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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 Annual Revenues for Natural Gas Service	)	Case No. GR-2014-0086

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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P R O C E E D I N G S

(SUMMIT EXHIBIT NOS. 1 THROUGH 20, STAFF EXHIBIT NOS. 100 AND 102 THROUGH 138, OPC EXHIBIT NOS. 200 THROUGH 205, MSBA EXHIBIT NOS. 400 THROUGH 402, DOE EXHIBIT NOS. 500 THROUGH 504 AND MPGA EXHIBIT NOS. 600 AND 601 WERE MARKED FOR IDENTIFICATION.)

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

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

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

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

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

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

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

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

JUDGE JORDAN: For the Missouri School Boards Association.

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

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

MR. KNEE: For the Division of

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

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

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

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

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

(No response.)

JUDGE JORDAN: Okay. I am not seeing anything. So I understand that what we'll be doing this morning will consist of general opening statements, and then as each issue comes up each day, we will be doing more focused opening statements relating to those issues. Do I understand that to be correct?

MR. BORGMEYER: Yes, your Honor.

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

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

MR. COOPER: That is correct.

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

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

Summit Natural Gas of Missouri is a natural gas corporation with approximately 17,800 customers being served through five operating divisions in the state of Missouri. Those five operating divisions are known as Gallatin, Warsaw, Lake of the Ozarks, Rogersville and Branson.

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

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

Shortly after formation, Missouri Gas Utility acquired the municipal gas facilities of Gallatin and Hamilton, Missouri. Those municipal systems were available because both the Gallatin and Hamilton town councils had elected to cease payments on the certificates of participation used to finance the original system, and the banks representing the holders of those certificates had foreclosed.

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

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

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

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

The origins of the Rogersville and Branson operating divisions are something quite different and more complex. In 1993, an entity by the name of Tartan Energy, doing business as Southern Missouri Gas Company, filed for a Certificate of Public Convenience and Necessity for certain parts of southern Missouri. The application for certificate was approved in the fall of 1994, and since then this entity has gone through multiple reorganizations and various owners in its nearly 20-year history.

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

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

IIF first invested in Summit Utilities in 2007. In 2010 IIF purchased all of the remaining shares of Summit Utilities. IIF obtained a majority interest in Southern Missouri Natural Gas in 2008 and completed its purchase of Southern Missouri Natural Gas in 2011.

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

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

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

In regard to the issues, I'll start with the good news. The parties yesterday afternoon have filed two stipulations. These stipulations can be considered unanimous by Commission rule as all parties are either signatories or have stated affirmatively that they do not oppose the stipulations and do not request any hearings on those issues.

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

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

Summit agrees with Staff's calculation of the revenue requirement for the various operating divisions and, again, we're asking you to come up with revenue requirements for each of the four divisions that are at issue in this case, with the exception of the cost of money issues related to return on equity, a debt issue and capital structure.

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

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

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

As to Gallatin, as I described earlier, that system consists of small troubled municipal systems that were brought onto the company's books at a much lower value than the original construction costs. This division has grown from the 740 customers that I mentioned earlier to almost 1,600 customers today. We don't think there's any justification as to that division for any imputation or otherwise adjusting the ultimate revenue requirement for that division.

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

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

The second Public Counsel issue with

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

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

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

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

In its direct case, Summit proposed a lower ROE than was recommended by its expert witness. As I discussed a few moments ago, Summit has further proposed certain Account 105 transfers which would serve to lower the revenue requirement in both the Warsaw and Branson division.

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

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

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

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

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

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

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

In Southern Missouri Natural Gas' last rate case proceeding, amounts of revenue were imputed by Staff to reflect the difference between the full transport tariff rate and the discounted transport tariff rate that had been given to the schools. This resulted in lost revenue for the company. In response, Summit began to move the schools to the full transport tariff rate. Much of that movement took place in the fall of 2013.

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

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

Past practice in regard to the

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

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

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

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

In conclusion, Summit Natural Gas of Missouri has been instrumental in bringing natural gas service to areas of the state that did not previously have access to that fuel source. In this case, Summit is asking the Commission to set rates that will allow it to continue to provide this service in a safe and adequate manner and that will provide it with the incentive to continue its growth in areas of the state where this fuel source will be useful and desired by Missourians.

That's all I have, your Honor.

JUDGE JORDAN: Thank you. Any inquiries, clarifications from the Bench? All right. Thank you. The general opening statement of Staff.

