89:24 90:6,18
subsidiary	116:18,19	104:20 109:6	S&P 166:21	126:4
116:12 145:2	117:5,12	169:2,8 174:2	187:16	Tartan's 88:3
substantially	120:13 121:1	179:11 181:23		89:23
70:12 137:20	121:13 132:14	185:21 188:20	T	task 159:6,13
success 87:16	132:25 135:1	191:16	T 59:18 221:6,8	tasked 84:22
90:23	138:6 139:19	surprise 93:19,22	222:2,2	tax 123:14
successors 89:6	139:20,24,24	129:15,16	table 117:22	taxes 69:18
89:19	139:25 140:9	surprised 125:4	150:4 173:25	taxing 76:21
sudden 92:16	144:24,25	surprisingly	take 62:24 88:5	Taylor 216:10,12
sufficient 76:22	155:5 157:24	115:5	89:12 90:23	technician
156:5 157:14	158:4,4,11,19	surrebuttal	101:16 108:19	104:20
157:21	158:23 159:12	115:10,25	109:11 110:16	telemetry 99:2
suggest 104:24	160:7 163:10	122:6 135:6,24	115:12 126:16	tell 111:18,20
123:16 127:8	163:14 165:5	136:21 137:18	141:23 142:7,8	149:9 161:9
130:6	167:21 168:6	153:18 156:17	150:21 156:16	170:14,16,17
suggestions	169:14 170:8	157:25 161:6	168:3 185:6	171:4,25
102:3,5	171:21,23	164:6 169:3	187:10,11	172:20
suggests 71:11	172:2 178:17	184:18 192:23	188:18 191:6	telling 92:16
Suite 60:9 61:2	182:10 188:9	212:4 215:8,14	194:10 212:22	ten 87:24 109:25
summary 83:2	196:22	215:18,20,24	taken 93:22	140:23,24
Summit 59:10	Summit's 71:5	216:8,17	108:2 110:2	172:8
60:7 62:2,12	73:4 74:8 77:4	218:12,14,16	146:19 195:16	tend 118:2
63:4 65:16,20	77:19 80:18	218:18,20,22	takes 78:22	tender 138:1
65:22 66:7,12	83:24 84:1,19	218:24 219:3,5	191:24	154:15
66:17,19 68:21	86:4,12 87:12	219:7,9,25	talk 87:19 91:10	tenets 185:24
68:22,24 69:1,9	87:20 88:20	220:5,9,16,22	100:2 130:25	186:10
69:11,15,19	91:11 115:13	221:3	talking 80:9	term 73:18
70:6,21 71:18	116:3,22 118:9	survey 151:15,18	93:25 107:3	166:10,12
72:9,11,16 73:2	120:10 132:24	susceptible	159:14 177:21	176:15 177:25
73:19,22,24	134:4 214:9	195:12	192:15 194:1	180:5
74:3,6,10,11,13	215:2 216:1	Swarengen 60:3	talks 162:20	terminology
75:3,6,13,21	sums 157:18	63:3	Taney 68:15	169:17
76:4,14 77:13	198:13	swing 118:23,24	taped 91:22	terms 74:17
77:21,24 78:3	supervision	swings 195:13	target 82:17	110:17 166:3
78:17 79:6,10	135:12	sworn 129:25	119:8 179:22	177:5 189:18
79:13,20 80:12	supplement	134:9 152:20	targeted 175:19	territories

EVIDENTIARY HEARING 8/19/2014

175:18 182:6 territory 69:22 75:18 87:21 Terry 60:8 64:5 106:11 Terry@healyl... 60:11 test 119:18 125:16 146:18 148:10 170:4 testament 123:7 testified 91:17 92:8 93:4 111:8 134:14 139:9 152:21 168:13 testify 112:1 116:18,20 119:21 120:22 testifying 91:1 107:20 108:3 134:25 testimony 64:11 79:5 81:16 82:3 94:19 99:1 107:24 110:18 110:20 111:4 114:4 115:10 115:24 116:1 117:11,23 119:4 122:6 123:24 125:17 128:17,18 131:1 133:13 135:4,5,5,6,11 135:16 136:1 136:12,16,19 136:23 137:5 137:14,17 138:15,22 139:16 142:9 145:22 146:9 