

1 STATE OF MISSOURI  
2 PUBLIC SERVICE COMMISSION  
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6 TRANSCRIPT OF PROCEEDINGS  
7 Hearing  
8 June 28, 2004  
9 Jefferson City, Missouri  
10 Volume 17  
11  
12 In the Matter of Missouri Gas )  
13 Energy's Tariffs to Implement a )  
14 General Rate Increase for Natural ) Case No. GR-2004-0209  
15 Gas Service )  
16  
17  
18 MORRIS L. WOODRUFF, Presiding,  
19 SENIOR REGULATORY LAW JUDGE.  
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22  
23 STEVE GAW, Chairman,  
24 CONNIE MURRAY,  
25 ROBERT M. CLAYTON,  
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1 P R O C E E D I N G S

2 JUDGE WOODRUFF: Welcome back to week two  
3 of Case No. GR-2004-0209. I believe we're going to start  
4 this morning with testimony from MGE's Witness Roger  
5 Morin; is that correct?

6 MR. FAY: Yes, it is, your Honor. Michael  
7 Fay for Missouri Gas Energy.

8 (Witness sworn.)

9 JUDGE WOODRUFF: You may be seated, and you  
10 may inquire, sir.

11 MR. FAY: Thank you, your Honor.

12 ROGER MORIN testified as follows:

13 DIRECT EXAMINATION BY MR. FAY:

14 Q. Would you please state your name and  
15 title for the record.

16 A. My name is Roger A. Morin.

17 Q. And are you presently employed, Dr. Morin?

18 A. Yes. My official title is Distinguished  
19 Professor of Finance at the College of Business, Georgia  
20 State University, and Professor of Finance for Regulating  
21 Industry at the National Center for the Study of Regulated  
22 Industry.

23 Q. Thank you, Dr. Morin.

24 A. In Atlanta, Georgia.

25 Q. Have you caused rebuttal testimony in your

1 name to be filed in this proceeding?

2 A. Yes, sir, I did.

3 Q. As you sit here today, do you have any  
4 changes, corrections you'd like to make to that testimony?

5 A. No changes.

6 Q. If I were to ask you this morning the  
7 questions set forth in your rebuttal testimony, would your  
8 answers here today be the same or similar to what's set  
9 forth in the written testimony?

10 A. Yes, sir, they would.

11 MR. FAY: I believe it's Exhibit 5. I'd  
12 like to submit Exhibit 5, Dr. Morin's rebuttal testimony,  
13 into evidence, please.

14 JUDGE WOODRUFF: Exhibit No. 5 has been  
15 offered into evidence. Are there any objections to its  
16 receipt?

17 (No response.)

18 JUDGE WOODRUFF: Hearing none, it will be  
19 received into evidence.

20 (EXHIBIT NO. 5 WAS RECEIVED INTO EVIDENCE.)

21 MR. FAY: I'd like to submit Dr. Morin for  
22 cross-examination.

23 JUDGE WOODRUFF: Thank you, sir. Kansas  
24 City and Joplin are not here. Federal Agencies have any  
25 questions?

1 MR. PAULSON: No, sir.

2 JUDGE WOODRUFF: I don't see Jackson County  
3 or Midwest Gas. Public Counsel?

4 MR. MICHEEL: Since Dr. Morin didn't rebut  
5 Mr. Allen, I have no questions for Dr. Morin today.

6 JUDGE WOODRUFF: For Staff, then?

7 MR. BERLIN: Yes, your Honor.

8 CROSS-EXAMINATION BY MR. BERLIN:

9 Q. Good morning, Dr. Morin. I'm Bob Berlin.  
10 I'm Staff Attorney.

11 A. Good morning.

12 Q. Also the same attorney that deposed you  
13 earlier.

14 A. Yes. Your appearance is as formidable as  
15 your voice.

16 Q. Dr. Morin, are you a full-time employee of  
17 Georgia State University in Atlanta?

18 A. Yes, sir.

19 Q. Dr. Morin, in looking at Schedule RAM No. 1  
20 of your rebuttal testimony, page 3, you list 25 utility  
21 companies under the header of professional clients; is  
22 that correct?

23 A. Yes, sir. The list continues all the way  
24 out to page 7.

25 Q. Well, on pages 4, 5, 6 and 7 of Schedule

1 RAM-1, you list a total of 79 utility companies as  
2 consulting clients?

3 A. That's correct.

4 Q. What is the difference between a  
5 professional client and a consulting client?

6 A. They're the same. The reason for the  
7 appellation consulting is it's not always rate of return  
8 testimony. It's frequently training programs or  
9 conferences or in-house training on financial issues. I  
10 do a lot of brainstorming sessions with commissions and  
11 companies, and it's a broader appellation to label it  
12 consulting, as opposed to professional, but they're  
13 virtually the same.

14 Q. Thank you.

15 Referring to the same Schedule RAM-1, I  
16 notice that the only U.S. utility commission that you list  
17 as either a /professional client or as a consulting client  
18 is the Illinois Commerce Commission. Is that correct?

19 A. There's one more since, the Maryland Public  
20 Service Commission, where I conducted a seminar on  
21 performance-based ratemaking for the benefit of the staff  
22 and the commissioners. I have to update that one.

23 Q. But your work in Maryland with the Maryland  
24 Commission was not on a rate case; is that right?

25 A. Correct.

1           Q.       Referring back to Schedule RAM No. 1, are  
2   there any consumer advocate clients?

3           A.       The CRTC, which is the equivalent of the  
4   FCC in Canada, would be considered such a body, I guess.

5           Q.       But there are no United States consumer  
6   advocate clients on your resume; is that correct?

7           A.       That's correct.

8           Q.       Looking at pages 10 through 14 of RAM-1,  
9   you made at least 104 separate appearances as an expert  
10   witness appearing for a utility company before regulatory  
11   commission or board. Does that number sound correct?

12          A.       Yes, sir. Probably closer to 125, if I  
13   updated it.

14          Q.       And would you agree that the 104 or perhaps  
15   125 appearances that you made for your client utility  
16   would actually be a bit higher because you represented  
17   many client utilities in more than one year?

18          A.       That's correct.

19          Q.       And an example might be Cincinnati Gas and  
20   Electric where, according to your Schedule RAM-1, you  
21   served as an expert witness in 1994, 1996, 1999 and 2004;  
22   is that correct?

23          A.       That's correct. I just filed testimony on  
24   behalf of CGE.

25          Q.       And, Dr. Morin, in looking at a letter that



1     you sent to Mr. Michael Fay at Kasowitz, Benson, Torres &  
2     Friedman, in your second sentence you state, quote, my  
3     mandate will consist of submitting written and oral expert  
4     rebuttal testimony to Mr. Murray's, parentheses, Missouri  
5     Public Service Commission Staff, parentheses, rate of  
6     return testimony in the determination of a fair and  
7     reasonable rate of return on equity, parentheses, ROE,  
8     parentheses, on MGE's common equity capital, quotation  
9     marks. Is that a correct statement?

10           A.     Yes, sir.

11           Q.     And for your review of Mr. Murray's  
12     testimony and submission of written and oral rebuttal  
13     testimony, you are being paid a fee of \$30,000 by MGE?

14           A.     That's correct.

15           Q.     And given that this proceeding -- in this  
16     proceeding you are hired for the limited purpose of  
17     critiquing Staff Witness Murray and that you're being paid  
18     \$30,000 for doing so, is it safe to conclude that you make  
19     a fair portion of your living testifying on behalf of  
20     client utility companies?

21           A.     Yes. I would be glad to testify on your  
22     behalf if you were to ask me.

23           Q.     I'm not sure that we can afford you, but  
24     that's fine.

25                   And Mr. -- or Dr. Morin, did you prepare

1 your own cost of capital study in this proceeding?

2 A. No, sir. But I have prepared obviously a

3 lot of testimonies recently for comparable utilities.

4 Q. And you do not support your own cost of

5 capital recommendation in this case; is that correct?

6 A. Correct.

7 Q. Dr. Morin, during a deposition I asked you

8 the question, do you have any material that you consider

9 as a standard narrative that you use for testimony

10 purposes? Do you recall that question?

11 A. Yes, and the answer.

12 Q. And that goes really to page 10, lines 2 to

13 7 of your deposition, but would you please read your

14 answer on lines 4 through 7, and that would be page 10.

15 A. I would need a transcript of the

16 deposition, which I do not have.

17 MR. BERLIN: Is counsel going to give him a

18 copy?

19 MR. MICHEEL: Here you go, Dr. Morin. You

20 can have my copy.

21 THE WITNESS: Appreciate that. Page 10?

22 BY MR. BERLIN:

23 Q. Yes, sir.

24 A. I have it.

25 Q. Lines 2 through 7.

1           A.       Question: Do you have any materials that  
2   you consider as a standard narrative that you use for  
3   testimony purposes?

4           Answer: Yes, sir. I have some boilerplate  
5   text that talks about the rudiments of rate of return  
6   regulation, describes the various methodologies that one  
7   uses. So the quick answer -- or the answer is yes.

8           Q.       And on line 8 of your deposition, I asked,  
9   when can you provide Staff a copy of that boilerplate that  
10   you use? Would you please read your answer to that  
11   question. I believe it's lines 10 through 13 on page 10.

12          A.       The answer is, all I can do for you is  
13   provide you any copy of any testimony that you'd want me  
14   to send to you. I have most of them for the last five  
15   years, so just tell me which one you want and I'll be glad  
16   to send it to you electronically.

17          Q.       Is that answer true and correct?

18          A.       Yes. I haven't received any request for  
19   such testimonies.

20          Q.       So MGE never contacted you about whether  
21   you keep copies of your past testimony?

22          A.       No.

23               MR. BERLIN: Your Honor, may I approach the  
24   witness?

25               JUDGE WOODRUFF: You may.

1                   MR. BERLIN: I have here Staff Data Request  
2   No. 325.

3                   JUDGE WOODRUFF: Do you wish to offer this,  
4   mark this as an exhibit?

5                   MR. BERLIN: Yes.

6                   JUDGE WOODRUFF: Be No. 853.

7                   (EXHIBIT NO. 853 WAS MARKED FOR  
8   IDENTIFICATION BY THE REPORTER.)  
9   BY MR. BERLIN:

10                Q.     So, Dr. Morin, what you have before you is  
11   Staff Data Request 325. And you indicated that MGE never  
12   contacted you about whether you keep copies of your past  
13   testimony; is that correct?

14                A.     That's correct.

15                Q.     If you would, sir, if you would read the  
16   description of paragraph 1, please.

17                A.     In the response?

18                Q.     Yes, sir.

19                A.     Professor Morin has not kept copies of his  
20   testimony. The matters in which he has served as an  
21   expert witness are on pages 10 to 14 of Schedule RAM-1 to  
22   his rebuttal testimony.

23                Q.     But I do understand, Dr. Morin, that you do  
24   keep copies of your testimony; is that correct?

25                A.     The recent ones I keep, but eventually the

1 archives get so voluminous that some disposal process has  
2 to take place. And you can always find the testimonies in  
3 the Lexis-Nexis database that most attorneys have access  
4 to.

5 Q. Dr. Morin, do you recall in your answer to  
6 me on the deposition that you keep most of the copies of  
7 your testimony over the past five years; is that correct?

8 A. Most of them. Not all of them, but most of  
9 them.

10 Q. So you never stopped keeping copies of your  
11 testimony, correct?

12 A. I keep most of the copies of most  
13 testimonies.

14 Q. Dr. Morin, on pages 9 through 10 of your  
15 rebuttal testimony, Schedule RAM-1, you list by my count  
16 28 separate utility commissions that you have appeared  
17 before. Is that correct, or would there be more state  
18 commissions?

19 A. Probably more. It's not quite up to date,  
20 but that's the vast majority. I think I counted a total  
21 of somewhere above 40 if you include foreign countries and  
22 Europe and Canada, provinces and so on.

23 Q. And on page 24 of your deposition, lines 24  
24 to 25, you indicate that you have worked in some 45  
25 different states. Is that about right?

1           A.       Jurisdictions I think would be a better  
2 term. That includes states, federal bodies and, of  
3 course, state bodies.

4           Q.       And with the exception of the Illinois  
5 Commerce Commission, you represented utility companies; is  
6 that right?

7           A.       As an expert, yes. In a formal rate case,  
8 the answer would be yes.

9           Q.       Of this universe of states and state  
10 commissions that you've appeared before, you said that you  
11 knew only analysts who would qualify as an expert on  
12 capital structure and rate of return, and I would refer  
13 you to page 25 of your deposition, lines 2 through 10.  
14 You cited actually five qualified experts in your opinion.  
15 Do you recall that?

16          A.       Yes.

17          Q.       So out of roughly 45 different commissions,  
18 you still agree that there's about five qualified expert  
19 witnesses on the subject of capital structure and rate of  
20 return, correct?

21          A.       We're a very small group, and I can't list  
22 here all the experts, but it's a handful. The ones that I  
23 do know personally amount to about five.

24          Q.       And, Dr. Morin, what is your definition of  
25 an expert?

1           A.       Wow.

2           Q.       If it helps, Dr. Morin, you did discuss  
3   that on page 21, lines 9 through 19 of your deposition.

4           A.       I would think there's several requirements.  
5   One of them would be the educational minimum requirement.  
6   I would think that someone with at least a master's of  
7   science in finance, at least. I'm not talking about an  
8   MBA and taking Finance 101 or something. I'm talking  
9   about a master's degree in finance would be the minimum  
10   requirement.

11                    Preferably a doctoral program or a doctoral  
12   diploma, because that's subject to peer review in a sense  
13   that you have to publish or perish, as the expression  
14   goes, and you've demonstrated some ability to conduct  
15   empirical research subject to peer review.

16                    So I would think those are the two minimum  
17   educational requirements. Another requirement would be  
18   experience in many, many jurisdictions, having been  
19   exposed to a variety of situations and problems and policy  
20   challenges that commissions face.

21                    No. 3, publications, someone who has  
22   contributed to the field in a peer review publication,  
23   talking about academic journals or textbooks that deal  
24   with regulatory finance.

25                    And one more qualifier. There are a lot of

1 experts in corporate finance, but that doesn't mean  
2 they're experts in regulatory finance. It's quite  
3 different. Just like in your field, you have attorneys  
4 that are specialized in contract law. That doesn't make  
5 them experts in regulatory law. It's the same thing in  
6 finance. There are very few experts in regulatory finance  
7 proper.

8 Does that answer the question?

9 Q. Thank you, Dr. Morin.

10 In your deposition, page 22, line 17  
11 through page 23, you indicated that you know Mr. David  
12 Parcell; is that correct?

13 A. Yes.

14 Q. And didn't Mr. Parcell write a  
15 Practitioner's Guide to Cost of Capital? I'm holding the  
16 book right here.

17 A. Yes, he did.

18 Q. Would you agree that David Parcell does not  
19 qualify as an expert on rate of return and capital  
20 structure?

21 A. There are many gradients of experts, and he  
22 would be on a scale of 1 to 10, 10 being a top expert and  
23 1 being a neophyte, he would be a 7 or 8.

24 Q. Do you recall --

25 A. Only because his monograph is not subject



1 to pier review.

2 Q. Do you recall stating in your answer to me  
3 in the deposition, he's a little bit short of what I would  
4 qualify as an expert?

5 A. Hence the score of 7 on a scale of 1 to 10.

6 Q. Dr. Morin, should the authorized return on  
7 equity for utilities reflect their cost of common equity?

8 A. Yes, sir.

9 Q. And should the allowed return on equity be  
10 based on the company's cost of common equity?

11 A. Yes, sir. It has to be company specific.

12 Q. And if the allowed return on equity is  
13 based on cost of capital, do you believe this will allow a  
14 company to raise the capital and maintain financial  
15 integrity?

16 A. As long as the allowed rate of return is  
17 set in a fair and reasonable fashion and reasonably close  
18 to the cost of capital, the answer is yes. That will  
19 enable the company to compete for capital with everybody  
20 else on fair and reasonable terms.

21 Q. Do you believe that setting the allowed  
22 rate of return equal to the cost of capital balances the  
23 interests of ratepayers and investors?

24 A. I do believe that, but we can launch  
25 ourselves into a discussion of incentive regulation and

1 wider bands of authorized rates of returns.

2 Q. So your answer is yes?

3 A. The answer is yes to your question.

4 Q. And would you agree that the cost of

5 capital is influenced by the level of interest rates?

6 A. Yes, it is, and along with risk.

7 Q. And, Dr. Morin, is it true that you did not

8 perform a cost of equity study for this proceeding?

9 A. Correct.

10 Q. With regard to the subject of floatation

11 costs, Dr. Morin, is it true that you always include

12 floatation costs when you make a rate of return

13 recommendation?