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

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

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

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

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

So the big issue in this case is rate of return, and Staff witness Dave Murray will be here to explain his rate of return calculations. And what he's done, as you've heard Summit say in their opening, that the Lake of the Ozarks region is not at issue in this case. And so what Staff witness Dave Murray has done is attempted to create a capital structure and a rate of return that removes the risk of that construction from that system from the rest of the case so that the ratepayers in these divisions are not bearing that cost.

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

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

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

And so Staff has proposed a capacity adjustment that removes that excess capacity, the plant, the excess plant from the rate base, transfers it to plant held for future use. As new customers come on the system, that can be reconsidered in an upcoming rate case. But for purposes of this case, the adjustment will -- the adjustment means that the current customers will be paying for the utility service that they use and no more than that.

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

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

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

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

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

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

And the Division of Energy has proposed a funding mechanism that Staff is opposed to, and you'll hear more about that when that issue comes up for hearing later on this week.

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

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

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

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

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

Summit's filed case requests $7.4 million. That's what customers were told the company was requesting. But if you read Summit's position statement, you'll see that they've added an additional 800,000 to their request. If you add up the revenue increases, their position statement says that their request for the four districts, that equals around 8.2 million.

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

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

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

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

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

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

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

An increase of this magnitude is a

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

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

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

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

This raises the question, why is Summit requesting so much from their customers when other companies only request a fraction of that? Because this is a growing company, an expanding company, and in the short life of this company, they have simply not realized the customer levels and gas volumes that they used to support their Certificates of Convenience and Necessity.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

And I ask you, please ask

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

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

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

Mrs. Debra Warner testified, quote, This is a community of single parents, elderly people, disabled people. I'm a caregiver for disabled people. It's a community of widows and widowers. In the winter, you go into people's homes and they have plastic taped over their windows and doors. It's also common to go into people's homes and they will ask you to step into a small bedroom because it's the only thing they're heating, and they're heating it with a small space heater, and they and their children are living in that little space. People are going without food trying to keep their utilities on. Any increase in this community is devastating. End quote.

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

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

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

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

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

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

I spent all my opening talking about

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

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

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

JUDGE JORDAN: Thank you, counselor.

COMMISSIONER W. KENNEY: Thank you. I appreciate the handout. At a lot of those public hearings, you have a lot of compelling testimony.

MR. POSTON: Yes, sir.

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

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

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

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

COMMISSIONER W. KENNEY: Okay. Thank you.

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

The opening statement of Missouri School Boards Association.

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

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

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

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

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

As all of us know, there have been -- the financial issues facing any public entity, schools and what have you, are critical, and they're critical to the counties and communities that all of you have represented and that are represented in this matter today, that financing is a critical issue. Of course, I think in this year we kind of have a special perfect storm because quite a bit of the schools were affected by the veto issues that are going on.

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

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

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

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

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

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

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

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

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

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

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

That is an issue that you'll hear. That's the flex rate issue. It was canceled by the company, I believe, unilaterally effective January 1 of 2014. So when we talk about rate increases to the schools, that's another factor that gets added on to that basic rate increase, and I'll cover those in a moment.

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

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

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

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

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

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

So really what we're ending up with to the schools are rate increases of 81, 86, 82, 87, 89, 79, Lebanon 91 percent rate increase. That's what rate shock is. And the solution, I'm not to answer. I think it's a question that I would hope the Commissioners would ask every witness that has anything to do because it's a critical issue.

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

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

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

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

JUDGE JORDAN: Inquiries?

COMMISSIONER W. KENNEY: Thank you,

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

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

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

MR. BROWNLEE: The gas, right.

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

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

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

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

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

Mr. BROWNLEE: You bet.

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

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

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

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

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

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

COMMISSIONER W. KENNEY: Thank you.

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

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

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

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

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

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

JUDGE JORDAN: Any inquiries from the Bench?

COMMISSIONER W. KENNEY: No. Thank you.

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

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

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

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

The reason MPGA is here today is

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

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

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

Now, Brian also filed testimony on appliance conversion and dual fuel issues, but we have a pending stipulation on those issues, so that has been taken off the issues list and he will not be testifying on those. As to the stipulation, we believe it is in the public interest and we would ask the Commission to approve it.

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

JUDGE JORDAN: Any questions?

CHAIRMAN KENNEY: No questions.

COMMISSIONER W. KENNEY: I have one. Mr. Jarrett, is this your first time before this Commission?