147:14 149:8 152:16 153:11 153:15,18,22 153:25 155:9 156:10,17,24 157:12 161:3,5	161:6 162:25 163:13,17 164:6,6 165:14 165:16 166:23 168:24 169:13 170:8,19,22,24 171:2,8,8,12,14 171:16 172:22 173:5,7,25 182:8 184:18 187:19 189:7 189:21 192:16 192:17,20,23 193:1,2,5,7,7 211:3,17 213:6 215:4,6,8,10,12 215:14,16,18 215:20,22,24 216:3,5,7,8,10 216:12,13,15 216:17,20,22 217:8,12,14,16 217:18,20,21 217:23,25 218:3,5,7,8,10 218:12,14,16 218:18,20,22 218:24 219:3,5 219:7,9,23,25 220:3,5,7,9,12 220:14,16,19 220:20,22,24 221:3,6,8 Texas 68:14 thank 63:1,6,8 63:13,15,23 64:9 65:17 78:10,12 83:10 83:12,14 94:15 94:16,17 95:14 95:17 102:23 102:25 105:6,7 105:8,9 106:5,7 108:6,14,21 124:6,8 132:9 132:12,13 133:17,18	134:6,10 136:24 138:3,8 138:11 144:1,2 144:3,5 145:22 145:25 151:5 152:2,5,8,10,13 152:15,15,18 154:11 155:3 164:3 169:12 170:2 174:12 174:13 180:20 180:22 182:25 183:3 188:8,10 188:21 191:23 194:13,15 198:14 210:5 212:18 Thanks 145:19 180:15 theme 93:19 thereof 222:10 thing 91:25 100:7 126:14 126:16 147:2 things 88:25 148:5 178:16 180:20 183:24 184:14 think 70:11 72:5 74:21,22 80:8 83:3 85:13 93:12 95:9,12 96:4,6,13 97:2 98:7,24 99:19 100:16,16,19 101:11,24 102:17 103:19 104:20 109:8 111:19,19,21 113:25 117:1 122:17 127:4 129:15 133:3 133:13 136:20 136:22 142:5 143:18 166:21 167:18 168:9 168:12,12	169:3,21 177:6 178:9 179:21 179:23 180:2 180:12 181:7 184:24 186:8 188:3,12 189:7 191:6 192:8 193:4,16,18 197:22 198:13 211:1,5 thinking 127:3 181:15 thinks 143:24 Thomas 216:20 217:8 218:19 Thompson 61:6 63:10 124:10 138:11,12 144:2,13 152:10,18,22 154:6,15 190:23 194:15 194:16 195:3 197:24 198:14 210:5,7,22 212:1,17 214:7 214:11,15,18 214:19 thought 118:9 176:25 177:14 183:6 192:4 threat 86:1 three 86:7 100:24 110:13 112:5 119:3 124:23 124:24 131:6 135:4 139:10 184:7 189:23 190:3 three-year 176:15 threshold 90:13 163:19 166:6 174:24 Thursday 213:5 time 64:15 67:4 67:12 69:8	83:16 86:4 88:16 89:12 94:4 98:8 108:11 113:1 114:1 129:23 129:25 134:7 136:13 137:14 141:16 146:20 148:11 149:13 149:24 151:3,4 171:2 178:8 181:15 184:3 185:11 187:22 187:24,25 193:12 194:10 196:18 222:9 222:14 times 86:10 139:10 160:3 166:13 184:21 193:9 Timothy 215:12 215:14 tip 168:10 today 62:9 65:9 69:10 72:4 97:1 105:19 106:11 106:25 109:15 133:3 134:25 135:16 137:19 137:19 153:11 153:25 159:7 212:21 told 83:25 92:13 104:22 132:16 Tom 81:14 tomorrow 107:20 213:2 Tomorrow's 213:2 tool 123:4 151:7 tools 127:12 top 84:15 101:14 149:14 172:1 topic 111:5,10 116:7,25 117:3 124:1 165:20
--	--	---	---	---

169:12	108:19 175:23	underlying	upcoming 81:3	176:6 185:4,10
topics 123:22	176:22 177:8	111:15	updated 167:23	185:13,21
total 67:12 99:15	177:21 185:8	understand	upper 155:24	186:22,25
100:21 112:6	trying 92:4 96:4	64:23 65:3 92:9	upward 125:10	187:13,13