14 A. I always include floatation costs except in

15 a case of government-owned utilities, like Tennessee

16 Valley Authority or Hydrovac. But for investor-owned

17 utilities, there's always a floatation cost. Equity's not

18 free. It has a cost.

19 Q. And in your testimony, do you recommend

20 that MGE collect floatation costs from the Missouri

21 ratepayers?

22 A. Absolutely. It's a cost of doing business,

23 just like you do it for bonds and for preferred stock, you

24 should do it for equity as well to be consistent.

25 Q. And how much of an upward adjustment do you

1     make to Mr. Murray's return on equity recommendation for  
2     inclusion of floatation costs?

3             A.       I believe it's 30 basis points.

4             Q.       Are you aware of any specific capital  
5     investment programs that are targeted toward MGE  
6     infrastructure replacement or improvement?

7             A.       I'm aware that the company will obviously  
8     have to finance additions to rate base, and some of the  
9     financing has to come from equity to keep a proper balance  
10    between debt and equity, and I'm also aware that the  
11    floatation cost has to take care of the equity that was  
12    invested in the past, in the same way that when you have  
13    plants in the utility, in the rate base, you have to  
14    continue to recover the costs associated with those plants  
15    through depreciation.

16            It's exactly the same thing for floatation  
17    costs. You recover the cost of past equity through an  
18    annual charge for floatation costs.

19            Q.       But, Dr. Morin, my question is, are you  
20    aware of any specific capital investment program or  
21    programs targeted toward MGE infrastructure replacement or  
22    improvement?

23            A.       As a general proposition, I'm sure there  
24    are, but I'm not aware of specific additions to rate base.

25            Q.       Do you believe that it is appropriate for

1 MGE to collect floatation costs for Southern Union's  
2 equity issues that are used to drive down the debt that  
3 Southern Union incurred from the acquisition of the  
4 Panhandle operations?

5 A. No, it is not appropriate. I think the  
6 equity that's invested in MGE's operations, the cost of  
7 that equity should be recovered, but not the Southern  
8 Union acquisition related equity.

9 Q. Dr. Morin, when you sponsor a rate of  
10 return recommendation, you stated in your deposition that  
11 you use an equally weighted average of CAPM to DCF and the  
12 risk premium methodology. Do you remember me asking you  
13 about that in your deposition?

14 A. Yes, I do.

15 Q. And if you would, sir, go to page 25,  
16 lines 19 through line 7 on page 36. If you would please  
17 read that.

18 A. Of the deposition?

19 Q. Yes, sir.

20 A. I'm on page 36. What would you like me to  
21 read?

22 Q. Lines -- I'm sorry. Let me go back here.

23 A. Page 35 perhaps, line 19?

24 Q. Yes, sir.

25 A. The question is, when you sponsor rate of

1 return recommendations, what model or models do you use?

2 Answer: Ever since I began in the business

3 25 years ago, I've been very, very, very consistent in

4 using an equally weighted average of CAPM, DCF and risk

5 premium methodologies. I've always done it in that way

6 for reasons of consistency and comparability and

7 credibility.

8 As I explain in the rebuttal, it's very,

9 very dangerous to rely on one methodology and back

10 yourself into a corner when that methodology doesn't work.

11 It's sort of like a pilot flying on a single instrument.

12 That could be a very dangerous flight. So I prefer to fly

13 on all the instruments in front of me so I get a better

14 read on investor inspected returns.

15 Q. And would your answer be the same today?

16 A. Yes, of course.

17 Q. In preparing your rebuttal testimony for

18 this case, did you read MGE Witness Dunn's direct

19 testimony?

20 A. Yes, I read it.

21 Q. When did you become aware that Mr. Dunn

22 used only the DCF model in his testimony?

23 A. In my first reading and only reading of his

24 testimony, I became aware that he was a user of the DCF

25 methodology. Probably because of the precedence set in

1 prior cases by this Commission, he felt that he had to  
2 present or limit himself to DCF presentations.

3 Q. Well, sir, you would agree, then, that  
4 according to your own analogy, MGE Witness Dunn was flying  
5 only on one instrument?

6 A. Well, yes. I think he was basically  
7 capitulating to Commission precedent in that regard.

8 Q. But if you were doing it, you wouldn't fly  
9 on one instrument?

10 A. I would never fly on one instrument.  
11 That's too dangerous. You've got too much measurement  
12 area using any one technique, and using more than one  
13 technique you can use each one as a check on the other.  
14 So it's very, very useful to use a variety of  
15 methodologies, what I call an arsenal of methodologies in  
16 my book.

17 Q. And didn't Mr. Murray use a DCF model and a  
18 CAPM model?

19 A. He did, but he placed absolutely no weight  
20 on the CAPM results. I think I quote that in my rebuttal.

21 Q. Dr. Morin, when I asked you at deposition  
22 what portions of Mr. Murray's study that he did right, in  
23 your opinion, you responded that he used the right beta  
24 risk measures and that you had no problem with the  
25 comparable group that used and that you did not have a

1     problem with the raw dividend yield, the spot dividend  
2     yield with respect to stock price.

3                     Do you still agree with those answers that  
4     you gave me?

5             A.       That is correct. The only disagreement  
6     with the dividend yield is I would have liked to use more  
7     current stock prices that reflect what's going on right  
8     now, not what went on four months ago. But generally  
9     speaking, I don't have a big problem with the dividend  
10    yield component of his DCF or his beta estimates in the  
11    CAPM.

12                    MR. BERLIN: Thank you, Dr. Morin. That  
13    completes my questions, your Honor.

14                    JUDGE WOODRUFF: All right.

15                    THE WITNESS: Thank you, sir.

16                    JUDGE WOODRUFF: We'll move up for  
17    questions from the Bench, beginning with Commissioner  
18    Clayton.

19    QUESTIONS BY COMMISSIONER CLAYTON:

20             Q.       Good morning, Dr. Morin.

21             A.       Good morning, Commissioner.

22             Q.       I have to ask. I was looking through our  
23    library upstairs and I found -- I found this book right  
24    here, and I didn't know if it would be reversible error to  
25    ask you to autograph it for our library. So I'm not going

1 to do that.

2 A. I would be glad to do that and send you a  
3 copy of the new updated version that's coming out this  
4 fall.

5 Q. Don't send me anything.

6 A. If you have insomnia, it will really help.

7 Q. I understand.

8 I just want to be clear on a couple of  
9 things, because we talked about this subject matter a week  
10 ago, so I'm a little rusty. Okay. I was rusty last week  
11 as well.

12 You do not offer any specific  
13 recommendation with regard to capital structure or cost of  
14 common equity or any other components in establishing a  
15 rate of return for MGE; is that correct?

16 A. That is correct. I would be very, very  
17 glad to supply you with policy guidelines or ideas on that  
18 subject if you want me to.

19 Q. In preparation of today's testimony and the  
20 filing of your testimony, you did have occasion to read  
21 each of the witnesses that did prepare testimony with  
22 regard to capital structure and rate of return analysis?

23 A. Yes, sir, I did.

24 Q. Okay. Is it a fair statement that you  
25 devoted much of your rebuttal testimony on the testimony



1 of the Staff Witness Mr. Murray?

2 A. Yes, sir, that's correct.

3 Q. But I don't recall, did you provide any  
4 analysis of any of the Office of the Public Counsel  
5 witnesses' testimony?

6 A. That is correct, it was not part of my  
7 mandate.

8 Q. Okay. So you didn't assess any of Office  
9 of Public Counsel's witnesses?

10 A. No, I did not.

11 Q. Okay. As someone who does not come from a  
12 financial background -- I'm talking about me -- what  
13 should I be looking at overall other than the formulas and  
14 the different policy recommendations overall, what should  
15 I be looking to establish in picking a capital structure  
16 and a cost of common equity in this financial analysis?  
17 What should be my goal as a regulator?

18 A. Okay. Your goal should be to provide a  
19 fair and reasonable rate of return on the equity capital  
20 that's been invested in MGE's natural gas distribution  
21 operations.

22 Perhaps I can go to the easel here and draw  
23 a very simple picture.

24 Q. Sure, if there's no objection from -- since  
25 he jumped right up there before anyone had a chance to say

1 anything. Don't be shy, Dr. Morin.

2 A. It's my instinct as a professor, I guess.

3 You have here a skeletal balance sheet, and

4 on the left-hand side you have an asset structure. These

5 are rate base assets used in providing service to our

6 customers here. On the right-hand side of the balance

7 sheet you have debt capital, and you have a little bit of

8 equity capital in the case of MGE. And the object of this

9 whole exercise here is to try to figure out the cost of

10 this pool of funds that is used collectively by the

11 company to finance the pool of assets over here. So we

12 have to come up with a cost of debt and, of course,

13 preferred stock and a cost of equity.

14 The cost of debt is very easy to ascertain.

15 It's just contractual. You just look up the interest cost

16 and that's it. The same with preferred stock. The cost

17 of equity is much, much more difficult to ascertain

18 because you can't read it in the Wall Street Journal.

19 It's not posted in the media or in Bloomberg or on

20 television or anything like this. So you have to infer

21 the cost of equity, what the investors actually expect.

22 But in order to do this, you have to use

23 several methodologies. You've talked a lot about DCF in

24 this proceeding. That's one way of looking at it.

25 Another way of looking at is risk premium technique.

1 Another way of looking at it is the C-A-P-M, or CAPM.

2 Before I get into that, the size of those  
3 two boxes here, the relative melange of debt and equity,  
4 the blend is referred to as the capital structure. In the  
5 case of MGE, there's a huge amount of debt and a very,  
6 very small equity cushion. To illustrate, it's roughly  
7 75/25, let's say for the sake of discussion here. And  
8 that's a pretty small equity cushion.

9 The equity here, the shareholders in this  
10 company, in this case Southern Union, they're pretty far  
11 down the food chain here, pretty far down the totem pole  
12 of claims on these assets. At the very top of the totem  
13 pole, the senior claimants are the bondholders, then the  
14 preferred shareholders, and then at the very bottom of the  
15 pile is the equity owners, the shareholders. So this is a  
16 very unusual and rather risky capital structure.

17 All right. If we look at other utilities  
18 in the natural gas distribution business, what we find is  
19 a more balanced mix of debt and equity, roughly 55/45,  
20 50/50. Let's use 55/45 as roughly the industry average.  
21 So you can see here that for the typical gas LDC, there's  
22 much less financial risk. There's a thicker equity  
23 cushion. The bondholders have a thicker equity cushion to  
24 sit on. They're better protected.

25 Now, here in this proceeding, this is a

1 very unusual capital structure. It's really, really  
2 unusual to have that thin an equity cushion. In cases  
3 like this, it's, I think, good public policy to use what  
4 we call an imputed, or a deemed, as they call it in Canada  
5 or in Britain, or as you call it here a hypothetical  
6 capital structure that is more reflective of a balanced,  
7 fair and reasonable low-cost capital structure.

8                   So one of the challenges that we have here,  
9 that you have as a Public Service Commission is to come up  
10 with the right set of weights when you compute the --

11           Q.       Can I stop you right there and ask a  
12 question?

13           A.       Absolutely.

14           Q.       I know you professors like waiting 'til the  
15 end of your presentation to take questions. Do you mind  
16 if I ask you a question right at this point?

17           A.       No. Please interrupt.

18           Q.       With regard to this capital structure, if  
19 you use a deemed capital structure or a hypothetical  
20 structure, how does that accurately reflect the risk and  
21 the actual costs incurred by a company in establishing  
22 rates? I mean, how does that give a fair representation  
23 to an investor that will be looking perhaps to invest and  
24 is assessing whether or not the return is sufficient to  
25 invest capital in the company? How does that provide any

1 accuracy to any of the parties if you change the actual  
2 structure?

3 A. Okay. The 75/25 capital structure we will  
4 admit is a very risky capital structure. If you're  
5 investing here in the shares of this company, you are in a  
6 very, very risky residual position. Therefore, in  
7 recognition of that, you should impute a much higher  
8 return on equity. That's why a lot of the witnesses in  
9 this case, I think all of them have a risk premium, an  
10 add-on, so to speak, over and above the average utility to  
11 recognize the fact that this is a very thin equity  
12 cushion. That's one way of doing it.

13 Another way of doing it --

14 Q. The first way of doing it would be to use  
15 the actual structure and then add a premium?

16 A. Exactly, to recognize that risk.

17 Q. Okay.

18 A. Which I discuss in my own rebuttal. The  
19 other way of doing it is to use a more balanced, a more  
20 representative, a more conservative capital structure, but  
21 then you don't have the add-on on the rate of return  
22 anymore, because you have recognized the risk of the  
23 capital structure by increasing the equity cushion. So  
24 you don't want to double count it. You don't want to  
25 impute an equity-rich capital structure and have an added

1 risk premium on top of that. You'd be double counting the  
2 risk.

3 This is a more -- can I be candid here -- a  
4 more politically correct, more politically strategically d  
5 acceptable regulatory policy.

6 Q. We understand that term here.

7 A. Okay. Because instead of having to  
8 authorize a return of 12, 13 percent in recognition of  
9 this very high risk, Wall Street would be a little bit  
10 concerned about a 12 or 13 percent return and you would be  
11 sort of at odds with what's going on elsewhere in the  
12 country. So I think it's more politically expedient to  
13 recognize the risk by imputing a higher equity ratio and  
14 awarding an ROE that's lower that's sort of consistent  
15 with what everybody else is awarding for the average risk  
16 utilities.

17 Q. Does a higher level of risk automatically  
18 by definition mean higher rates for customers? Is more  
19 risk going to mean higher -- by its definition or by -- I  
20 suppose in the abstract, does it always mean higher risk  
21 of a company is going to mean more money that's needed or  
22 higher rates for a customer?

23 A. The answer is yes. When you talk about  
24 rate of return, what you're trying to do here is you're  
25 trying to compensate investors for two things. You're

1     trying to compensate them for time, because they have  
2     postponed their consumption. When you invest money, you  
3     postpone consumption and you want to be rewarded for that.  
4     We call that the rate of interest, let's say the yield on  
5     U.S. Treasury bonds, plus a compensation for risk.

6                     All right. And this encompasses business  
7     risk, whether you have a weather normalization clause, the  
8     risk that I was talking about over here, which we labeled  
9     financial risk. There's a variety of elements of risk  
10    that are deemed compensated here inside the rate of  
11    return.

12                    So the quick answer to your question is,  
13    yes, the higher the risk, the higher the rate of return.

14                    Q.     How do we take into consideration this  
15    balancing act between the shareholders and the rate-paying  
16    customers if risk is increasing based on decisions by the  
17    company, how do we assess where the higher costs are going  
18    to go, whether they stay with the company or whether they  
19    go to the ratepayer? Because if a higher risk means  
20    higher rates, then how do we balance where the  
21    responsibility should fall in paying that higher cost?

22                    A.     The key concept here is what we call the  
23    stand-alone principle. You have to view MGE's natural gas  
24    distribution operations as a stand-alone entity, separate  
25    of its affiliations with Southern Union. If this was a

1 stand-alone corporate entity, what kind of return would  
2 investors expect from that unbundled specific divisional  
3 entity, so to speak? We call that the stand-alone  
4 approach.

5                   And the way to do that is to try to find  
6 proxies for such companies. In both Witness Murray's and  
7 Allen's testimony, there are comparable groups that are  
8 fairly representative of that industry, and you should be  
9 looking at that.

10                   And with regard to the compensation for  
11 financial risk, the way to get around that is to impute a  
12 more normal capital structure that consists of sort of an  
13 industry average amount of equity versus debt.

14                   All right. You asked me about risk.  
15 One of the things we do in all the testimonies here is we  
16 have risk over here -- and this is something everybody can  
17 relate to -- we have return over here, cost of capital.  
18 What we find is high risk, high return, like this  
19 (indicating). I'm not sure anybody wouldn't agree with  
20 that. And this is called the risk-free rate. It's got  
21 zero risk, so we want to lease compensation for time that  
22 I was talking about earlier.

23                   And as we speak today, Treasury bonds are  
24 yielding about 5 1/2 percent, and they're -- the forecast  
25 is for 6 percent next year. That's something you should



1 keep in mind when you make your deliberations, that we are  
2 in a rising interest rate environment right now and the  
3 era of descending interest rates of the last four years,  
4 it's over. Officially this Wednesday will be over when  
5 the fed announces an increase in the discount rate.

6                   Anyway, here's the average stock. We call  
7 that the stock market. It has so much risk. And this we  
8 call the market return,  $R_N$ . Now, the big challenge that  
9 we all have as experts here is to sort of position MGE's  
10 gas distribution operations on the risk spectrum. Are  
11 they riskier than the market? Are they much less risky  
12 than the market? Where are they?