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

COMMISSIONER W. KENNEY: Welcome.

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

JUDGE JORDAN: Anything else?

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

MR. JARRETT: Thank you.

JUDGE JORDAN: That concludes opening statements. The Commission will now go into the issues remaining on the issue list. The first one is rate of return, which will include issues of return on equity, cost of debt and capital structure. We'll have a more focused opening statement on this issue, beginning with Summit.

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

JUDGE JORDAN: Sure. Do you need a recess?

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

JUDGE JORDAN: Yes.

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

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

MR. BROWNLEE: Yes.

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

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

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

(A BREAK WAS TAKEN.)

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

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

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

Your Staff through the testimony of cost of capital witness David Murray is expected to offer testimony that an appropriate cost of -- appropriate cost of common equity for ratemaking purposes in this case is within the range of 9.8 to 10.8 percent. This includes a risk adjustment of 200 basis points. Mr. Murray's midpoint recommendation is 10.3 percent. He relies primarily on the discounted cash flow or DCF model.

Summit Natural Gas of Missouri, which I'll refer to here as either Summit or the company, will present the testimony of cost of capital witness James Anderson on this topic. And I don't mean to cast any aspersions on the many learned and highly regarded academics who have previously testified to this Commission in rate cases on the issue of cost of capital, but Mr. Anderson brings to the topic a unique expertise, and that is he's highly -- he's a highly experienced broker dealer who has engaged in the origination and sale of securities.

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

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

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

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

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

As a general statement, this may be true, but there's nothing much stable about the character of this particular company's operations in the state of Missouri at this time. Summit is very much in a growth and expansion mode, as the Commission is well aware.

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

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

Ultimately, the high end of Staff's ROE range is 10.8, as I noted earlier. The company has assumed a 12 percent return as part of its direct case. So the differences on this particular issue are not as dramatic as one might initially think. Nevertheless, an authorized return at this time of 12 percent is certainly more than justified by the record.

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

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

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

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

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

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

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

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

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

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

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

I'll move on to the topic of capital

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

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

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

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

I mean, the fact of the matter is

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

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

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

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

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

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

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

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

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

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

Mr. Lawler will testify to how dissimilar the two companies actually are, that at a very high level CNG is a steady-state operating utility with proven revenue streams. In contrast, Summit is still very much in a build-out mode with customer penetration numbers in some areas that are currently below expectations. CNG has less debt and a larger customer base. It's less risky. The fact of the matter is the two companies are not at all similarly situated.

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

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

So as you can see, the Lake of the Ozarks expansion has not been at all a decisive factor in this. You can also back calculate to get to the same location. If you back out the debt associated with construction at the Lake of the Ozarks division, the debt to equity ratio for the four divisions in this rate case is approximately 42 to 58. This verifies the company's pre-Lake-of-the-Ozarks actual capital structure.

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

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

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

As a division of the Department of

Economic Development, this Commission should not follow a ratemaking policy that discourages investment of private capital in infrastructure that will provide an important tool for economic development throughout the state of Missouri. The tremendous spike in propane prices during last winter's heating season is silent testament to the need to provide citizens of this state with energy alternatives, energy options.

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

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

Again, the company's witnesses on these topics are as follows: With respect to cost of common equity and long-term debt, we will present the testimony of Mr. Jim Anderson. Mr. Anderson and Mr. Rick Lawler both will address the topic of the appropriate capital structure for the company. I encourage you to explore these issues and facts with these gentlemen as you consider these issues in the case.

With that, I'll complete my remarks. Thank you.

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

And the opening statement of Staff.

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

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

The three issues are: What is the cost of common equity, what is the cost of debt, and what is the capital structure?

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

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

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

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

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

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

Throughout the Commission's concern has been to insulate the customers from the cost of that risk. To insulate the customers from that risk. Who is it that should bear the risk of a speculative venture? The shareholders. The shareholders. Those are the ones who decide to put their money into the venture that may pay high dividends or may fail because it's risky. And this is risky. This is risky.

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

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

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

Mr. Murray is urging the Commission to use a hypothetical capital structure of 60 percent debt and 40 percent equity. Why is he doing that? He is doing that, again, to safeguard and protect the customers from the effects of the heightened risk of what this company is doing, particularly now that the company is engaged in its buildout in the Lake of the Ozarks district.