146:10,10,13	103:6 160:2	92:22 103:21	125:21 210:9	192:16 193:8
146:14,24	179:8 182:19	133:20 143:9	urge 82:9 86:2	194:18,19
169:23,24	182:20 184:15	161:15 165:13	93:15 102:13	195:12
185:5,9 187:24	189:17 190:11	166:23 179:5	urging 127:16,21	utility's 174:25
188:1 189:19	196:25 197:1	179:12 180:12	use 72:14 75:7,14	
189:23	Tuesday 62:9	211:22	81:1,6 100:24	V
touch 95:24	turn 62:21	understandable	104:3,8 111:19	valid 163:6
town 66:24	122:16 169:12	92:18	116:2,15	valuation 186:21
track 151:22	two 65:8 69:25	understanding	118:18 120:12	value 72:1,22
trade 96:9	71:9 81:8 83:4	94:2 115:25	127:17,22	147:6 148:15
106:14	83:4 120:19,23	158:16 159:5	150:17 161:13	148:16 158:22
transactions 67:9	121:5 128:19	177:3,13	163:5 171:21	158:23 159:12
176:13	135:7,18	understands	178:9 179:13	ValueLine 141:3
transcript 59:5	147:18,20	111:14	185:3 197:9	148:1 150:2,23
198:20 222:13	168:21 185:7	understates	210:14	151:12,13
transfer 72:12,17	186:13 187:8	113:18	useful 78:8	172:24 184:23
73:10	194:22,24	undertaken	user 99:12	187:8
transfers 72:18	195:5	130:13	uses 69:10	ValueLine's
73:25 81:1	two-part 81:20	underutilization	106:18 166:21	147:15 148:4
transport 75:14	100:25	72:10,19	usually 114:16	values 158:10
75:19 76:1,2,5	type 95:5 150:11	Unfortunately	179:20	variable 74:5
76:10 97:22	178:5 180:2	173:6	utilities 66:17,19	81:17
98:14,18 99:21	185:8	Uniform 72:13	68:22,25 69:1	variables 190:18
104:9	typical 158:17	uniformly 102:7	69:11 92:4	varies 101:11
transportation	162:23 163:1	unilaterally	114:8 115:2	various 68:8,21
96:14 97:17	175:16	100:1	116:13 117:13	70:23 74:20
98:18 99:9	typically 97:7	Union 117:14	121:14 125:13	142:11
102:8	175:11	unique 111:10	139:24 144:25	varying 151:23
treat 140:17	typos 135:17	117:4 122:19	148:19 157:24	venture 126:23
treated 75:19	Tyson 216:5,7,8	140:9	158:4,11,19,23	126:25 129:1,2
treating 76:15	U	Unit 153:5	159:12 160:8	vent-free 107:5
90:9	ultimate 72:7	unjust 80:19	165:10 168:7	verifies 122:2
treatment 77:20	177:18	unpersuasive	169:10 178:17	verify 109:9
tremendous	ultimately 68:12	119:2	182:10 187:17	versions 135:8
123:6	70:13 88:10	unravel 177:11	196:22	versus 161:11
tried 177:9	97:23 113:20	unreasonable	utility 66:14,21	162:17 184:23
troubled 71:24	unacceptable	80:20 118:4	69:7,8 79:15	veto 97:5
true 79:8 107:15	130:8	130:8,16	81:6 93:9 98:8	viable 89:14
112:24 137:22	unadjusted	unreliable	113:6 120:25	view 88:1 105:22
138:20 154:3	155:20 157:9	194:25	148:14 149:4,6	164:9
222:12	unanimous 70:1	unusual 125:22	149:10,20	violates 185:24
Truman 60:20	underlined 88:25	126:11,13	153:4,6 162:2	violation 185:18
try 96:7 99:20		127:15	169:7 172:10	186:10

vital 93:3	133:14	109:2 191:22	83:9 111:18	yield 151:1 162:1
voiced 119:5	Warren 219:10	we're 62:17	115:16 123:21	162:21 167:2