13                   Well, somewhere here, approximately, one  
14 can say that MGE is about 75 percent as risky as the stock  
15 market as a whole.

16           Q.       One can say or one does say?

17           A.       One does say. And this is called beta, by  
18 the way. I avoid the use of Greek letters whenever I can.

19                   A company like MGE is about 75 percent as  
20 risky as an investment in the stock market. So its rate  
21 of return or cost of equity would be here. This is the  
22 risk premium that everybody talks about. How much more  
23 compensation over and above the risk-free rate should we  
24 give investors in MGE? What is that slope here, what is  
25 that line? That's the CAPM, by the way, that everybody's

1 using in this proceeding.

2 Does that help a little bit or am I --

3 Q. It does, and I've got to tell you, I keep  
4 waiting for you to turn around and ask me a question.

5 A. I won't do that.

6 Q. You've got me into this academic feeling  
7 here.

8 No. I follow what you're saying.

9 A. This is the real world, too. Wall Street  
10 is very much modern portfolio oriented, very much beta  
11 oriented, CAPM oriented, rather than DCF oriented.

12 Q. Well, if at the end of the day we are  
13 trying to assess the type of return that is necessary to  
14 encourage capital to be invested in this company, and we  
15 are using formulae to establish what that number is, isn't  
16 at the end of the day, there is a total dollar amount of  
17 money that needs to be increased in rates that we are  
18 trying to come up with that is going to encourage this  
19 investment rather than these actual figures? Because  
20 there are other variables that go into setting rates, not  
21 just the return of equity. You could get a similar amount  
22 of money out of your operating expense.

23 A. You're absolutely correct. At the end of  
24 the day when all this is over, you will make a decision on  
25 the revenue requirement, the cost of service. That has to

1 be sufficient to cover the O&M, the operations, the labor  
2 cost, the materials cost, the depreciation and all that,  
3 and produce a fair rate of return on the capital supplied  
4 in the business.

5                   And my testimony or other witnesses'  
6 testimony is concerned with determining how many dollars,  
7 and you're right, it's dollars, that are necessary to  
8 service capital. These dollars will service the  
9 bondholders, their coupons. It will service the return  
10 requirements of the shareholders through dividend payments  
11 and capital gains. That's the guts of the process that  
12 we're going through. So the answer is yes.

13               Q.       So we could -- if we were to deviate from  
14 suggestions that you are making in terms of these costs or  
15 that the company is making, but were to perhaps authorize  
16 higher O&M costs, that dollar amount that comes out in  
17 revenue requirement may be sufficient to attract capital.  
18 Is an investor going to look at what type of rate of  
19 return we authorize or is it the overall dollar amount  
20 that we approve in increased rates?

21               A.       The investment community will focus on this  
22 particular number. I'm part of a group called all the  
23 Gurman Group on Wall Street, and I receive phone calls  
24 probably weekly from Goldman Sachs, Solomon Brothers and  
25 all the big huge brokerage houses, and their question

1 always centers around what kind of allowed rates of  
2 returns are going on these days? What do you think this  
3 commission's going to do? It's a major, major driver of  
4 their evaluation of stocks.

5 Q. So they do pay attention --

6 A. Oh, absolutely.

7 Q. -- to the -- and that may be a silly  
8 question, but we have so many cases that are settled in  
9 the state of Missouri where there is no finding of a  
10 specific dollar amount of cost of equity or determination  
11 of policy on a capital structure that it would lead one to  
12 believe that it's the actual dollar amount at the end that  
13 matters the most. That's not an accurate statement on my  
14 part.

15 A. Well, what they will do, they will infer or  
16 they will calculate the inferred or implicit ROE in the  
17 decision from the black -- we call this a black box  
18 settlement. They would literally calculate, look, what  
19 kind of ROE ends up here in the bottom line? That's what  
20 they're concerned with.

21 And you don't want to deviate too much  
22 from, you know, the authorized returns across the United  
23 States or that you've already authorized other utilities  
24 in Missouri because that looks kind of strange when you do  
25 that.

1                   So the answer to your question is, yes, the  
2     authorized ROE is a major concern and is scrutinized by  
3     analysts to see if it's reasonable and fair and comparable  
4     and consistent and so on.

5           Q.       And in -- are you familiar with past  
6     decisions by the Missouri Commission on rates of return  
7     for our utilities?

8           A.       Not specific decisions. The general  
9     climate, yes.

10          Q.       Are we-- is it your opinion that we are out  
11     of line with what is going on in the rest of the country?

12          A.       No, you're not. You're viewed as an  
13     average commission, and that's not a bad label. If I  
14     was -- I would love to be a utility commissioner, by the  
15     way. If I was --

16          Q.       What state do you live in?

17          A.       Georgia.

18          Q.       You have to run for office down there.

19          A.       Yeah, I know. I much prefer to be  
20     appointed and have a much longer planning horizon.

21          Q.       We'll talk later on.

22                   (Laughter.)

23          A.       Yeah. But I would like -- I would not like  
24     to be rated above average because that suggests that  
25     you're more generous to the utility, but I would not like

1 to be rated below average. That means you're overly  
2 generous on the consumer side. So I would like to retain  
3 the appellation, you know, average, fair, reasonable,  
4 supportive. And I think that's the label that's placed on  
5 this particular commission.

6 Q. So past decisions or at least reputation  
7 would indicate Missouri is an average commission somewhere  
8 in middle of the 50 states?

9 A. Well, the ROEs are a little bit lower than  
10 what's being reported by Regulatory Research & Associates,  
11 which is a very well-known publications in the field of  
12 regulatory finance. They literally survey and catalog all  
13 the ROE decisions on a monthly basis actually.

14 And it seems to me that you're a little bit  
15 lower than some of the average rates of return that have  
16 been awarded. So I would think about that a little bit.

17 Q. Are we more generous in other areas to make  
18 up for that or not, to the best of your knowledge?

19 A. To the best of my knowledge, I don't like  
20 to say this, but I think you're being less generous, and  
21 that's why MGE has a very, very difficult time ever  
22 earning the return that is being authorized to them. So  
23 that would suggest to me that perhaps this piece here, the  
24 O&M pieced, the cost of service, cost of doing business  
25 perhaps has not been compensated adequately. But that's a

1     general statement that I'm making.

2             Q.       Now, we have -- you're aware we have some  
3     utilities that have had a history of achieving their  
4     authorized rates of return or even exceeding that?  You're  
5     aware of that?

6             A.       Yes, I am aware of that.  And if that's the  
7     case, you have the show-cause tool to call them back in  
8     and say, hey, you're earning too much money.

9             Q.       So we haven't been that bad on all  
10    utilities, just I suppose a handful of utilities?

11            A.       No.  That's why you're rated favorably as  
12    an average commission, which is the way it should be, I  
13    think.

14            Q.       Just so that I will -- I just want to  
15    clarify a couple of things.  According to your testimony,  
16    I think that you suggest that we use an actual  
17    consolidated capital structure with a number of risk  
18    additions in the return.  Is that an accurate statement?

19            A.       No, not really.

20            Q.       You offered -- you suggested a number of  
21    adjustments to the -- to the actual return on equity, I  
22    thought.

23            A.       My suggestion is this:  If you're going to  
24    use the actual consolidated capital structure of Southern  
25    Union, which is very equity poor, you have to recognize

1     that increased risk by adding an add-on on the rate of  
2     return on equity.

3             Q.       Right. I understand.

4             A.       I quantify that, and this is very easy to  
5     quantify in finance.

6                     My preferred approach would be to impute a  
7     more reasonable capital structure by imputing a more  
8     equity rich capital structure, perhaps 55/45, similar to  
9     the comparable groups, and then work with the average ROE.  
10    No need to have an added risk premium on top of that.

11                    My own estimates these days run anywhere  
12    from 10 1/2 to 11 1/2 percent, depending on the particular  
13    utility. And, of course, I didn't do a specific study for  
14    this particular company, but that ballpark figure or range  
15    is something you should be looking at if you're going to  
16    go to an imputed capital structure, which is more  
17    representative of that of the industry.

18                    And ratepayers are better off that way  
19    because -- I'm going to draw you another picture. Last  
20    one, I promise.

21             Q.       I like pictures. They work well for me.  
22    These books don't have enough pictures.

23             A.       I'll take note of that in my next edition.

24                     Here's the cost of capital here on the  
25    vertical axis, and on the horizontal axis I'm going to



1 have the capital structure, let's say the debt ratio. And  
2 one of the holy grails of finance is that this behaves in  
3 a U-shaped fashion. As you increase the debt ratio, the  
4 overall cost of capital declines because the company's  
5 using more and more low-cost tax-deductible capital.

6 And as you keep doing that, as you keep  
7 increasing the debt, more debt and more debt and more  
8 debt, eventually the low-cost tax advantage of debt is  
9 offset by the rising risk associated with debt and it  
10 starts turning up again. We call this the optimal or the  
11 cost-efficient capital structure.

12 I could change the axis here and call this  
13 revenue requirements, which is the burden that the  
14 ratepayers have to face, and somewhere there is an optimal  
15 capital structure, and the industry benchmark is somewhere  
16 in the range of 45 to 50 percent common equity or 55, 50  
17 percent debt ratio, somewhere around here. That also  
18 happens to match a single A bond rating.

19 Now, what's happening right now here for  
20 Southern Union, they're way up here. All right? They  
21 don't have an optimal capital structure, from the  
22 ratepayers' perspective or from investors' perspective.  
23 And by imputing a hypothetical capital structure that's  
24 closer to here, you will be minimizing capital costs.  
25 That tradeoff between risk and return would be optimized.

1                   So I don't know if that picture helps a  
2 little bit --

3           Q.       It does.

4           A.       -- from a policy perspective.

5           Q.       It does. In terms of the overall cost,  
6 it's easy to get lost up in the different components, but  
7 the U does reflect what the overall cost that will be  
8 necessary. As you increase the risk, it would indicate  
9 that it's going to increase the cost while debt is  
10 actually cheaper than common equity, and that's where I  
11 would get --

12          A.       The confusion probably arises, you have to  
13 remember, this is the overall cost of the composite, the  
14 overall cost of all the capital used by the utility. It's  
15 a weighted average cost of debt and equity. And as you  
16 increase the weight of debt, it lowers the average. But  
17 eventually that's offset by a rise in the cost of equity,  
18 which makes the overall cost of capital go up. It's risk  
19 and return.

20          Q.       You summarized, I believe, your concerns  
21 about testimony that had been offered by, I believe,  
22 Mr. Murray, and you had a list of about ten items. Is that  
23 a fair statement, you summarize, I think, at the end of  
24 your testimony?

25          A.       Yeah. It's 15 items, but --

1           Q.       15 items. Excuse me. I must have ran out  
2 of time.

3           A.       It's summarized right up front on --

4           Q.       You -- I think -- is it a fair statement  
5 that you disagree with using the discounted cash flow  
6 method in this analysis?

7           A.       Not at all. I agree with the use of the  
8 DCF method, but I want the method to be complimented and  
9 supported by the other technologies. I go back to my  
10 analogy of the pilot flying on the single instrument that  
11 makes for a potentially dangerous flight.

12                    The same thing if you rely just on DCF,  
13 you're back -- as a commissioner, I would not want to see  
14 myself painted into a corner and be sort of the prisoner  
15 or the -- yeah, the prisoner of one methodology for all  
16 subsequent rate cases. That's very dangerous to do. No  
17 more than I would like to be labeled a CAPM commission or  
18 risk premium commission. That's a very dangerous thing to  
19 do. So give yourself as much room as possible to use your  
20 own judgment.

21           Q.       Did you assess -- I think you were  
22 concerned about one of the methods, the DCF model not  
23 being reflective of the actual dividend payouts if the  
24 company was not an accurate piece to the analysis?

25           A.       Another picture.

1           Q.       No one's objected to your pictures yet, so  
2 I think that's a good sign.

3           A.       Okay. This is a bar chart where the return  
4 is made up of two pieces; the dividend yield, which is  
5 dividend over price, that's easy, and the growth that's in  
6 the minds of investors. That's a very, very difficult and  
7 challenging number to come up with. What is in the mind  
8 of investors with regards to growth in the picture  
9 forever? How do you measure that?

10                   One way to do it is history, and I have  
11 lambasted the use of history here because it's not  
12 representative of future because of the tremendous  
13 upheaval, instabilities and the transformations that have  
14 occurred to the energy business. You cannot look at  
15 history. People cut dividends, they've suspended  
16 dividends, they've made acquisition, history is not a very  
17 good guide.

18                   The other way to do it is ask analysts.  
19 All right? If they don't make good forecasts, they get  
20 fired. So a consensus forecast of analysts of growth,  
21 which also relies on history is probably -- and the  
22 empirical literature supports that -- the best proxy, the  
23 best proxy for growth in the DCF model.

24                   The other method that's sometimes used is  
25 called a sustainable growth method, where you look at the

1 drivers of growth being the retention ratio, how much you  
2 retain and increase the asset base, but that technique is  
3 not very good because you need an answer -- you start with  
4 the answer before you get the ROE, so throw that one out.

5                   So the disagreement here, to summarize, is  
6 history is not in this case a very good guide as to the  
7 growth prospects of the future, and the way to go with is  
8 analyst forecast, which already include historical  
9 information. And then the next question and the big  
10 controversy in this case, I think, is, well, the growth of  
11 what? In theory, it's dividends, but nobody forecasts  
12 dividends except ValueLine. Everybody forecasts earnings;  
13 Thompson, they're all on websites.

14                   So because utilities are in that profound  
15 transformation right now, they're lowering the dividend  
16 payout ratio voluntarily. Actively, you cannot use the  
17 growth in dividends right now, because right now, as we  
18 speak, utilities are in the process of lowering the  
19 dividend payout ratio, and after that is completed, then  
20 they will resume the steady state growth, and we'll track  
21 earnings.

22                   But the other controversy is, we should  
23 focus on earnings at this time only because of what I just  
24 said, and not dividend growth.

25           Q.       And is that a temporary phenomenon where we

1 focus on earnings rather than dividends, or at some point,  
2 two, three, four, five years down the road we will go back  
3 to dividends in your opinion?

4 A. I think we will return to dividend growth  
5 once the dividend policy, the dividend payout ratio of  
6 utilities has assumed a steady state, which is roughly  
7 70 percent payout, then we can be a little more confident  
8 about dividend forecasts. But at this time it's just not  
9 the right thing to do.

10 Q. I just want to speak briefly about the  
11 other methods beyond the DCF model. You also assessed  
12 staff Witness Murray's CAPM analysis. I think there  
13 was -- did he also do a risk premium analysis?

14 A. Yes, he did.

15 Q. And what were your concerns with regard to  
16 those two models? Take them one at a time, together,  
17 however you feel appropriate.

18 A. Well, let's go back to the picture. On the  
19 vertical we have return on equity, and on the horizontal  
20 axis we have a measure of risk, and here we have what we  
21 call beta. And this line that you see over here, this  
22 rising linear line is indeed the CAPM. The higher the  
23 risk, the higher the return.

24 The problem is the inputs. What is an  
25 appropriate measure of the risk-free rate? There's a

1 consensus among practitioners and academics and scholars.  
2 I said a consensus; doesn't mean everybody agrees. But  
3 there's a general consensus that this should be the yield  
4 on U.S. Treasury bonds, long-term Treasury bonds, and  
5 right now it's about 5.4 percent. The forecast is  
6 approximately 6 percent. So that's not too controversial.

7 The next input is, where is MGE on the risk  
8 spectrum? What is the beta for a natural gas distributor?  
9 I don't think there's too much controversy between all the  
10 witnesses here. We can just look at the ValueLine beta  
11 estimates, and right now they're approximately .7, .75,  
12 depending on the sample. So we can position MGE on the  
13 spectrum here.

14 Probably the biggest element of controversy  
15 is, what is this market risk return here, or what is the  
16 market risk premium? There is a consensus in the  
17 literature and in the textbooks -- I'm talking about the  
18 best selling textbooks, Brealey and Myers corporate  
19 Finance, Gene Brigham's Managerial Finance. These are by  
20 far the leading textbooks in the field. They are of the  
21 view, which I agree, that the market risk premium is  
22 somewhere between 6 and 8 1/2 percent, probably closer to  
23 7 percent.

24 Again, that vertical distance here, what is  
25 the market risk premium for an average investment in the

1 stock market. You can look at it historically, which is  
2 what I think everybody does in this case. And the  
3 Ibbotson & Associates publication, which is sort of the  
4 standard source for that, argues that historically, from  
5 Adam and Eve until today, stocks have outperformed bonds  
6 by approximately 7 percent, historically. So we look at  
7 that.