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

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

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

But remember, I said this is a

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

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

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

So this is a very real issue here. Every time this company has come in here for an application for a certificate allowing it to expand, every time it has done that, it has sworn and promised to this Commission that it will protect the customers from the costs and the risks incumbent and inherent in this expansion, and the Commission has accepted those promises.

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

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

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

You'll recall, there's much talk in

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

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

The existing ratepayers should pay only for the service they're getting. That's what they should pay for, the cost of the service they're getting. And, of course, this is a gas case, so that doesn't include the cost of the gas. It includes everything but the cost of the gas itself. So all of those costs involved in serving those four districts, that's what the customers in those four districts should pay.

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

Thank you very much.

JUDGE JORDAN: Questions? Clarifications?

CHAIRMAN KENNEY: No, thank you.

JUDGE JORDAN: Thank you, counselor. Summit may begin its case in chief.

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

JUDGE JORDAN: Please.

MR. POSTON: May it please the Commission?

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

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

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

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

Thank you.

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

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

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

JUDGE JORDAN: So you may have

recross, but you don't plan any cross?

MR. POSTON: Yes, sir.

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

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

(Witness sworn.)

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

MR. BOUDREAU: May it please the Commission?

JAMES M. ANDERSON testified as follows:

DIRECT EXAMINATION BY MR. BOUDREAU:

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

A. James M. Anderson.

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

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

Q. And on whose behalf are you testifying today?

A. Summit Natural Gas.

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

A. I am.

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

A. It has.

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

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

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

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

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

THE WITNESS: Oh, this is from the

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

BY MR. BOUDREAU:

Q. So the revised heading would read how?

A. Percentage of revenue recovered from fixed customer charges.

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

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

Q. Well, to your direct testimony?

A. Oh, direct. No.

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

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

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

A. Thank you.

Q. See if that refreshes your memory.

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

Q. Did you say line 19 or --

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

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

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

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

A. Yes.

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

A. No.

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

A. Yes.

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

A. Yes.

MR. BOUDREAU: With that, I would

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

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

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

MR. BOUDREAU: Very good. Thank you.

JUDGE JORDAN: Cross-examination from Staff?

MR. THOMPSON: Thank you, Judge.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Good morning, Mr. Anderson.

A. Good morning.

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

A. Yes.

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

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

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

A. Yes.

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

A. No.

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

A. No.

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

A. Yes.

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

A. No.

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

A. I am.

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

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

Q. How are you associated?

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

Natural Gas.

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

A. No. I'm an alternative member.

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

A. No.

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

A. Yes.

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

A. No.

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

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

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

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

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

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

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

Q. Okay.

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

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

A. Yes.

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

A. Yes.

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

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

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

A. It is.

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

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

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

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

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

THE WITNESS: Okay.

JUDGE JORDAN: Thank you.

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

THE WITNESS: Thank you.

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

QUESTIONS BY CHAIRMAN KENNEY:

Q. Mr. Anderson, good morning.

A. Good morning.

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

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

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

A. Well, to all -- Summit Natural -- or Summit Utilities is the parent company, and then that same board is also the board of directors of the other subsidiary company.

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

A. Yes. 2011 actually.

Q. 2011. From what period to what period?

A. From 1996 'til the end of 2010.

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

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

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

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

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

JUDGE JORDAN: Further questions?

COMMISSIONER STOLL: No questions. Thank you for your testimony.

COMMISSIONER W. KENNEY: No questions.

COMMISSIONER RUPP: Thank you, Judge.

QUESTIONS BY COMMISSIONER RUPP:

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

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

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

So that is -- that's the total return. So it's a reinvestment of the dividends, which any financial advisor will advise you is the best thing to do with your dividends is to reinvest those dividends.

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

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

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

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

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

A. That's correct.

Q. Is there a historical average of

these ValueLine companies that goes beyond 2007?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Q. Thank you.

A. But dividend reinvestment is a powerful tool.

QUESTIONS BY JUDGE JORDAN:

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

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

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

Q. Okay. Thank you.

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

JUDGE JORDAN: Okay. Thank you. That's helpful. Recross from the Office of Public Counsel?

MR. POSTON: No, sir. Thank you.

JUDGE JORDAN: Recross from Staff?

MR. THOMPSON: None. Thank you, Judge.

JUDGE JORDAN: Any redirect?

MR. BOUDREAU: I have none. Thank you.

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

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

(Witness sworn.)

DAVID MURRAY testified as follows:

DIRECT EXAMINATION BY MR. THOMPSON:

Q. Please state your name.

A. David Murray.

Q. Could you spell your last name for

the reporter?