volatility 195:16	Warsaw 66:1	70:23 100:24	191:18 210:25	168:20 186:6
volume 59:8	67:16,22 72:8	101:20 107:3	213:4	186:17 187:2
89:16,18 90:9	72:18 74:2	110:3 112:21	Won 218:11	yields 151:3
92:15 98:2	80:17,22 84:16	119:10 141:22	word 115:12	167:2 168:19
198:19 214:19	84:18 92:6,24	148:7,9 159:7	136:3,3	186:2 211:8
volumes 72:21	178:24 219:20	175:16 198:3	words 129:16	You-all 150:20
82:5 87:5 88:14	wasn't 88:9	210:1	work 70:12	
88:17 90:13,22	148:18	we've 92:15	100:9 107:19	Z
volumetric 74:4	water 107:4	100:13 101:11	131:7	zero 66:15,16
75:1 81:21	172:12	102:15 127:19	worked 102:15	94:24
voluntarily 129:7	way 77:15 79:13	128:16 143:11	works 111:21	
vote 144:21	80:11,19 90:22	213:5	worth 80:4	\$
	105:15 116:18	wholly 114:25	124:15	\$1 189:19 191:13
W	118:24 119:4	122:14	worthwhile	\$1.3 86:6
W 94:17,21 95:4	133:6 147:21	widow 85:15	78:24	\$100 131:6
95:14 102:25	157:3 169:18	widowers 91:21	worthy 111:24	\$115 86:22
103:7,12,21	175:9 179:5	widows 91:20	wouldn't 132:16	\$3 80:4 124:16
104:10,13,21	180:5 193:19	WILLIAM	132:17 159:20	124:21 189:16
105:2,6 106:5	ways 79:12 81:8	59:17	159:22	189:19
108:10,15,19	weather 98:22	willing 89:25	Wright 68:14	\$35 150:15
145:23 180:21	weatherization	124:18 180:1	write-up 151:24	\$350 85:11,14
180:23 182:24	82:14 105:18	windows 91:23	wrote 89:10	\$36 86:15
214:16	105:21	winter 91:21	183:6	\$40 86:19
wait 183:8	Webster 68:13	winter's 123:7		\$5.1 124:19
waiving 133:21	week 70:13,16,19	wisdom 161:21	X	\$54 86:8
walk 88:21	77:19,22 83:1	wish 64:19	X 214:1	\$7.4 83:25
184:20,21	102:22 105:14	withdraw 210:22		\$72 86:16
Wankum 216:14	119:21 151:15	witness 65:10	Y	\$8.2 124:18
216:16,18	171:1	73:24 79:18,23	Y 59:18	\$88 131:3
want 99:12	week's 65:21	80:15 81:13	yeah 172:7	\$90 176:11
151:10 163:23	weight 115:13	82:10 97:13	184:12	
164:5 168:13	165:20	102:1 107:17	year 85:11,14	0
169:8 170:16	weighted 115:21	110:19 111:5	86:8,19,22	08 148:16
171:4,11 174:2	120:5 169:14	114:16 116:18	96:20 97:2	09 148:17 150:9
174:21 182:3	179:17	119:20 133:22	119:18 120:16	
184:11 186:24	Welcome 108:15	134:9 135:25	141:11 182:9	1
189:4 194:11	well-recognized	138:2 139:13	183:25,25	1 62:2 89:1 96:19
212:22	127:11	143:14,25	years 86:7 92:23	100:2 135:7
wanted 119:10	went 85:8 92:13	144:5 152:20	93:10 122:21	138:1,6,16
183:5 184:1	143:17 148:6	173:21 174:12	125:3 129:6	142:24 215:3
191:4,5	176:20 193:18	174:13 188:25	131:3,6 141:7	1st 69:7
wants 84:16 85:2	West 60:20 88:2	194:13 210:4	157:19 165:9	1,600 72:4
85:3	126:18	211:4,5,19	172:8 184:7	10 59:8 174:6
Warner 91:17	we'll 64:23 94:2	212:20,21	yesterday 69:24	187:16 193:1
warranted	101:13 105:16	witnesses 65:8,9	84:13 93:17	215:21
				10th 114:13