8 Others do a prospective analysis, applying  
9 a DCF model to the stock market as a whole, and I do that  
10 typically in my testimony, and we get about 6 1/2,  
11 7 percent when you do that also.

12 So to summarize, we need three inputs, a  
13 risk-free rate -- and that should be the yield on U.S.  
14 Treasury bonds, very long term, preferably even the  
15 forecast, a measure of risk beta, which is usually the  
16 ValueLine beta, and then the most elusive piece is  
17 probably the market risk premium, which I believe to be  
18 about 7 percent.

19 Q. And what did Witness Murray use, do you  
20 recall?

21 A. I think he used 4.8, 4.9 over here, a  
22 little bit stale. Should have used current spot rates and  
23 preferably even the forecast rates, and the beta was okay.  
24 I didn't have any problem with that.

25 Q. What beta did he use?



1           A.       It was somewhere around .7, if my memory  
2 serves me right. I'd have to check on that. And I think  
3 market risk premium was outdated. He used data ending  
4 2002 or something, instead of using more current  
5 historical data in 2004, which shows about 7 percent  
6 market risk premium.

7           Q.       Okay. And did you also assess his analysis  
8 under the risk premium model?

9           A.       Well, that was fairly simple to do, because  
10 what he did is he looked at expected returns, published by  
11 ValueLine, minus the risk-free rate prevailing at the same  
12 time, year to year to year to year. In other words, he  
13 sort of went back to the future and looked at the expected  
14 returns, let's say, 1980 versus interest rates, in 1981  
15 what was expected return versus the risk-free rate, etc.,  
16 and he averaged that.

17                   The only problem with that is what we're  
18 trying to do here in this rate case is figure out the  
19 expected return. So I think it's inappropriate to use an  
20 expected return to infer another expected return, which is  
21 the goal of this proceeding. So in other words, it's  
22 highly circular to do that.

23                   If you think that a utility is expected to  
24 earn 11 percent, the only way a utility can earn that is  
25 if you people here set the rates to produce 11 percent.

1     So how can the cost of capital be any different than  
2     11 percent, for example? So my deep concern with that  
3     approach is the circularity that's inherent in that  
4     approach. And my comments here are made in all due  
5     respect to Staff testimonies and Staff witnesses,  
6     certainly.

7                     COMMISSIONER CLAYTON: I think I'm going to  
8     give everyone else a chance to ask some questions. Thank  
9     you very much, Doctor.

10                    THE WITNESS: Thank you, sir.

11                    JUDGE WOODRUFF: Chairman Gaw, do you have  
12     questions?

13                    COMMISSIONER APPLING: Can I ask a  
14     question?

15                    JUDGE WOODRUFF: Please go ahead.

16     QUESTIONS BY COMMISSIONER APPLING:

17             Q.     Good morning, Dr. Morin.

18             A.     Good morning, sir.

19             Q.     Just off the record, I was born and raised  
20     near Macon, Georgia.

21             A.     That's one of my favorite towns. It's  
22     almost a suburb of Atlanta now.

23             Q.     Yes, it is.

24                    Let's go back to your chart on cost of  
25     capital. No. Go forward. Keep going forward. Well, go

1 back one. You drew so many there you got me confused.

2                   Would you -- would you help me out here  
3 with how MGE fits on this chart? Tell me where they're at  
4 in relationship to the cost of capital. We talked about  
5 the debt versus the cost of capital. And what has been  
6 described for me -- I'm a new Commissioner. This is my  
7 first rate case, so all of this is very impressive. Help  
8 me out here with where MGE fits on this chart.

9           A.       Okay. If we use the actual capital  
10 structure of Southern Union as a proxy for MGE, they have  
11 a very high leverage or debt ratio. They're roughly over  
12 here in the 70, 75 percent debt ratio level. And the cost  
13 of capital that you should decide upon at this debt ratio  
14 would be simply too high and the ratepayer burden would be  
15 correspondingly higher as well.

16                   It would appear that the best tradeoff  
17 between risk and return, the idea is you want to take  
18 advantage of debt because it's cheaper and it's tax  
19 deductible, but it's accompanied by higher risks, so how  
20 do you -- where is the knife edge circumstance where you  
21 have the best risk and return tradeoff? That appears  
22 right here at this point (indicating).

23                   Now, what is this point? If you look at  
24 the industry average for natural gas distribution  
25 utilities, this number is in the vicinity of somewhere

1 around 45, 46, 47 percent equity, or 53 percent debt  
2 ratio. Hence my recommendation to use a hypothetical  
3 capital structure consistent with this amount of debt and  
4 equity to minimize the ratepayer burden and the cost of  
5 capital to the company.

6 And that way you also avoid having to  
7 reward shareholders with a much higher rate of return on  
8 equity for bearing this tremendous amount of financial  
9 risk. So it's a tradeoff between risk and return. The  
10 optimum point there, the cost-efficient point occurs  
11 roughly at a single A bond rating, roughly at 55 percent  
12 debt ratio or 45 percent common equity ratio.

13 COMMISSIONER APPLING: Thank you.

14 JUDGE WOODRUFF: Chairman Gaw?

15 CHAIRMAN GAW: Thank you, Judge.

16 QUESTIONS BY CHAIRMAN GAW:

17 Q. Let me ask you, Dr. Morin, when you look at  
18 the risk-free rate, is there a standard of practice in  
19 what to look at in particular with the Treasury bonds? Is  
20 it a 10 year, 30 year, what are you utilizing?

21 A. Again, the consensus -- not everybody  
22 agrees, but the vast majority of scholars I can name, if  
23 you want me to, but there's a consensus that since we're  
24 dealing with common equity, which has infinite life, the  
25 best match would be 30-year Treasury bonds.

1           Q.       All right.

2           A.       And the reason for that is because those

3       yields are much more stable than yields on shorter-term

4       securities. And the other rationale, if you wish, is

5       utility assets are extremely long-term in nature, so it

6       makes sense to compare long long-term assets with the cost

7       of long long-term capital. So 30 years would be my

8       recommendation, and there's a lot of support and consensus

9       on that.

10          Q.       And the 30 year is you say how much, 5 1/2?

11          A.       Right now, this morning on Bloomberg, was

12       5.4 percent. The blue chip consensus forecast and the

13       ValueLine forecast suggest 6 percent for 2005 for the

14       yield on 30-year Treasury bonds.

15          Q.       I'm sorry. I didn't mean to interrupt.

16          A.       No. I was going to say, in response to the

17       growing economy and job creation and job growth, it's not

18       unusual to see interest rates going back up, and Chairman

19       Greenspan has made it very clear that they will tighten

20       the monetary policy a little bit on the Wednesday meeting

21       this week.

22          Q.       What's the 10 year?

23          A.       It's approximately right now 5 percent,

24       4.9 percent.

25          Q.       What is the -- what's the rationale for

1 those that advocate using the 10-year Treasury yield  
2 instead of 30?

3 A. I don't know. But there's two polar views  
4 here. One view is the pure, pure, pure unadulterated  
5 risk-free rate is Treasury bills, 90-day Treasury bills.  
6 But it's illogical to compare stocks, returns on stocks to  
7 a 90-day Treasury bill. It's apples and oranges. So  
8 because of the maturity matching, because of the  
9 consistency, because of need to compare apples to apples,  
10 we try to pair common stocks with 30-year bonds.

11 And there's a little bit more of an  
12 intellectual reason why we do that is that the kinds of  
13 inflation forecasts that are embedded in the yield on  
14 Treasury bonds are very similar to the kind of long-term  
15 inflation forecasts that are reflected in stock yields.  
16 Again, it's an argument of matching; it's an argument of  
17 proper consistency, apples versus apples.

18 Q. I don't know if you answered my question.  
19 What is the argument for utilizing a 10 year as opposed to  
20 the 30 year?

21 A. The only argument that I've ever heard on  
22 that one is that it's reported in the media, it's a bell  
23 weather rate of some kind. It's a compromise between the  
24 fact that there is interest rate risk in the 30-year bonds  
25 and there's no interest rate risk at all in 90-day

1 Treasury bills. It's sort of a compromise between two  
2 extremes.

3 Q. I see. Okay. Did I understand you  
4 correctly earlier that you did not analyze Public  
5 Counsel's witness on this subject matter?

6 A. That's correct.

7 Q. You did not look at their testimony?

8 A. Obviously I've read it, but I did not  
9 formally rebut their testimony.

10 Q. Well, let me give you a chance to do that.

11 A. Well --

12 Q. If you feel that you have looked at it  
13 sufficiently.

14 A. Again, it's very much DCF oriented, as is  
15 the case for Staff. A much better job was done with the  
16 growth rates in the DCF model. There's more reliance on,  
17 at least, the forecast growth rates rather than historical  
18 growth rates.

19 I think the one black eye would be -- and I  
20 discussed this on my charts earlier -- the use, the  
21 generous use of the sustainable growth rate method  
22 requires one to make a forecast on ROE to implement the  
23 method, and the goal of this proceeding is to establish an  
24 ROE. So we're sort of going around in circles here. That  
25 would be two of my comments.

1                   And again, the number 9.2 percent is just  
2 completely out of the mainstream of currently allowed  
3 rates of returns in the United States at 11.1, and let's  
4 not forget that interest rates are increasing.

5           Q.       Would you have said the same thing a year  
6 ago?

7           A.       A year ago?

8           Q.       About that number. In other words, has  
9 it -- have we seen things change in the last year or two  
10 years in regard to returns that would be deemed within the  
11 mainstream?

12          A.       I think they've been steady, very steady at  
13 11 percent. If you look at the quarterly Regulatory  
14 Research & Associates publications, which surveys all the  
15 awarded ROEs, you find that in 2002 there was 11 percent,  
16 2003, it was 11 percent, and the first quarter of this  
17 year is 11.1 percent.

18                   So I sort of agree with you that it's been  
19 very, very steady and stable in terms of authorized  
20 returns over the last 2 1/2 years. It is just at this  
21 juncture in time that we're seeing an upward movement in  
22 long-term interest rates that we haven't seen for a long  
23 time.

24          Q.       Your reference to Regulatory Research  
25 aside, looking just at expected returns in the market, has



1     that changed in the last couple of years --

2             A.       I think --

3             Q.       -- outside of the regulatory environment?

4             A.       I think one can make a case that up to

5     about the spring of 2000, before the debacle and -- the

6     debacle of the Internet stocks and the high tech stocks,

7     the market risk premium, according to a lot of people, had

8     shrunk a very small amount.

9             Q.       Shrunk to about what?

10            A.       2000 -- in the spring of 2000, it might

11     have shrunk as low as 4 or 5 percent.

12            Q.       Okay.

13            A.       But because of the debacle in the stock

14     market in the spring of 2000 and continuing 'til today,

15     notwithstanding the amount of recovery we've had, I think

16     those aggressive sort of go-go years and those perceptions

17     of a declining market risk premium have been reversed and

18     we're going back to -- we're reverting back to a more

19     normalized market risk premium again, which is somewhere

20     in the 6 to 7 percent range, in my view.

21                    CHAIRMAN GAW:  Judge, could you hand him

22     that exhibit, Exhibit 219, would you mind?

23                    JUDGE WOODRUFF:  I can do that.

24     BY CHAIRMAN GAW:

25            Q.       Dr. Morin, there was a witness from Public

1 Counsel also that testified and I think put together just  
2 one page of his own calculation of what the cost of equity  
3 should be. If you would look at that, and I don't know if  
4 there's enough information there for you to say anything  
5 one way or the other about it.

6 A. Yeah. I've seen it, so I can make some  
7 comments on it. Obviously the first input, the risk-free  
8 rate of 4.7 percent in line with our earlier discussion,  
9 you and I, would be probably 5.4 percent if you believe in  
10 using spot rates.

11 Q. Do you know, can you attribute that  
12 4.7 percent?

13 A. It's a 10-year Treasury yield that I  
14 presume prevailed at the time that this exhibit was  
15 prepared.

16 Q. Okay.

17 A. I would -- since the regulation is  
18 prospective as much as possible, I would prefer to use  
19 longer-term rates and preferably even forecast rates. The  
20 beta, you know, these are fairly reasonable ValueLine beta  
21 estimates for gas companies around .7, .75.

22 The big huge problem here is the market  
23 risk premium, which relies on Welch's surveys, and that's  
24 about the worst technique you can think of to determine  
25 the market risk premium. The preferred technique is to

1 use the historical record, the historical market risk  
2 premium over a long, long, long time period.

3 I refer to the Ibbitson & associates market  
4 risk premium of about 7 percent earlier in my comments, or  
5 to do sort of a prospective DCF analysis on the market as  
6 a whole, which also indicates about 6 to  
7 7 percent.

8 The survey technique is particularly in  
9 September 2001, we've seen the debacle again of the high  
10 tech sector of the economy. I'm sure Mr. Welch would  
11 probably have revised upwards his estimate of market risk  
12 premium since. But that is not reflective of the  
13 consensus in both the academic communities and the  
14 empirical research in finance.

15 The market risk premium, as I said earlier,  
16 can vary anywhere between 6 and 8 1/2 percent, according  
17 to all the empirical studies that have been done on the  
18 subject. So if you substitute a risk-free rate of  
19 5.4 percent and market risk premium somewhere around 6 to  
20 7 percent, you'll get cost of equity estimates that are a  
21 little bit closer to 11.

22 CHAIRMAN GAW: That's all I have, Judge.  
23 Thank you.

24 THE WITNESS: Thank you very much.

25 JUDGE WOODRUFF: I have a question about

1     hypothetical capital structures.

2     QUESTIONS BY JUDGE WOODRUFF:

3             Q.       We've been talking about the fact in this  
4     case that, as you've talked about as well, that Southern  
5     Union has a lot of debt and is, therefore, outside the  
6     normal range of debt equity ratio. The question is, does  
7     it matter why the company has a structure that's out of  
8     line with normal?

9             A.       That's a good question. The answer is no,  
10    it really doesn't matter. If you go back to my  
11    stand-alone principle and if you review MGE's gas  
12    operation on a stand-alone basis and ask yourself what  
13    would be a fair and reasonable representative capital  
14    structure, it would be probably around the 45, 55 range.  
15    So that's a pretty good point that it really doesn't  
16    matter from a regulatory prospect.

17                    The high leverage of Southern Union is a  
18    happenstance of the fact they made a huge acquisition that  
19    was debt financed, and we shouldn't be concerned with  
20    that.

21             Q.       Now, there was also a Stipulation &  
22    Agreement entered into before this Commission in that  
23    merger case where Southern Union acquired Panhandle  
24    Eastern, and it's my understanding of that Stipulation &  
25    Agreement that essentially Southern Union agreed that that

1 acquisition would not affect its cost of capital in any  
2 future rate proceeding?

3 A. That's correct, and it shouldn't.

4 Q. Okay. Does that make any difference in  
5 what you just said about the hypothetical capital  
6 structure?

7 A. No.

8 Q. And why is that?

9 A. Again, the principle of stand-alone from  
10 economics reigns supreme in my mind, and should be in your  
11 mind as regulators, that what's a fair and reasonable  
12 capital structure that would be fair for ratepayers if MGE  
13 was standing alone out there as a publicly traded company  
14 with its bonds rated and so on and so forth. I believe  
15 the debt that's issued by MGE would be nonrecourse debt  
16 anyway. So MGE ratepayers are protected from any mishaps  
17 that occur in Southern Union's level.

18 JUDGE WOODRUFF: All right. Then that's --

19 CHAIRMAN GAW: Let me follow on that one.

20 JUDGE WOODRUFF: Certainly.

21 FURTHER QUESTIONS BY CHAIRMAN GAW:

22 Q. Would you mind explaining how -- the  
23 nonrecourse issue?

24 A. If Southern Union's debt runs into  
25 difficulties, can't meet principal payments or interest

1 payments, it cannot recourse to the utility to get the  
2 money to sort of service the bondholders. The debt of MGE  
3 would be, I presume, nonrecourse; in other words, you  
4 cannot go back to MGE and say, hey, I need some cash here  
5 to pay the debt that was issued at the Southern Union  
6 level.

7 That's normally what happens in the case of  
8 an engineering subsidiary that's a utility of a parent  
9 company.

10 Q. Normally I would tend to agree with you  
11 with a subsidiary, but in this case, isn't MGE a division  
12 of Southern Union, rather than a separate subsidiary?

13 A. Yeah, I believe that's the case here.

14 Q. So it would not necessarily be the case  
15 that it would be nonrecourse, would it?

16 A. Probably not. I would ask the CFO or the  
17 treasurer, because I'm not familiar with all the  
18 intricacies of each division.