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

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

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

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

A. Yes, it is.

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

A. Yes.

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

A. Yes.

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

A. Yes.

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

A. I do not.

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

answers be the same?

A. Yes.

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

A. Yes.

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

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

MR. BOUDREAU: No objection.

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

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

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

JUDGE JORDAN: Very good.

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

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

MR. POSTON: I have no questions.

JUDGE JORDAN: You have no questions.

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

MR. BOUDREAU: Thank you very much.

JUDGE JORDAN: Cross-examination from Summit.

CROSS-EXAMINATION BY MR. BOUDREAU:

Q. Good morning, Mr. Murray.

A. Good morning, Mr. Boudreau.

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

A. Yes.

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

A. Yes.

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

A. Yes.

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

A. Yes.

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

in your opinion?

A. Yes.

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

A. Yes.

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

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

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

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

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

A. I didn't see a need to.

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

A. Yes.

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

A. Yes.

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

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

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

A. Yes.

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

A. Yes, it is.

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

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

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

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

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

A. I don't believe I did.

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

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

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

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

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

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

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

Q. Was that a yes or a no answer?

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

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

A. Yes.

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

A. Yes.

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

A. There's some overlap, but yes, generally there's a difference. Obviously equity investors have a residual claim to cash flow.

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

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

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

A. Yes.

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

A. Let me just clarify. Within the same company, that is definitely correct. I mean, you could have junk bonds that yield higher than a utility stock required return on equity.

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

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

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

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

As far as your specific question about, is there anything that talks about the specific spread between the debt yield and the required return on equity as far as, you know, how that affects, you know, what would be a typical spread, I would say that I do have something in direct testimony that is considered an authoritative source of what a typical spread over a company's cost of debt would -- what it would be equivalent to for a cost of equity.

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

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

A. It is, yes.

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

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

Q. Bear with me a moment, please.

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

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

JUDGE JORDAN: Thank you.

BY MR. BOUDREAU:

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

A. I'm there.

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

A. Yes, I see that.

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

A. Yes. And may I elaborate?

Q. Certainly.

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

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

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

A. No.

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

A. Yes.

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

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

Q. But you have read his testimony?

A. I have.

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

A. No.

Q. You would not agree with that?

A. I would not agree with that.

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

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

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

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

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

A. It is not.

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

A. It is.

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

A. That is correct.

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

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

A. That is correct.

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

A. It is.

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

A. It is.

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

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

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

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

A. Yes, that's correct.

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

A. Let me refer to my testimony.

Q. Let me direct you to page 13 of

your --

A. Sure.

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

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

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

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

Q. I appreciate that. Thank you. Currently, at least as filed, the company's actual capital structure at the end of its test period was 43 percent debt to 57 percent equity; is that correct?

A. Yes.

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

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

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

A. It is.

Q. Where does that appear in your prepared testimony?

A. I don't know that it's in my testimony. We had problems with getting information from IIF. And once I got that information, I mean, I got that about a week before I was filing testimony, and I've had more time to look at it. And as I look at the strategic plans, I can tell you something, you know, if you want me to.

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

A. What I'm saying is --

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

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

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

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

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

A. So Summit Natural Gas going back to MGU, I'd have to go back and look. I don't -- MGU's been around since 2004, 2005. I can't tell you right now off the top of my head.

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

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

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

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

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

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

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

A. I have.

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

companies?

A. I did.

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

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

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

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

Q. Okay.

A. I apologize. I printed this from EFIS.

Q. That's perfectly okay.

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

JUDGE JORDAN: Yes.

BY MR. BOUDREAU:

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

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

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

JUDGE JORDAN: Yes.

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

THE WITNESS: Thank you.

JUDGE JORDAN: Questions from the Bench?

QUESTIONS BY CHAIRMAN KENNEY:

Q. Good morning, Mr. Murray.

A. Good morning, Mr. Chairman.

Q. How are you?

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

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

hypothetical capital structure as compared to the actual capital structure?

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

Q. Which way, up or down?

A. It would be down.

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

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

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

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

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

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

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

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

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

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

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

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

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

But my position is if they -- if for whatever reason they just had halted and let some of these districts mature, you know, the -- you know, and were able to get some of the conversions and growth that they hope for specifically in Branson and Warsaw, that, you know, that this -- this was the strategy of the company, and this is what their required return was premised on. So that's why.