10.3 110:25 115:8 122:11 125:5 127:10 130:15 155:18 156:11 161:4	146:22 147:8 149:1 150:21 164:11 216:3 12:26 213:10 120 218:8 121 60:15 218:10 122 218:12 123 218:14 124 214:7 218:16 125 218:18 126 218:20 127 218:22 128 218:23 129 219:3 13 136:23 137:4 164:12 168:25 213:3 216:5 13HC 217:19 130 153:19 154:7 154:13 176:7 130HC 219:5 131 153:19 154:7 154:14 219:7 132 114:14 214:7 219:9 133 93:17 219:11 134 214:10 219:12 135 219:14 136 219:16 137 219:18 138 62:3 214:11 215:4,6,8 219:20 139 114:14 14 142:16 14NP/14HC 216:6 14th 190:22 1402 98:7 144 214:11 146 214:12 15 112:7 129:8 141:21 142:3 150:19 216:8 151 214:12 152 214:15	153 214:15 154 218:5,7 219:6,8 16 216:10 17 114:12,13 216:11 17,800 65:23 17.6 112:2 174 214:16 18 216:13 180 214:16 182 114:15 183 214:17 188 214:17 19 59:7 101:7 137:1,3,4 193:1 216:15 19th 62:9 194 214:18 1958 96:10 199 198:19 1990s 97:11 1993 68:1 1994 68:7 71:20 87:21 1996 145:8	2004 66:15 67:7 171:25 2005 67:11 171:25 2007 68:25 146:16,23 147:22 148:1 149:11 2008 69:3 141:3 149:12 193:17 2009 121:16 201 219:24 2010 68:25 144:16 145:4,8 145:15,15 2011 69:4 119:5 131:2 145:5,6 145:10,11,13 182:9 2011-2012 196:9 2012 69:7,14 121:18 2013 76:6 100:22 117:8 120:16 137:2,11 146:19 193:18 193:22 194:2 2014 59:7 62:9 100:2 137:2,10 169:6 193:19 193:23 194:5 2015 66:11 176:19 202 214:19 220:3 203 220:5 204 220:7 205 62:4 214:20 220:8 208 214:20 209 198:19 21 164:7 22 60:9 2230 61:2 23 184:17 24 70:9 89:8 25 89:8 192:22 260 96:15	28 101:7 <hr/> 3 3 135:7,7 141:11 184:8 185:11 185:20 186:7 189:25 3HC 138:1,7 3NP 138:1,6 3NP/3HC 215:7 3.21 115:20 131:6 30 151:16 187:18 30th 117:7 137:2 193:19,22 194:5 301 60:20 31 85:4,5 101:12 193:22 194:2 31st 193:17,18 312 60:4 322 168:22 169:10 360 61:8 37 101:8 393.310.5 76:17 <hr/> 4
110.3 110:25 115:8 122:11 125:5 127:10 130:15 155:18 156:11 161:4	146:22 147:8 149:1 150:21 164:11 216:3 12:26 213:10 120 218:8 121 60:15 218:10 122 218:12 123 218:14 124 214:7 218:16 125 218:18 126 218:20 127 218:22 128 218:23 129 219:3 13 136:23 137:4 164:12 168:25 213:3 216:5 13HC 217:19 130 153:19 154:7 154:13 176:7 130HC 219:5 131 153:19 154:7 154:14 219:7 132 114:14 214:7 219:9 133 93:17 219:11 134 214:10 219:12 135 219:14 136 219:16 137 219:18 138 62:3 214:11 215:4,6,8 219:20 139 114:14 14 142:16 14NP/14HC 216:6 14th 190:22 1402 98:7 144 214:11 146 214:12 15 112:7 129:8 141:21 142:3 150:19 216:8 151 214:12 152 214:15	2 <hr/> 2 117:22 135:7 138:1,6 142:18 173:25 215:5 2,000 96:12 2,400 151:14,16 2/10 142:24 20 62:2 101:13 101:19 131:3 213:4 216:17 20-year 68:9 116:22 200 61:2,8 62:4 110:24 113:16 125:10,20 155:14 166:24 210:10 211:12 219:23 2000 148:2 2002 98:6 103:3	2004 66:15 67:7 171:25 2005 67:11 171:25 2007 68:25 146:16,23 147:22 148:1 149:11 2008 69:3 141:3 149:12 193:17 2009 121:16 201 219:24 2010 68:25 144:16 145:4,8 145:15,15 2011 69:4 119:5 131:2 145:5,6 145:10,11,13 182:9 2011-2012 196:9 2012 69:7,14 121:18 2013 