19 CHAIRMAN GAW: Sure. I just wanted to make  
20 sure I was on the same path. Okay. Thank you, Judge.

21 JUDGE WOODRUFF: Okay. We'll move to  
22 recross, then. Kansas City and Joplin are not here.  
23 Federal Agencies?

24 MR. PAULSON: No questions.

25 JUDGE WOODRUFF: Jackson County and Midwest

1 Gas are not here. Public Counsel?

2 MR. MICHEEL: Yes, your Honor, I have a  
3 couple.

4 RECROSS-EXAMINATION BY MR. MICHEEL:

5 Q. Dr. Morin, Commissioner Gaw was asking you  
6 about the risk-free rate on Exhibit 219, the 4.7 percent,  
7 and you indicated that it was your belief for a 10-year  
8 Treasury note it was about 5.4 percent; is that correct?

9 A. No, that's not correct. I was talking  
10 about the yield on long-term, 30-year Treasury bonds being  
11 at the 5.4 level, not the 10 year.

12 Q. Okay. And you would agree with me that the  
13 10 year is right around the 4.7 percent shown on  
14 Exhibit 219?

15 A. What is the date of that?

16 Q. This was placed into evidence last week.

17 A. Well, then I would agree, subject to  
18 checking the numbers.

19 MR. MICHEEL: Let me approach the witness,  
20 your Honor. I've got Friday's Wall Street Journal with  
21 the 10-year Treasury note yield through last Thursday,  
22 June 24th.

23 JUDGE WOODRUFF: You may approach.

24 THE WITNESS: If it makes life a little  
25 easier, I will accept it subject to check.

1 BY MR. MICHEEL:

2 Q. We can't do that in this jurisdiction,

3 Doctor. You've got to play by our rules here, sir.

4 A. Okay. Okay.

5 Q. Is it correct that the 10-year Treasury

6 note through last Thursday, June 24th, is 4.65 percent,

7 Doctor?

8 A. Yes. Yes, that's correct.

9 Q. So it's a little bit lower than what was

10 shown in Exhibit 219; is that correct?

11 A. That's correct. The raw number is actually

12 lower.

13 Q. Is it correct that a portion of the yield

14 that investors will require on a 30-year Treasury bond is

15 the compensation required by the investor for making a

16 long-term investment over a period of years where

17 inflation may be greater than what is currently expected?

18 A. That is true. And it's true as well for

19 10-year bonds as it is for 30-year bonds, but most

20 institutional investors that hold such bonds in their

21 portfolios are pension funds and insurance companies, and

22 they have a very, very, very long-term asset structure

23 and, therefore, they tend to invest in very, very

24 long-term securities. In other words, they keep the bond

25 to maturity, so they're not subject to interest rate risk,



1 if you keep the bond to maturity.

2 Q. You talked with Commissioner Gaw also about  
3 the market premium rate, and you said that it was in a  
4 whole bunch of the textbooks that they were thinking it's  
5 between the 6 and 7 percent rate. Do you recall those  
6 questions?

7 A. Yes, I mentioned two very prominent  
8 textbooks.

9 Q. Okay. And when were those textbooks  
10 published?

11 A. The latest edition of Brealey and Myers is  
12 2004, and the latest edition of the Brigham Managerial  
13 Finance, I think it's the 9th edition is 2003, so it's  
14 pretty fresh.

15 Q. And they're saying it's 7 to 8 percent?

16 A. Brealey and Myers talk about 6 to  
17 8 1/2 percent over Treasury bills, which translates into a  
18 slightly lower range over long-term Treasury bonds.

19 Q. And what would that range be, Doctor?

20 A. Well, with probably 1 percent lower, 5 to  
21 7 1/2, and the historical record is closer to 7 1/2.

22 Q. And when you say the historical record, is  
23 that the Ibbitson historical record?

24 A. Yes, sir.

25 Q. And that Ibbitson historical record, when

1 did they start calculating those?

2 A. When reliable data was available, started  
3 in 1926 until 2003.

4 Q. So they started right at -- right before  
5 the crash?

6 A. Around the time of the crash, that's  
7 correct.

8 Q. Have you reviewed Dr. Iva Welch's study?

9 A. I've seen it in the past. I think the  
10 Welch has ceased to update the study. I haven't seen  
11 anything in 2004, 2003.

12 Q. Are you aware that that survey was looking  
13 for 30 years out?

14 A. I'm not aware of that, no. Like I said,  
15 that's probably the worst technique of getting a handle on  
16 the market risk premium.

17 Q. Have you seen -- one minute. I just want  
18 to check.

19 MR. MICHEEL: No further questions, your  
20 Honor.

21 JUDGE WOODRUFF: Thank you. For Staff?

22 MR. BERLIN: Thank you.

23 RECROSS-EXAMINATION BY MR. BERLIN:

24 Q. Dr. Morin, there was some discussion about  
25 the CAPM model and the risk-free rate. I have here a copy

1 of your textbook, Regulatory Finance, and I'm looking at  
2 page 309 in your chapter in which you deal with the CAPM  
3 model, and I'm wondering if I can get you to read three  
4 sentences here in which you're addressing the risk-free  
5 rate.

6 A. Sure.

7 MR. BERLIN: May I approach the witness?

8 JUDGE WOODRUFF: You may.

9 BY MR. BERLIN:

10 Q. Do you see that?

11 A. Yes.

12 Q. On page 309? Go ahead.

13 A. You want me to read the paragraph to an  
14 outline here?

15 Q. Well, or where it says "alternately".

16 A. Oh, yes. Got you. And I read,  
17 alternately, the consensus inflation forecast by  
18 economists over the requisite horizon could be employed to  
19 derive the risk-free rate statement. However, none of  
20 these techniques is likely to provide superior estimates  
21 to that supplied by current yield data. The complexity  
22 and computational costs are likely to outweigh their  
23 marginal usefulness.

24 Q. Dr. Morin, the way I understand that is  
25 then you make a pretty strong endorsement for using the

1 current risk-free rate?

2 A. Yes.

3 Q. Right.

4 A. Excuse me. I didn't mean to interrupt.

5 Q. Go right ahead.

6 A. I have the choice here between the spot

7 rate, and it's observable, that's the big advantage,

8 versus a forecast, which is a little bit more arbitrary,

9 and I tend to lean more on spot data. I'm a little bit

10 apprehensive about using predictions, unless it's

11 absolutely obvious that interest rates are increasing, but

12 you're right. I lean more on the spot data than I do on

13 forecast data.

14 Q. Dr. Morin, does the risk to the debtholders

15 decrease with a hypothetical capital structure as well?

16 A. Yes, because they have a stronger equity

17 cushion and presumably higher interest coverage to back up

18 or support the interest payments to the bondholders.

19 Q. Isn't it true that the current capital

20 structure of Southern Union is a result of management's

21 decisions?

22 A. Yes.

23 Q. And if Southern Union did not think that a

24 leveraged capital structure was optimal for their

25 purposes, then why would it maintain an average common

1 equity ratio close to 30 or 35 percent?

2 A. I think this was driven by their  
3 acquisition strategy, financed by debt, but I think  
4 they're quite aware because they've been bombarded by Wall  
5 Street lamenting the fact that they have too high  
6 leverage, but they do have an intention or target capital  
7 structure to be more equity rich in the future.

8 MR. BERLIN: Thank you, Dr. Morin. No  
9 further questions.

10 THE WITNESS: Thank you.

11 JUDGE WOODRUFF: Thank you. Then we'll go  
12 to redirect.

13 MR. FAY: May we have a second to confer  
14 before redirect?

15 JUDGE WOODRUFF: If you mean seconds, yes.  
16 If not, we'll take longer if you need it.

17 MR. FAY: Could we take a break now, your  
18 Honor?

19 JUDGE WOODRUFF: Yeah. We're about due for  
20 a break. We'll come back at 10:15. Thank you.

21 (A BREAK WAS TAKEN.)

22 JUDGE WOODRUFF: All right. Let's go ahead  
23 and get started again. Before we go to redirect, I have a  
24 question for Staff.

25 You marked Exhibit 853 but it's not been

1 offered. Do you wish to offer it into evidence?

2 MR. BERLIN: Yes, your Honor, I would like

3 to offer Exhibit 853 into evidence.

4 JUDGE WOODRUFF: Are there any objections

5 to its receipt?

6 (No response.)

7 JUDGE WOODRUFF: Hearing none, it will be

8 received into evidence.

9 (EXHIBIT NO. 853 WAS RECEIVED INTO

10 EVIDENCE.)

11 JUDGE WOODRUFF: All right. Then for

12 redirect.

13 MR. FAY: Thank you, your Honor.

14 REDIRECT EXAMINATION BY MR. FAY:

15 Q. Just a few questions, Dr. Morin.

16 A. Attorneys always say that.

17 Q. Yes, they do.

18 Dr. Morin, in response to some questions

19 from Commissioner Gaw, you said that you thought that the

20 debt of Southern Union was nonrecourse to MGE. Do you

21 remember that?

22 A. Yes.

23 Q. Did you mean the debt of Panhandle wasn't

24 recourse to MGE?

25 A. I meant the debt of Panhandle, the other

1 operating companies.

2 Q. And that is your understanding, correct?

3 A. That's correct.

4 Q. In response to a question from Mr. Berlin,

5 you said that you had recently done a cost of capital

6 analysis on companies comparable to MGE. Do you recall

7 saying that?

8 A. Yes.

9 Q. Okay. What companies were you referring

10 to?

11 A. You mean the client?

12 Q. Yes.

13 A. The AGL Resources.

14 Q. Okay.

15 A. In Tennessee and Virginia.

16 Q. And do you recall the result of your

17 analysis?

18 A. It was 11 percent. Lots of electric cases,

19 which is probably not as relevant here.

20 Q. During your testimony, and, quite frankly,

21 I forget who asked you this question, but you were asked a

22 question, and in your answer you said that Mr. Murray from

23 the Staff had ignored his other results. Do you recall

24 that?

25 A. Yes, I do.

1           Q.       And when you said he had ignored his other  
2 results, did you mean his CAPM model and his risk premium  
3 analysis; is that correct?

4           A.       What I meant to say very clearly is that he  
5 placed primary reliance on the DCF method.

6           Q.       Okay.

7           A.       I think that was the exact quote, and  
8 ignored essentially the other results produced by --  
9 particularly by the risk premium method, which were around  
10 11 percent.

11          Q.       Okay. In your opinion, how should he have  
12 treated the results of his CAPM and risk premium analysis?

13          A.       I think he should have accorded each  
14 methodology equal weight.

15          Q.       Thank you. You testified, did you not,  
16 Dr. Morin, that you have not made a direct cost of capital  
17 recommendation in this proceeding; is that correct?

18          A.       Yes, sir.

19          Q.       But it is true, isn't it, Dr. Morin, that  
20 in your rebuttal testimony you recommend adjustments to  
21 Mr. Murray's recommendations, correct?

22          A.       That's correct.

23          Q.       And was the purpose of those adjustments to  
24 put Mr. Murray's recommendations into a more reasonable  
25 range with respect to cost of capital?



1           A.       Yes. It was essentially a summary of -- I  
2     don't want to use the word "biases" -- misestimates to the  
3     raw cost of equity estimate, and I simply allowed for  
4     floatation costs and corrected some of the mistakes and so  
5     on and so forth.

6                     And this -- if you allow for those  
7     understatements, is probably a better word, you get to a  
8     much more reasonable rate of return estimate, somewhere in  
9     the 11 percent range for the typical natural gas  
10    distribution company, plus, of course, the add-on to  
11    recognize MGE's much higher risk because of its highly  
12    levered capital structure. That argument would not apply,  
13    of course, if you impute a more equity rich capital  
14    structure.

15                    MR. FAY: Thank you very much, Dr. Morin.  
16    Your Honor.

17                    JUDGE WOODRUFF: All right. Then  
18    Dr. Morin, you can step down.

19                    THE WITNESS: Thank you very much, your  
20    Honor.

21                    JUDGE WOODRUFF: You are excused.

22                    MR. FAY: Your Honor, may Dr. Morin be  
23    excused?

24                    JUDGE WOODRUFF: Yes, he is excused.

25                    Let me make an announcement concerning one

1 of the witnesses that was on Friday. Ms. Lesa Jenkins, we  
2 took her right at the end of the day after I had sent an  
3 e-mail to some of the Commissioners upstairs that we might  
4 not be taking any other witnesses, and at that time I  
5 indicated that we might need to ask questions of her after  
6 that. I've spoken with the Commissioners, and that will  
7 not be necessary. We will not be bringing Ms. Jenkins  
8 back.

9 Where do we go next? According to my  
10 chart, the next is bad debt expense level.

11 MR. FRANSON: Your Honor, if I may, I was  
12 thinking, and I think Staff has been talking we go back to  
13 joining common costs, then come up to incentive comp,  
14 going back in time is what we were thinking. And  
15 actually, Mr. Hack, Judge, if we can get our partial  
16 stipulation filed today, that will put a totally different  
17 look on this, is the belief that Staff has anyway.

18 MR. HACK: Yeah.

19 JUDGE WOODRUFF: You were talking about  
20 that a little bit on Friday, that there may be some other  
21 issues settled.

22 MR. HACK: Right. And I think we had  
23 always intended, even if we did not reach an agreement in  
24 principle, to try bad debt later anyway. So really I  
25 think where we're going is to finish up the joint and

1 common issues, and then go to the incentive comp. We took  
2 Mr. McLaughlin on the joint and common, so we have the  
3 Staff witnesses first up on that, and then we will go to  
4 incentive comp with Mr. Noack and then the Staff and OPC.

5 MR. FRANSON: And on that, your Honor, we  
6 had already done Deborah Hayes, the MGE witness. Mr.  
7 Noack was the other one. And then I guess we see where we  
8 go from there.

9 JUDGE WOODRUFF: All right. Let's go to  
10 joint and common costs, then. I believe we've already had  
11 Mr. McLaughlin testify on that. As I recall, MGE already  
12 did their mini opening on that; is that correct?

13 MR. HACK: That's correct.

14 JUDGE WOODRUFF: Does Staff wish to make a  
15 mini opening?

16 MR. FRANSON: Yes, your Honor, if I may  
17 have just a moment.

18 JUDGE WOODRUFF: Let me ask the other  
19 parties, does anyone else wish to make a mini opening on  
20 this issue?

21 MR. MICHEEL: Public Counsel does not. Our  
22 position is clearly stated on the list of issues on this.  
23 We support the Staff.

24 JUDGE WOODRUFF: And Federal Agencies does  
25 not?

1                   Okay. Then you can proceed when you're  
2 ready.

3                   MR. FRANSON: Thank you, your Honor. Staff  
4 witnesses on this issue of joint and common costs will be  
5 Chuck Hyneman and Mark Oligschlaeger.

6                   What we're talking about here are rather --  
7 they're rather interesting choices made by Southern Union  
8 to have a New York office and to remodel that office, and  
9 the compensation that goes to certain company officials.

10                  Staff's position, as set out in the  
11 testimony of Mr. Hyneman, that those are excessive, and,  
12 your Honor, Mr. Hyneman's testimony also sets out the  
13 history of this matter, that this Commission has dealt  
14 with this issue before, and the Commission -- the Staff  
15 would ask the Commission to carefully consider the  
16 evidence and, in this particular instance, follow the  
17 recommendations of Staff Witness Hyneman.

18                  Thank you, your Honor.

19                  JUDGE WOODRUFF: Thank you.

20                  Mr. Hyneman, I believe this is your first  
21 time on the stand at this proceeding, so I'll swear you in  
22 now.

23                  (Witness sworn.)

24                  JUDGE WOODRUFF: You may be seated, and you  
25 may inquire when you're ready.

1                   MR. FRANSON: Thank you, your Honor.

2       CHARLES HYNEMAN testified as follows:

3       DIRECT EXAMINATION BY MR. FRANSON:

4           Q.       Sir, please state your name.

5           A.       Charles R. Hyneman.

6           Q.       Mr. Hyneman, how are you employed?

7           A.       I'm employed by the Missouri Public Service

8       Commission.

9           Q.       How long have you been so employed?

10          A.       It's approximately 10 years.

11          Q.       Mr. Hyneman, did you, in fact, in this case

12       file direct and surrebuttal testimony?

13          A.       Yes, I did.

14          Q.       Okay. First of all, a question, do you

15       have any additions, deletions or corrections to your

16       testimony?

17          A.       I have one minor correction to my

18       surrebuttal testimony.

19          Q.       Okay. I believe that's been marked as

20       Exhibit 817. What is that correction?

21          A.       On page 18, line 7, the word "MGE" should

22       be changed to "Staff."