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

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

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

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

In this situation, the -- you know,

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

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

A. Yes.

Q. All right. I think I understand now.

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

JUDGE JORDAN: Other questions from the Bench?

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

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

QUESTIONS BY COMMISSIONER W. KENNEY:

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

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

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

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

A. It's not actual, no.

Q. It's your opinion?

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

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

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

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

A. Yes.

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

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

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

A. It is hypothetical, without a doubt.

COMMISSIONER W. KENNEY: All right. Thank you.

JUDGE JORDAN: Further questions from the Bench, Commissioner?

COMMISSIONER RUPP: Thank you, Judge.

QUESTIONS BY COMMISSIONER RUPP:

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

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

A. I'm not taking an opinion as to whether or not they should or shouldn't have invested in Lake of the Ozarks. What I'm saying is that if this was a standalone company without having all these other expansions occur, which obviously increase the risk and increase the amount of capital deployed and increases the amount of equity they have to put into the system, my -- my opinion is that, if they let things play out, whether it was this year, next year, what have you, that they wanted to capitalize it at 60/40, and they were able to do it at CNG and it was at the same time.

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

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

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

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

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

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

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

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

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

I mean, this really isn't even controversial in mainstream financial, you know, media is that, you know, the valuation levels of regulated utility companies is at an all-time high because we are in a low interest rate environment, and it's not -- nobody -- I don't want to say people don't invest in utility companies for growth, but they invest into it for a dividend yield.

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

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

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

Q. Would that -- would that calculate the reinvestment of dividends through that time or is that --

A. It would be total return. Any time you look at the averages over a period of time, it's total return. It assumes reinvestment of dividends.

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

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

MR. POSTON: No, sir. Thank you.

JUDGE JORDAN: Recross from Summit?

MR. BOUDREAU: Yes. Thank you.

RECROSS-EXAMINATION BY MR. BOUDREAU:

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

A. I do.

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

A. Sure.

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

JUDGE JORDAN: You may.

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

JUDGE JORDAN: You may.

BY MR. BOUDREAU:

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

A. Yes.

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

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

A. That's correct, yes.

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

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

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

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

Q. Okay. Fair enough.

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

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

MR. THOMPSON: Yes, Judge.

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

BY MR. BOUDREAU:

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

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

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

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

A. Amanda McMellen.

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

JUDGE JORDAN: Okay. Redirect from

Staff?

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

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

BY MR. BOUDREAU:

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

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

MR. BOUDREAU: Rupp. I apologize for that.

BY MR. BOUDREAU:

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

A. Yes.

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

A. I do.

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

A. Yes.

Q. Okay. And between approximately

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

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

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

A. Yes.

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

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

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

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

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

A. Yes.

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

A. That is correct.

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

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

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

JUDGE JORDAN: Redirect from Staff?

MR. THOMPSON: Thank you, Judge.

REDIRECT EXAMINATION BY MR. THOMPSON:

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

A. Yes. They're two different indexes.

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

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

BY MR. THOMPSON:

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

A. Yes.

Q. What would those problems be?

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

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

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

A. Yes.

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

A. No.

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

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

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

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

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

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

A. Yes.

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

A. Yes.

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

A. Both.

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

A. Yes.

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

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

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

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

MR. THOMPSON: Thank you, Judge.

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

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

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

MR. THOMPSON: Yes, Judge. Thank you.

BY MR. THOMPSON:

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

A. Yes.

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

A. Yes.

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

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

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

MR. BOUDREAU: We have expert witnesses giving their opinions. To characterize it as making stuff up I think is inappropriate.

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

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

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

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

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

JUDGE JORDAN: That answers my question.

BY MR. THOMPSON:

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

A. No.

Q. So your figure is still 5.0?

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

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

A. Yes.

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

A. No.

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

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

(No response.)

JUDGE JORDAN: I am not hearing any,

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

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

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

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C E R T I F I C A T E

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, Kellene K. Feddersen, Certified Shorthand Reporter with the firm of Midwest Litigation Services, do hereby certify that I was personally present at the proceedings had in the above-entitled cause at the time and place set forth in the caption sheet thereof; that I then and there took down in Stenotype the proceedings had; and that the foregoing is a full, true and correct transcript of such Stenotype notes so made at such time and place.

Given at my office in the City of Jefferson, County of Cole, State of Missouri.

____

Kellene K. Feddersen, RPR, CSR, CCR

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