76:6 100:22 117:8 120:16 137:2,11 146:19 193:18 193:22 194:2 2014 59:7 62:9 100:2 137:2,10 169:6 193:19 193:23 194:5 2015 66:11 176:19 202 214:19 220:3 203 220:5 204 220:7 205 62:4 214:20 220:8 208 214:20 209 198:19 21 164:7 22 60:9 2230 61:2 23 184:17 24 70:9 89:8 25 89:8 192:22 260 96:15	28 101:7 <hr/> 3 3 135:7,7 141:11 184:8 185:11 185:20 186:7 189:25 3HC 138:1,7 3NP 138:1,6 3NP/3HC 215:7 3.21 115:20 131:6 30 151:16 187:18 30th 117:7 137:2 193:19,22 194:5 301 60:20 31 85:4,5 101:12 193:22 194:2 31st 193:17,18 312 60:4 322 168:22 169:10 360 61:8 37 101:8 393.310.5 76:17 <hr/> 4

EVIDENTIARY HEARING 8/19/2014

<p>43 117:8 118:3 118:16 121:17 121:19 127:19 165:9 170:5 184:6 44 117:22 173:24 184:6 45 101:7 456 60:4 48 117:24 173:13 49 101:7 490.57 194:3</p> <hr/> <p style="text-align: center;">5</p> <p>5 66:19 82:18 115:24 131:4 139:9 151:1 161:8,8 215:11 5.0 212:6 5.1 94:24 5.15 80:6 5.37 115:23,24 116:9,11 161:5 5.8 141:7 50 92:14 50/50 117:17 169:19 500 62:5 149:10 187:16 220:18 501 220:20 502 220:22 503 220:24 504 62:5 221:3 51 101:6 51s 101:15 514 60:9 52 101:7 117:24 142:8 173:13 525 149:15 53 86:22 530 149:15 54 85:3 55 101:7 56 101:7 57 101:7 117:8 118:3,16 121:17 127:20</p>	<p>167:18 170:5 57.4 120:16 573)415-8379 60:10 573)522-3304 60:22 573)616-1911 60:16 573)635-7166 60:5 573)751-3234 61:9 573)751-4857 61:3 576.98 194:6 58 122:2 59 101:7</p> <hr/> <p style="text-align: center;">6</p> <p>6 89:3 139:9 215:13 6.37 122:13 156:14 157:13 6.5 116:24 6.8 157:20 60 87:25 116:5,6 121:15 127:23 168:8 169:24 170:10 171:18 172:17 177:16 196:16 60/40 118:23 119:7,12,19,23 120:11,16 121:10 156:13 169:16 179:15 180:25 181:3 182:13,20,21 183:10 184:1 196:2,7,8,25 197:6 600 62:6 149:11 221:6 601 62:6 601HC 221:8 61s 101:15 62 215:4,6,8,10</p>	<p>215:12,14,16 215:18,20,22 215:24 216:4,5 216:7,9,10,12 216:14,16,18 216:21,23,24 217:3,5,7,9,11 217:13,15,16 217:18,20,21 217:23,25 218:4,5,7,9,11 218:13,15,17 218:19,21,22 218:24 219:4,6 219:8,10,11,13 219:15,17,19 219:21,23,25 220:4,6,7,9,12 220:14,16,19 220:21,23,24 221:4,7,9 62s 101:15 63 88:2 65 214:2 650 61:2 65101 60:10,15 65102 60:21 61:9 65102-0456 60:5 65102-2230 61:3 67 101:15</p> <hr/> <p style="text-align: center;">7</p> <p>7 89:3 114:13 115:11 116:24 138:17 186:8 187:17,18 215:15 7.25 116:21 7.4 84:10 7.8 155:21 157:10 70 88:4 73 84:19 740 67:12 72:3 76 99:17 77 84:17,17 85:5 92:25</p>	<p>78 214:2 79 101:22</p> <hr/> <p style="text-align: center;">8</p> <p>8 80:7 186:8 215:17 8.2 84:6,8 94:23 8.8 155:21 800,000 84:3 81 101:21 82 101:21 83 214:3 838 59:22 86 101:21 87 101:22 88 196:15 89 101:22</p> <hr/> <p style="text-align: center;">9</p> <p>9 182:7 187:16 215:19 9.8 110:22 125:9 130:14 155:10 157:5 90 151:22 90-day 151:16 91 101:22 95 214:3 96 145:10,11</p>
--	---	---	---