23          Q.       Mr. Hyneman, do you have any other

24       additions deletions or corrections to your testimony?

25          A.       No, I do not.

1           Q.     If you were asked these questions today,  
2     would your answers be substantially similar?

3           A.     Yes, they would.

4           Q.     And to the best of your knowledge, is your  
5     testimony truthful and accurate in all regards?

6           A.     Yes, it is.

7           MR. FRANSON: Your Honor, at this time I  
8     would tender the witness for cross-examination. Your  
9     Honor, I understand the practice has been so far that when  
10    a witness will be back up, and Mr. Hyneman will, in fact,  
11    on the next issues, I'll offer him, but I expect you might  
12    defer your ruling until he has, in fact, testified for the  
13    last time.

14           JUDGE WOODRUFF: That is correct.

15           MR. MICHEEL: Your Honor, just a  
16    housekeeping matter. Did we admit Exhibit 853, Staff  
17    Exhibit 853, which was Staff DR?

18           JUDGE WOODRUFF: Yes, it was offered after  
19    we came back from break, and it was admitted.

20           MR. MICHEEL: Thank you.

21           JUDGE WOODRUFF: All right. Then for  
22    Mr. Hyneman, for cross-examination we'll begin with Public  
23    Counsel.

24           MR. MICHEEL: I have no questions today.

25           JUDGE WOODRUFF: Kansas City and Joplin are

1 not here. Federal Agencies?

2 MR. PAULSON: No questions, sir.

3 JUDGE WOODRUFF: Jackson County, Midwest

4 Gas are not here. MGE?

5 MR. SWEARENGEN: Yes, thank you.

6 CROSS-EXAMINATION BY MR. SWEARENGEN:

7 Q. Good morning, Mr. Hyneman.

8 A. Good morning.

9 Q. How are you today?

10 A. Good.

11 Q. I take it that you've audited Missouri Gas

12 Energy prior to this case, have you not?

13 A. Yes, I've been involved and supervised the

14 audits of MGE in three previous rate cases previous to

15 this.

16 Q. So would I be correct in assuming that you

17 understand how Southern Union Company, of which MGE is an

18 operating division, you're familiar with how Southern

19 Union Company is structured?

20 A. Yes, I am.

21 Q. Would you agree that it is a single

22 corporation with various operating divisions?

23 A. And a subsidiary, Panhandle subsidiary.

24 Q. But the answer is it does have operating

25 divisions?

1           A.       Yes, it does.

2           Q.       It does have, at least as far as you know,  
3 one wholly-owned subsidiary or one subsidiary, Panhandle  
4 Eastern Pipeline Company?

5           A.       Currently it does.

6           Q.       Where are the corporate headquarters of the  
7 Southern Union Company?

8           A.       It's in Wilkes-Barre, Pennsylvania.

9           Q.       With respect to Southern Union's Missouri  
10 operations, those operations are conducted through the  
11 Missouri Gas Energy operating division; is that your  
12 understanding?

13          A.       With respect to the operations? Would you  
14 be more specific?

15          Q.       Well, the operations conducted in the state  
16 of Missouri by Southern Union Company are conducted  
17 through the MGE operating division; is that a correct  
18 statement?

19          A.       Yes, that is correct.

20          Q.       And MGE is headquartered in Kansas City; is  
21 that correct?

22          A.       That is correct.

23          Q.       Now, you indicated you'd been involved in  
24 other cases involving MGE, Missouri Gas Energy. Have you  
25 also been involved in other cases before the Commission



1 with respect to other utility companies?

2 A. Yes, I have.

3 Q. And I think you've set out as an attachment  
4 to your testimony a schedule which lists your  
5 participation in various cases before this Commission; is  
6 that correct?

7 A. That is correct.

8 Q. Based on your involvement with these other  
9 utility companies that you've indicated you filed  
10 testimony with respect to, and also based on your general  
11 experience here at the Public Service Commission and your  
12 involvement with other Missouri jurisdictional utility  
13 companies, would you agree that the way Southern Union is  
14 structured, an operating company with -- a parent company  
15 with various operating divisions is not really unusual or  
16 unique?

17 A. No. I mean, Aquila is a regulated utility  
18 that I have audited that has a similar structure to  
19 Southern Union.

20 Q. And when you say a similar structure, you  
21 mean a single corporation with various operating  
22 divisions?

23 A. Correct.

24 Q. Can you think of any other utility that  
25 you've been involved with that is structured in that

1 fashion?

2 A. Well, I've audited United Cities Gas  
3 Company, which is a part of Atmos, which has divisions in  
4 seven different states. Empire District is primarily  
5 Missouri. KCPL is primarily Missouri and Kansas. St. Joe  
6 Light & Power is just Missouri. So Aquila would be the  
7 only utility that's really related or structured similar  
8 to Southern Union.

9 Q. You don't find that there's anything  
10 improper about the way Southern Union Company is  
11 structured, do you?

12 A. No, I do not.

13 Q. Would you also agree that the way in which  
14 a company such as Southern Union is structured is a  
15 management decision?

16 A. I would say it's maybe a combination of  
17 director/board decision, not strictly management decision.

18 Q. Well, what's your definition of the  
19 management of Southern Union Company, for example?

20 A. Well, the management of Southern Union are  
21 the executive officers, which would be the CEO, chief  
22 executive officer, chief financial officers, the vice  
23 presidents, primarily the nonboard leadership.

24 Q. So would it be your testimony that the  
25 board of directors of the company would have no say in how

1 the company is structured?

2 A. No. They would have predominant say in how  
3 the company is structured.

4 Q. You're familiar with the board of directors  
5 of Southern Union Company?

6 A. Yes, I am.

7 Q. Would you agree that the board has an  
8 executive committee?

9 A. Yes, I would.

10 Q. And that committee is made up of three  
11 individuals; is that correct?

12 A. That's correct.

13 Q. And those individuals are Mr. Tom Carran,  
14 who is the president and chief operating officer of  
15 Southern Union Company; is that right?

16 A. Yes, it is.

17 Q. And Mr. George Lindeman, the chairman and  
18 chief executive officer of the company; is that correct?

19 A. That's his title.

20 Q. And Mr. John Brennan, who's the vice  
21 chairman and assistant secretary; is that true?

22 A. That's correct.

23 Q. Is it also your understanding that under  
24 the Southern Union Company structure, that the executive  
25 committee of the board has the authority to exercise all

1 the powers of the board in the management of the company?

2 A. Sub -- substantially, yes. I don't know if

3 they have the authority to make all corporate decisions.

4 I think there are maybe legal restrictions on that, but I

5 know they do make decisions when it's impractical for the

6 full board to meet.

7 Q. Would you agree that in order to fulfill

8 those responsibilities, that the executive committee must

9 be involved in the management of the company?

10 A. Well, it actually depends on what those

11 responsibilities are, what actions they need to take.

12 Q. Well, you just testified as to what you

13 thought the responsibilities of the executive committee

14 were under the structure. And my question is, to exercise

15 those responsibilities, would you agree that the executive

16 committee must be involved in the management of the

17 company?

18 A. Same as any board of directors' involvement

19 in any company.

20 Q. Well, I'm not talking about the board of

21 directors. I'm talking about the executive committee now.

22 A. Well, it is the executive committee of the

23 board of directors. That's what it is.

24 Q. Let me ask you this question, take you back

25 just a second. I think you said it was your understanding

1     that under the Southern Union Company structure, the  
2     executive committee had the authority to exercise all of  
3     the powers of the board of directors in the management of  
4     the company?

5             A.       Correct.  They're like a mini board.  
6     They're part of the board of directors.  That's a  
7     committee of the board of directors.

8             Q.       My question then is, once again, in order  
9     to fulfill those responsibilities, would you agree that  
10    the executive committee must be involved in the management  
11    of the company?

12            A.       No.

13            Q.       Let me ask you this question:  How can the  
14    executive committee fulfill its responsibility to exercise  
15    these powers without being involved in the management of  
16    the company?

17            A.       The executive committee responsibilities  
18    are the duties that -- are the responsibilities of the  
19    board of directors.  It's a part of the board of  
20    directors.  It performs the duties that the board of  
21    directors perform.  They do not manage the company.  
22    They're separate and distinct from the management of the  
23    company.

24            Q.       So it's your testimony now that the  
25    executive committee of the board of directors does not

1 have the authority to exercise all the powers of the board  
2 in the management of the company?

3 A. It's my same testimony that they have  
4 significant powers delegated by the board of directors to  
5 perform the duties that the board of directors normally  
6 perform. They haven't given themselves authority to manage  
7 the company. That's why Southern Union has a management.

8 Q. Is it your testimony that the board of  
9 directors does not have the ultimate responsibility to  
10 manage the company?

11 A. They supervise the management of the  
12 company. They don't manage the company, no.

13 Q. Let me ask you this question: Is it true  
14 that for purposes of this case, for ratemaking purposes,  
15 you have allowed the fully allocated share of Mr. Carran's  
16 cost to be included in rates?

17 A. Yes, I have, with the exception of the  
18 incentive compensation portion of that.

19 Q. Which is going to be another issue in this  
20 proceeding later on; is that correct?

21 A. Correct.

22 Q. Just for the record, what is that  
23 allocator? What is the allocated portion to Missouri, the  
24 percentage?

25 A. MGE's proposed level or the level that the

1 Staff determined?

2 A. The level that the Staff has used.

3 A. The Staff has determined, and I think MGE

4 has concurred with, it's approximately 17 percent.

5 Q. So 17 percent of Mr. Carran's costs have

6 been allocated to the Missouri jurisdiction; is that

7 right?

8 A. That is correct.

9 Q. With the exception of the incentive

10 compensation piece that he mentioned?

11 A. That is correct.

12 Q. Now, with respect to the other two members

13 of the executive committee, Mr. Lindeman and Mr. Brennan,

14 is it true that you have made an adjustment and allowed

15 for ratemaking purposes something less than the fully

16 allocated share of their costs to be included in rates?

17 A. That is correct.

18 Q. So you're treating Mr. Lindeman and

19 Mr. Brennan differently than you are Mr. Carran; is that

20 true?

21 A. That is correct.

22 Q. For ratemaking purposes?

23 A. Yes.

24 Q. Are you also treating Mr. Lindeman and

25 Mr. Brennan differently for ratemaking purposes than you

1 are the other members of the board of directors of  
2 Southern Union Company?

3 A. Yes, we are.

4 Q. And how are you doing that?

5 A. The Staff has made a determination in this  
6 case, as well as MGE's previous rate cases, that although  
7 Mr. Lindeman and Mr. Brennan don't participate in the  
8 day-to-day activities of Southern Union Company and the  
9 management, they are involved as board members, and it has  
10 been my experience they are involved more than your  
11 typical board member.

12 So we -- for ratemaking purposes, we  
13 included three times the normal -- three times the normal  
14 compensation that Southern Union pays its board members  
15 for both Mr. Lindeman and Mr. Brennan.

16 Q. Is that because you recognize that  
17 Mr. Lindeman and Mr. Brennan provide more, and I'm going  
18 to use the word of executive officer type of service for  
19 the company than do the regular board members?

20 A. Well, to some extent. In deference to the  
21 fact that Mr. Lindeman is titled CEO of the company, we're  
22 willing to accept that he has more than your typical  
23 chairman of a board would have involved. And the Staff is  
24 understanding that Mr. Brennan, because of recent SEC and  
25 legislation, that he -- his duties at the board have



1     become increased over the past year or so.

2             Q.       So was the answer to my question a yes?

3             A.       Could you repeat the question?

4             Q.       You're allowing more of Mr. Lindeman and

5     Mr. Brennan's costs to be passed through to the Missouri

6     ratepayers because they provide more of an executive

7     officer type of service to the company than do the other

8     board members?

9             A.       Yes.

10            Q.       But in your view, they provide less value

11     for the Missouri ratepayers than does Mr. Carran; is that

12     a fair statement?

13            A.       I didn't get into value. I didn't make an

14     adjustment based on what value they added.

15            Q.       Well, you're eliminating more of their

16     costs than you are with respect to Mr. Carran; is that not

17     correct?

18            A.       Well, if you want to talk about value, then

19     you have to encompass the merger and acquisition

20     activities. Mr. Lindeman has significant involvement in

21     merger and acquisition activities, but that's not a cost

22     that we would pass through to Missouri ratepayers. So he

23     may add value in his role in merger and acquisition

24     activities, he and Mr. Brennan, and they have

25     significantly in the past and they are currently, but

1     that's not the type of costs that we pass on -- recommend  
2     to the Commission that they should charge Missouri  
3     ratepayers for.

4             Q.       If you could have your direct testimony in  
5     front of you, Mr. Hyneman, and look at page 24, please.

6             A.       Yes, I'm there.

7             Q.       There you testify that there are certain  
8     types of services provided to Missouri Gas Energy from  
9     Southern Union's corporate office; is that correct?

10            A.       That's correct.

11            Q.       And you indicate just in summary that  
12     Southern Union's corporate offices provide MGE with  
13     various resources, including financing?

14            A.       Yes.

15            Q.       Financial reporting?

16            A.       Yes.

17            Q.       Corporate governance?

18            A.       Yes.

19            Q.       Risk management?

20            A.       Did I -- is there a list that you're going  
21     through, just those lists that I have here on page 24?

22            Q.       Well, I read your testimony, and my  
23     question is, I'm trying to summarize what I understand you  
24     to say.

25            A.       I didn't know -- corporate governance, can

1     you show me where I listed that?

2             Q.       I'm asking you, is that one of the things

3     that you include as something that is one of the resources

4     that Southern Union's corporate offices supply to MGE?

5             A.       Corporate governance is performed by the

6     board of directors, which we generally allow in rates.

7     It's not a function of management.

8             Q.       How about risk management?

9             A.       Yes.

10            Q.       Human resources?

11            A.       Yes.

12            Q.       Legal services?

13            A.       Yes.

14            Q.       Accounting services?

15            A.       Yes.

16            Q.       Information technology?

17            A.       Yes.

18            Q.       Corporate communications?

19            A.       Yes.

20            Q.       How about the treasury function?

21            A.       Yes.

22            Q.       How about environmental work, is some of

23     that done in the corporate offices?

24            A.       I think predominantly all of it is.

25            Q.       Would you agree that those type of services

1 are the types of services that all publicly traded  
2 companies must have and must provide?

3 A. Yes. We haven't made any adjustment to  
4 those types of service. We've allowed 100 percent of cost  
5 of those types of services to be flowed through to  
6 Missouri ratepayers in this case.

7 Q. And that's because those services are  
8 necessary for the company to provide service in Missouri;  
9 is that true? You wouldn't allow costs to be flowed  
10 through to Missouri customers if you didn't think they  
11 were reasonably necessary to provide utility service?

12 A. Well, under the assumption that we do a  
13 perfect audit and no costs that shouldn't be allowed are  
14 allowed, yes, but I don't think we do perfect audits.

15 Q. Has the Staff ever done a perfect audit?

16 A. I know I never have.

17 Q. Is it fair to say that you agree that  
18 Mr. Lindeman and Mr. Brennan do provide some service to  
19 MGE's customers because you are, in fact, allowing some of  
20 their costs to be flowed through the ratemaking process to  
21 those customers?

22 A. Yes, they have a significant role in the  
23 board of directors.

24 Q. But you don't think their level of service  
25 rises to the point where you can allow the entire amount

1 of their allocable compensation to be recovered through  
2 rates; is that a fair statement?

3 A. That's a very fair statement.

4 Q. On page 23 of your surrebuttal, if you have  
5 that in front of you --

6 A. Yes.

7 Q. -- I think there you say on line 15 that  
8 you're not allowing all of their costs to be flowed  
9 through because the Staff feels that Mssrs. Lindeman and  
10 Brennan function more as active board members than  
11 executive officers; is that your testimony?

12 A. Yes, it is.

13 Q. And when you say you feel that they  
14 function more as active board members than executive  
15 officers, you mean this is your belief?

16 A. Based on evidence, yes, it is.

17 Q. And because of that, you've made a decision  
18 to only allow a part of their costs in rates; is that  
19 true?

20 A. Yes.

21 Q. And you've made -- is it fair to say that  
22 you made a judgment as to how much to allow and how much  
23 to disallow?

24 A. Based on the evidence that we've seen in  
25 this case, we made a judgment call as to the amount of

1 costs at the corporate chairman office to allow in this  
2 case.

3 Q. Is it your testimony that Mr. Lindeman and  
4 Mr. Brennan duplicate the work done by Mr. Carran?

5 A. No. As in my testimony, the Staff has the  
6 opinion that Mr. Carran focuses or performs in the role of  
7 the CEO. He's at the headquarters site on a day-to-day  
8 basis, whereas Mr. Lindeman hasn't been to Pennsylvania  
9 in, I know, the last 12, 14 months.

10 Q. You say Mr. Carran is at the headquarters  
11 site. By that you mean Pennsylvania?

12 A. Yes.

13 Q. I think you testified earlier MGE is based  
14 in Kansas City; is that correct?

15 A. Yes.

16 Q. How far away from Kansas City is  
17 Wilkes-Barre, Pennsylvania, do you know offhand?

18 A. No, I do not.

19 Q. And Mr. Lindeman and Mr. Brennan are based  
20 in New York City; is that true?

21 A. I don't know if the correct term is based.  
22 I know they have an office there for their convenience.

23 Q. How about primary work location, would that  
24 be an accurate description?

25 A. Yes.

1           Q.       How far away is New York City from  
2 Wilkes-Barre, Pennsylvania, do you know?

3           A.       No, I do not.

4           Q.       Do you know how far New York City is from  
5 Kansas City?

6           A.       No, I do not.

7           Q.       So you really can't say that there's much  
8 difference between the distance of Mr. Carran's office on  
9 the one hand from Kansas City and the office of  
10 Mr. Lindeman and Mr. Brennan on the other hand; is that  
11 true?

12          A.       Well, the distance from Kansas City is  
13 totally irrelevant to these costs.

14          Q.       And why is that?

15          A.       Well, because the functions that are  
16 charged to MGE, those treasury functions, those risk  
17 functions, all those functions are done in Wilkes-Barre,  
18 Pennsylvania.

19          Q.       So to the extent that Mr. Lindeman and  
20 Mr. Brennan provide service for MGE that you would  
21 recognize in rates, it doesn't really matter where they're  
22 located, then, does it?

23          A.       Yes, it does.

24          Q.       I thought you just said where they're  
25 located didn't matter.

1           A.       It does. It matters if they're in  
2   Pennsylvania where the services are performed.

3           Q.       Is your testimony that Mr. Lindeman and  
4   Mr. Brennan cannot perform services for MGE unless they're  
5   physically present in the state of Pennsylvania?

6           A.       No. They could perform functions that the  
7   general board of directors perform, just like in any other  
8   company. I don't believe that Mr. Lindeman can function  
9   as the chairman of the executive offices of the company  
10  when he spends most of his time in Florida and other  
11  location, and he doesn't go to the headquarters.

12          Q.       That wasn't my question. My question is  
13  this: Assume for me that Mr. Lindeman and Mr. Brennan do  
14  provide services for MGE that you would recognize in rates  
15  and, in fact, you have recognized some of those services  
16  in rates; is that true?

17          A.       That is true.

18          Q.       Does it make any difference where they're  
19  physically located when they perform those services?

20          A.       Depends on the services they perform.

21          Q.       Okay. Well, with respect to the services  
22  you have allowed to be passed on to the Missouri  
23  ratepayers, where were Mr. Brennan and Mr. Lindeman  
24  physically located when they performed those services?

25          A.       Well, it depends on where the board



1 meetings were. Board holds their meetings in different  
2 locations.

3 Q. Do you know where they were when they  
4 performed the services that you're allowing in rates?

5 A. I know a lot of the board meetings are in  
6 New York City.

7 Q. You said, I think, in your surrebuttal  
8 testimony that with respect to Mr. Lindeman and  
9 Mr. Brennan, you did not receive any auditable records; is  
10 that true?

11 A. Well, I asked a specific Data Request.

12 Q. Can you answer my question yes or no? Was  
13 that a true statement that I just asked you, that you said  
14 in your testimony that with respect to Mr. Lindeman and  
15 Mr. Brennan, you did not receive any auditable records; is  
16 that not your testimony?

17 A. No. That's taking out of context my  
18 testimony.

19 Q. Okay. What did you say?

20 A. I said the Staff asked specific -- could  
21 you refer me to the page?

22 Q. Take a look at page 27 of your surrebuttal  
23 testimony.

24 A. Yes. At page 27, I give a quote from Case  
25 No. GR-96-285 where this Commission said specifically --

1                   MR. SWEARENGEN: Well, your Honor, I'm  
2 going to object to that. I'm asking the witness what he  
3 said in his testimony, not what the Commission may have  
4 said in some order.

5 BY MR. SWEARENGEN:

6           Q.       The question is, is it your testimony that  
7 you did not receive any auditable records from Missouri  
8 Gas Energy in this case on this issue?

9           A.       No.

10          Q.       That's not your testimony?

11          A.       No.

12          Q.       You're not saying that you did not get any  
13 auditable records?

14          A.       When I talk about auditable records, that's  
15 strictly in response to that Data Request that I asked  
16 for.

17          Q.       What records --

18          A.       I did ask for other records from them.

19          Q.       What records did you receive with respect  
20 to this issue?

21          A.       I know I received Mr. Lindeman and  
22 Mr. Carran's appointment calendars, board of director  
23 meetings, SEC documents, 10-Ks, 10-Qs I reviewed, press  
24 releases. Those were obtained, you know, by other means,  
25 but those are some of the documents that I reviewed.

1 Q. Did you look at any payroll records?  
2 A. Payroll records from corporate?  
3 Q. From any source on this issue.  
4 A. I looked at the -- MGE's or Southern  
5 Union's joint and common cost study, which included  
6 payroll data for the corporate employees, yes.  
7 Q. Based on the data that you did review,  
8 could you quantify the amount of expense related to  
9 Mr. Lindeman and Mr. Brennan that should be recovered  
10 through rates?  
11 A. The amount that should?  
12 Q. Uh-huh.  
13 A. Yes, I can.  
14 Q. My question was, did you?  
15 A. Certainly.  
16 Q. And is that the amount that you're  
17 recommending be passed on to the ratepayers in this case  
18 with respect to Mr. Lindeman and Mr. Brennan?  
19 A. The amount that I determined?  
20 Q. Yes.  
21 A. Yes.  
22 Q. And you made a calculation --  
23 A. Yes.  
24 Q. -- that supports that number?  
25 A. Yes, it does.

1 Q. Have you provided that to the company?

2 A. Yes, I have.

3 Q. Now, let me ask you, you are allowing a

4 portion of the compensation of Mr. Lindeman and

5 Mr. Brennan, but you're not allowing any of the costs of

6 the facilities and personnel which support them; is that

7 true?

8 A. That's correct.

9 Q. And is it fair to say that that adjustment

10 is based on your judgment?

11 A. No. We don't allow the administrative

12 support for any board of directors. That's not a cost

13 that's included in cost of service.

14 Q. Is that a policy that the Commission has?

15 A. Well, I know no company that I've ever

16 audited ever sought individual board member administrative

17 support to be recovered.

18 Q. Let me ask you this question: Is there a

19 policy that you're aware of where this Commission has

20 enunciated that, that no administrative support of the

21 board of directors will be allowed in rates?

22 A. A policy?

23 Q. Yes.

24 A. Not that I'm aware of.

25 Q. Is it a Staff policy?

1           A.       I don't know if Staff has a written policy  
2   on it.  It's just something that's not done.

3           Q.       You are, though, allowing, are you not,  
4   some of the costs of two of the board members?  I think  
5   we've established that.

6           A.       Board member compensation is a typical cost  
7   that's allowed in cost of service.

8           Q.       And you're going above and beyond typical  
9   board member compensation with respect to Mr. Brennan and  
10  Mr. Lindeman; is that true?

11          A.       That is true.

12          Q.       And because you see that they provide --  
13  and I use the word "value" -- some service above and  
14  beyond what the normal board member provides for the  
15  Missouri customer; is that true?

16          A.       Well, you may define value differently from  
17  how I define value.

18          Q.       Well, let's use the word "service."  They  
19  provide some service that benefits the Missouri customer  
20  above and beyond the service that the other board members  
21  provide?

22          A.       Right.  They are more actively involved in  
23  the board than what your typical board member is.

24          Q.       But you're not allowing any of the costs of  
25  the facilities or the personnel which support those two

1 gentlemen; is that true?

2 A. Well, that's -- typically, yes, we don't  
3 allow administrative support for any board members.

4 MR. SWEARENGEN: Thank you. That's all I  
5 have.

6 JUDGE WOODRUFF: Thank you. Then we'll  
7 move up to questions from the Bench. Commissioner Murray?

8 COMMISSIONER MURRAY: I have no questions,  
9 thank you.

10 JUDGE WOODRUFF: Commissioner Davis?

11 COMMISSIONER DAVIS: No questions.

12 JUDGE WOODRUFF: No questions from the  
13 Bench, so no recross. Any redirect?

14 MR. FRANSON: Yes, your Honor. May I  
15 proceed, your Honor?

16 JUDGE WOODRUFF: You may.

17 MR. FRANSON: Thank you.

18 REDIRECT EXAMINATION BY MR. FRANSON:

19 Q. Mr. Hyneman, there was considerable  
20 discussion in questions from Mr. Swearngen over the  
21 Southern Union board of directors and the executive  
22 committee of the board. Do you remember those questions?

23 A. Yes, I do.

24 Q. And the question was, does the -- the  
25 questions were about whether the executive committee of

1     this board manages Southern Union.  Do you recall those  
2     questions?

3             A.       Yes, I do.

4             Q.       And in that discussion, how were you  
5     defining the word "manage"?

6             A.       Typical functions of the management of a  
7     company include the list that was in my direct testimony.  
8     They perform treasury functions, financial reporting, they  
9     do internal controls, audit services.  They actually do  
10    manage the day-to-day operations of the company, do the  
11    payroll, make sure customer service is being met, the  
12    safety requirements are being met.  That's a general  
13    definition.

14            Q.       Okay.  And that's a definition you use?

15            A.       Yes.

16            Q.       With that definition, is it your belief  
17    that Mr. Lindeman and Mr. Brennan managed the affairs of  
18    Southern Union?

19            A.       No.

20            Q.       Why not?

21            A.       Well, for one thing, they're not at  
22    Southern Union's headquarters.  Another thing, they're  
23    involved in significant other operations, and they're  
24    also -- they're primarily involved in the board of  
25    directors.

1 Q. Okay. Were you involved in Case  
2 No. GR-96-285?

3 A. Yes, I was.

4 Q. Okay. In that case, did the Commission  
5 require that MGE keep auditable records of Mr. Lindeman  
6 and Mr. Brennan's services that benefit Missouri  
7 ratepayers?

8 A. Did they require?

9 Q. Yes, if you know.

10 A. Yes, they did.

11 Q. Okay. Has Southern Union provided  
12 auditable records in this case regarding Mr. Lindeman and  
13 Mr. Brennan's activities more -- well, actually, have they  
14 provided more records in that case than they did in  
15 GR-96-285?

16 A. No. In that case we actually had time  
17 sheets kept by Mr. Lindeman and Brennan. In this case  
18 I've been advised that they no longer keep time sheets.

19 Q. Okay. Mr. Swaengen asked you some  
20 questions from your surrebuttal testimony. If you could  
21 turn to page 27 and tell me when you're there, please.

22 Q. I'm there.

23 Q. Okay. If you could review -- don't read it  
24 out loud necessarily. Just review page 27, lines 12  
25 through 17 of your surrebuttal, and please tell me when



1     you have done that.

2             A.       I've read it.

3             Q.       Okay.  You used the term in line 14

4     "auditable records and Data Request No. 328."  What is

5     missing to make -- to give you auditable records that you

6     would need to determine what contribution Mr. Brennan and

7     Mr. Lindeman make to the company?

8             MR. SWEARENGEN:  Your Honor, I'm going to

9     object to the form of that question.  He's pretty specific

10    that he did make a calculation to determine that and

11    that's how he came up with the number.  I would object to

12    the form of the question and it's assuming facts not in

13    evidence and inconsistent with what the witness said.

14             JUDGE WOODRUFF:  Can you clarify your

15    question?

16             MR. FRANSON:  Your Honor, on page 27,

17    lines 12 through 17 of Mr. Hyneman's surrebuttal, there

18    was a question about what auditable records MGE keeps.

19    And then the question was, Staff didn't receive it.  I'm

20    asking this witness what he would need, and that was

21    opened up by Mr. Swearengen, and I think it's a fair

22    question.

23             JUDGE WOODRUFF:  I'll overrule the

24    objection.  You can answer the question.

25             THE WITNESS:  Well, I asked that Data

1 Request 328 and specifically addressing the Commission's  
2 Order in GR-96-285, the Order required documentation  
3 supporting the inclusion of Mr. Lindeman and Mr. Brennan's  
4 cost in the rate case. And I just simply asked the DR,  
5 what do you have to support that? And there was no  
6 auditable records included in response to that Data  
7 Request, just a general description of the services that  
8 Mr. Lindeman and Mr. Brennan provide.

9 BY MR. FRANSON:

10 Q. Okay. Let me ask you this: You received  
11 some questions about administrative support of the board  
12 of directors, I believe, specifically to Mr. Brennan and  
13 Mr. Lindeman. To your knowledge, has any company ever  
14 requested to recover the cost of support staff -- well,  
15 actually administrative support functions provided to  
16 board of directors members?

17 A. No.

18 Q. So to your knowledge, is this a case of  
19 first impression -- or let me rephrase that -- an issue of  
20 first impression before this Commission?

21 A. Yes, it is. Well, but MGE has sought  
22 recovery of these costs in the past. This is not the  
23 first case that sought recovery of these costs, so --

24 Q. Okay. Let me -- is it fair to say this is  
25 an issue, to your knowledge, where MGE's been the only one

1 to seek this?

2 A. Yes.

3 MR. FRANSON: I don't believe I have any  
4 further questions of the witness, your Honor.

5 JUDGE WOODRUFF: All right. Thank you.

6 Mr. Hyneman, you can step down. I believe  
7 the next witness is Mr. Oligschlaeger.

8 Mr. Oligschlaeger, I believe you have  
9 testified previously in this proceeding, so you are still  
10 under oath, and you may proceed.

11 MR. FRANSON: Your Honor, I've asked this  
12 witness the questions, and I'll just ask him now.

13 MARK OLIGSCHLAEGER testified as follows:

14 DIRECT EXAMINATION BY MR. FRANSON:

15 Q. Mr. Oligschlaeger, has any of your  
16 testimony changed since you've been up the first couple of  
17 times?

18 A. No, it has not.

19 Q. Okay. And if you were asked those  
20 questions today, your answers would be the same?

21 A. Yes, they would.

22 Q. And to your knowledge, your testimony is  
23 truthful and accurate in all regards?

24 A. Yes, it is.

25 MR. FRANSON: Your Honor, I believe these

1 have been previously marked as Exhibits 828,  
2 Mr. Oligschlaeger's direct, 829, Mr. Oligschlaeger's  
3 rebuttal, and 830, Mr. Oligschlaeger's surrebuttal. At  
4 this point, if I've counted right, Mr. Oligschlaeger will  
5 be up one more time. So I'll offer them, but I think your  
6 ruling will probably be deferred.

7 JUDGE WOODRUFF: Yes. We'll just go on to  
8 cross-examination. Public Counsel?

9 MR. MICHEEL: No questions at this time on  
10 this issue.

11 JUDGE WOODRUFF: Kansas City and Joplin are  
12 not here. Federal Agencies?

13 MR. PAULSON: No questions, sir.

14 JUDGE WOODRUFF: Jackson Counties and  
15 Midwest Gas are not here, so MGE?

16 CROSS-EXAMINATION BY MR. SWEARENGEN:

17 Q. Good morning, Mr. Oligschlaeger. How are  
18 you?

19 A. Good morning.

20 Q. Were you the witness on joint and common  
21 cost issue in MGE's last rate case?

22 A. I don't believe so.

23 Q. Okay. Do you know who was?

24 A. Mr. Hyneman.

25 Q. Did you sponsor any testimony in MGE's last

1 rate case that might have had figures which would have  
2 indicated a level of joint and common costs being  
3 experienced by Missouri Gas Energy?

4 A. I don't believe so.

5 MR. SWEARENGEN: Could I approach the  
6 witness?

7 JUDGE WOODRUFF: You may.

8 MR. SWEARENGEN: Let me not approach the  
9 witness at this time.

10 JUDGE WOODRUFF: All right.

11 BY MR. SWEARENGEN:

12 Q. Are you familiar with the level of joint  
13 and common costs that are being recommended for inclusion  
14 by the Staff for MGE in this proceeding?

15 A. I'm generally familiar with the contents of  
16 Staff Witness Hyneman's testimony on that subject and on  
17 the subject of those costs which we are not recommending  
18 recovery of.

19 Q. Would you agree that approximately  
20 \$1.8 million of joint and common costs are being  
21 recommended for inclusion by the Staff for rate recovery  
22 in this case?

23 A. That sounds reasonable.

24 Q. And with respect to what -- the level of  
25 joint and common costs currently in MGE's rates, do you

1 have an idea as to what that number might approximate?

2 A. Do you mean the level that would have been  
3 established in Case No. GR-2001-292?

4 Q. If that was the last case that MGE had  
5 before this Commission, yes.

6 A. Well, I can't read you the number or  
7 recollect the number entirely. It does appear, I think,  
8 in Mr. Noack's analysis of MGE O&M costs compared to other  
9 Missouri LDCs as a schedule to his direct testimony, and I  
10 think the same number appears in my rebuttal testimony in  
11 the same context.

12 Q. Your rebuttal testimony in this proceeding?

13 A. Yes.

14 Q. If you have that in front of you, if you  
15 would turn to Schedule 1-3, please.

16 A. Unfortunately, I do not have that because I  
17 didn't think that testimony was relevant to this issue.

18 MR. SWEARENGEN? Well, now can I approach  
19 the witness, your Honor?

20 JUDGE WOODRUFF: You may.

21 MR. FRANSON: Your Honor, only if he has  
22 something relevant to this proceeding.

23 BY MR. SWEARENGEN:

24 Q. Mr. Oligschlaeger, I've handed you a  
25 document. Would you just briefly tell the Commission what

1 it is, please?

2 A. It is my rebuttal testimony that was  
3 previously filed in this rate proceeding.

4 Q. And can you turn to the schedule that I  
5 indicated to you? Do you have that in front of you?

6 A. Yes, I do.

7 Q. And I've indicated an amount of joint and  
8 common costs for Missouri Gas Energy in what year?

9 A. Well, the number appears in the O&M  
10 analysis of MGE for the years 2001, 2002 and 2003.

11 Q. What's the number for 2002?

12 A. It is \$6,934,982.

13 Q. Let me ask you, and you indicated  
14 previously that you thought that the level of joint and  
15 common costs being recommended for inclusion in this case  
16 is now approximately \$1.8 million?

17 A. Just as a reasonable guess, yes.

18 Q. Based on the knowledge that you have of  
19 Southern Union Company, Missouri Gas Energy and  
20 developments in recent years, would you agree that that  
21 reduction in joint and common costs of roughly \$5 million  
22 is related to the inclusion of Panhandle Eastern Pipeline  
23 Company in the allegation of joint and common costs?

24 A. I think it's reasonable to say there is  
25 some relationship to the addition of Panhandle to the

1 Southern Union corporate family to an overall reduction of  
2 common costs allocated to the pre-existing divisions of  
3 Southern Union.

4 Q. And would that be a significant  
5 relationship?

6 A. I haven't done a detailed study. I would  
7 expect there would be a material impact on the overall  
8 level of costs allocated to the divisions.

9 Q. And it would be a lesser amount being  
10 allocated to the divisions as a result of the acquisition;  
11 is that true?

12 A. I would agree with that.

13 MR. SWEARENGEN: Okay. That's all I have.  
14 Thank you.

15 JUDGE WOODRUFF: Thank you. We'll come up  
16 for questions from the Bench, beginning with Commissioner  
17 Murray.

18 COMMISSIONER MURRAY: No questions.

19 JUDGE WOODRUFF: Commissioner Davis?

20 COMMISSIONER DAVIS: No questions.

21 JUDGE WOODRUFF: Commissioner Appling?

22 COMMISSIONER APPLING: No questions.

23 JUDGE WOODRUFF: No questions from the  
24 Bench, so no recross. Any redirect?

25 MR. FRANSON: My turn, your Honor?



1 JUDGE WOODRUFF: Yes, redirect.

2 REDIRECT EXAMINATION BY MR. FRANSON:

3 Q. Okay. Mr. Oligschlaeger, first of all,  
4 some of these detailed questions about differences in O&M  
5 expenses from one year to the next, did you do a detailed  
6 analysis personally regarding that?

7 A. No, I did not.

8 Q. Wasn't that, in fact, done by Mr. Hyneman?

9 A. In regard to the corporate costs, yes.

10 Q. Okay. Fair to say Mr. Hyneman could answer  
11 any questions regarding that?

12 A. Probably with a greater degree of accuracy  
13 and detail than I could.

14 Q. Thank you. Now, you looked at -- what I've  
15 got here is your rebuttal testimony, and it was handed to  
16 you by Mr. Swaengen. Do you remember that?

17 A. Yes, I do.

18 Q. Okay. In 2002, there was joint and common  
19 costs of 6.9 million -- 6,934,982. Do you remember that?

20 A. That sounds like the number I read off,  
21 yes.

22 Q. And approximately the same number -- well,  
23 the same number for 2003?

24 A. Well, it would be the same number because  
25 that is the rate allowance for this item that was

1 established in the last MGE rate case. It does not  
2 represent the actual allocated costs per year on an annual  
3 basis, because those numbers would be different.

4 Q. Now, haven't some events taken place  
5 regarding Southern Union and MGE in particular that  
6 would -- that would have been taken into account for  
7 Staff's approximate \$1.8 million corporate cost allowance  
8 here?

9 A. Certainly there's the Panhandle  
10 acquisition. I'm sure there's a myriad of other things  
11 that would have had an impact on those allocated amounts.

12 Q. Wouldn't one of those events have been the  
13 fact that Southern Union got rid of its entire joint gas  
14 purchasing department?

15 MR. SWEARENGEN: Objection, leading.

16 JUDGE WOODRUFF: Sustained.

17 BY MR. FRANSON:

18 Q. Okay. Are you familiar with -- well, let  
19 me ask you, did Southern Union divest itself of a joint  
20 gas purchasing department?

21 A. Yes. And in I believe 2003 they made a --  
22 or they probably made the decision beforehand. They  
23 implemented a previous decision to decentralize their gas  
24 purchasing operations from the corporate level to the  
25 divisional level at MGE, and they did something similar

1 with their information technology operations.

2 Q. And would you know what impact that would  
3 have had, if any, on their joint and common costs?

4 A. Well, costs that used to be incurred on the  
5 corporate level are now incurred directly by MGE. That  
6 would reduce the level of corporate costs allocated to MGE  
7 and the other operating divisions.

8 Q. But you wouldn't necessarily know by how  
9 much, would you?

10 A. No, I would not.

11 Q. Would that -- would Mr. Hyneman know more  
12 on that subject than you do?

13 A. On most subjects he probably knows more  
14 than I do, but on that one, yes.

15 MR. FRANSON: Thank you. With that, your  
16 Honor, no further questions.

17 JUDGE WOODRUFF: Thank you.  
18 Mr. Oligschlaeger, you can step down.

19 THE WITNESS: Thank you.

20 JUDGE WOODRUFF: And I believe we'll be  
21 ready to move into the next area of incentive  
22 compensation, M&A time reporting.

23 MR. FRANSON: Your Honor?

24 JUDGE WOODRUFF: Yes?

25 MR. FRANSON: Mr. Oligschlaeger tells me I

1     might have been wrong on something. He just said he won't  
2     be testifying again. And with that, I would offer into  
3     evidence his testimony, and that would be Exhibits 828 and  
4     829, and 830, your Honor.

5                     JUDGE WOODRUFF: Exhibits 828, 829 and 830  
6     have been offered into evidence. In fact, I believe I've  
7     got them marked I've already received 830.

8                     MR. FRANSON: Actually, I believe you did,  
9     your Honor, and I stand corrected on that, because I  
10    believe that was on just one subject earlier.

11                    JUDGE WOODRUFF: All right. Then 828 and  
12    829 have been offered into evidence. Are there any  
13    objections to their receipt?

14                    (No response.)

15                    JUDGE WOODRUFF: Hearing none, they will be  
16    received into evidence.

17                    (EXHIBIT NOS. 828 AND 829 WERE RECEIVED  
18    INTO EVIDENCE.)

19                    JUDGE WOODRUFF: Okay. Then we'll move on  
20    to our next area of incentive compensation. I don't  
21    believe anyone has done mini openings on this yet; is that  
22    correct?

23                    MR. SWEARENGEN: Not that I'm aware of.

24                    MR. FRANSON: Your Honor, Mr. Berlin is  
25    coming up. I wasn't sure. I was thinking MGE did a mini

1 opening when they put up one witness, but I'm not sure if  
2 my memory's right.

3 JUDGE WOODRUFF: My recollection is that  
4 they did not, they indicated they would do it later, so  
5 we'll go ahead and start with mini opening from MGE.

6 MR. SWEARENGEN: Yes, thank you, your  
7 Honor, members of the Commission. The issue now is  
8 incentive compensation. We've already had one witness  
9 from MGE, Deborah Hayes, testify out of turn on that last  
10 Friday, and we appreciated the opportunity to let her go  
11 at that time, but I did not make a statement then  
12 summarizing the issue.

13 The issue is simply this: The Staff has  
14 recognized for ratemaking purposes a certain amount of the  
15 so-called incentive compensation paid to Southern Union  
16 employees at both the corporate level and at the MGE  
17 divisional level. The Staff, however, opposes rate  
18 recovery of any incentive compensation which is tied to  
19 financial goals, based on the theory that such  
20 compensation plan may be harmful to customer service.

21 Missouri Gas Energy has several responses  
22 to the Staff's argument and adjustment. First, with  
23 respect to incentive compensation plans in general, you  
24 have already heard the testimony from MGE Witness Deborah  
25 Hayes, who testified last week that the company -- the

1 company's use of incentive compensation is well within the  
2 mainstream of market practices, and furthermore it's  
3 necessary to attract and keep quality employees.  
4 Moreover, this form of compensation is the method which  
5 the company has, in fact, chosen to compensate its  
6 employees, and we think management has a great deal of  
7 prerogative in that area.

8               Second, we are unaware that this Commission  
9 has ever said that it does not want its utilities to be  
10 financially efficient. In fact, we believe that just the  
11 opposite is true, that this Commission wants the utilities  
12 under its jurisdiction to be financially efficient, and  
13 we, of course, believe that our compensation plan promotes  
14 that goal.

15              Third, we believe that incentive  
16 compensation which is awarded on the basis of achieving  
17 financial objectives should be included in cost of service  
18 because it is, in fact, in the best interests of the  
19 company's customers. It's in the best interest of this  
20 company's customers or any utility's customers, for that  
21 matter, to have a financially efficient utility providing  
22 service, and incentives to bring this about benefit  
23 customers.

24              Finally, we believe that there's no  
25 evidence to support the notion that Southern Union's

1 financially based incentive program somehow puts customers  
2 at risk. The Staff's evidence on this point is simply  
3 speculative at best. The value of this issue in terms of  
4 revenue requirement is approximately \$210,000. Thank you.

5 JUDGE WOODRUFF: Thank you. Mini opening  
6 from Staff?

7 MR. BERLIN: No mini opening, your Honor.

8 JUDGE WOODRUFF: Public Counsel?

9 MR. MICHEEL: Yes, your Honor. May it  
10 please the Commission? The evidence is going to be in  
11 this case that our good friends at MGE have a  
12 three-pronged incentive compensation goal. The Office of  
13 the Public Counsel has not taken issue with one of the  
14 three prongs with respect to the incentive compensation,  
15 the safety prong of the incentive compensation. We're  
16 recommending that the Commission adopt that.

17 However, there are two other prongs, the  
18 financial goal and the customer service goal prong of the  
19 incentive compensation for which the Office of the Public  
20 Counsel requests that the Commission deny those incentive  
21 compensation goals, and this is what the evidence is going  
22 to show:

23 With respect to the customer service goal,  
24 the evidence is going to demonstrate that that goal for  
25 customer service where they're providing incentive

1 compensation is a goal that is tied to customer service  
2 that is below the industry average, a goal that is a below  
3 industry average goal. And the Office of the Public  
4 Counsel does not believe that its clients, the ratepayers,  
5 should be required to pay incentive compensation for the  
6 company to meet a goal of customer service that is below  
7 the industry average.

8                   The second goal is the financial goal, and  
9 Mr. Swearingen talked a little bit about that in his  
10 opening. And I would just say the evidence is going to  
11 demonstrate that incentive compensation should not be  
12 included in the cost of service if it's to reward the  
13 company from maximizing shareholder wealth.

14                   And this isn't a new issue to this  
15 Commission. Indeed, this Commission on at least two  
16 occasions with respect to this company has denied this  
17 very specific goal. And if I could just read to you what  
18 this Commission said in its Report and Order in GR-98-285  
19 on this issue.

20                   The Commission finds that the cost of MGE's  
21 incentive compensation program should not be included in  
22 MGE's revenue requirement because the incentive  
23 compensation program is driven at least primarily, if not  
24 solely, by the goal of shareholder wealth maximization and  
25 is not significantly driven by the interests of



1 ratepayers.

2 For example, how does the shareholder gain  
3 wealth? How do they do that? They file rate cases, they  
4 increase customer rates. And I can tell you that every  
5 single customer that I've heard from doesn't support that  
6 goal.

7 And that's what this is about. If the  
8 company wants to provide incentive compensation, they  
9 should be able to do it. The issue here is, who should  
10 pay for that incentive compensation, the ratepayers or the  
11 shareholders.

12 At the close of all the evidence, I think  
13 you'll come to the conclusion that the appropriate parties  
14 to pay for that are the shareholders and not the  
15 ratepayers.

16 JUDGE WOODRUFF: Thank you. Did any other  
17 party wish to make a mini opening?

18 (No response.)

19 JUDGE WOODRUFF: Hearing none, we'll  
20 proceed to the first witness, which would be Mike Noack  
21 for MGE.

22 Welcome back, Mr. Noack. You have  
23 testified previously so you are still under oath.

24 THE WITNESS: Yes, sir.

25 MR. SWEARENGEN: May I proceed?

1 JUDGE WOODRUFF: You may.

2 MIKE NOACK testified as follows:

3 DIRECT EXAMINATION BY MR. SWEARENGEN:

4 Q. Mr. Noack, you filed testimony in this

5 proceeding. Could you just direct us to the piece of your

6 testimony that pertains to the incentive compensation

7 issue, please?

8 A. It is my rebuttal testimony. I believe

9 it's Exhibit 10.

10 Q. Thank you. And can you direct us to pages

11 in that testimony?

12 A. It is pages 15, 16 and 17.

13 MR. SWEARENGEN: Thank you. With that,

14 your Honor, I would tender the witness for

15 cross-examination.

16 JUDGE WOODRUFF: All right. Very good.

17 And for cross-examination, Kansas City and Joplin aren't

18 here. Federal Agencies?

19 MR. PAULSON: No questions.

20 JUDGE WOODRUFF: Jackson County and Midwest

21 Gas are not here. Public Counsel?

22 MR. MICHEEL: No questions.

23 JUDGE WOODRUFF: Staff?

24 MR. BERLIN: Yes, sir.

25 CROSS-EXAMINATION BY MR. BERLIN:

1 Q. Good morning, Mr. Noack.

2 A. Good morning, Mr. Berlin.

3 Q. Mr. Noack, are you familiar with the 2003

4 proxy statement of the Southern Union Company regarding

5 executive incentive bonus plans?

6 A. No, I'm not.

7 MR. BERLIN: Your Honor, may I approach the

8 witness?

9 JUDGE WOODRUFF: You may. I assume you

10 wish to mark this as an exhibit.

11 MR. BERLIN: Yes, your Honor.

12 JUDGE WOODRUFF: It will be 854.

13 (EXHIBIT NO. 854 WAS MARKED FOR

14 IDENTIFICATION BY THE REPORTER.)

15 BY MR. BERLIN:

16 Q. Mr. Noack, you have the 2003 proxy

17 statement on executive incentive bonus plans before you,

18 correct?

19 A. Yes.

20 Q. And I'm interested in knowing about how the

21 performance goal is necessary for the payment of

22 remuneration under the plan, and if you would, if I could

23 ask you to read just the second paragraph on this

24 document.

25 A. Begins with remuneration?

1 Q. Yes, sir.

2 A. Remuneration payable under the plan is  
3 intended to constitute, quote, qualified performance-based  
4 compensation, unquote, for purposes of Section 162M  
5 of the Internal Revenue Code of 1986, as amended, and  
6 Section 1.162-27 of the Treasury regulations promulgated  
7 thereunder, and the plan shall be construed consistently  
8 with such intention. The performance goal necessary for  
9 the payment of remuneration under the plan will be the  
10 achievement of positive consolidated net income as defined  
11 below.

12 Q. And going down to subparagraph E, the  
13 definition of consolidated net income, sir, if you'd read  
14 that.

15 A. E, consolidated network shall mean for any  
16 fiscal quarter or fiscal year, the net income before  
17 extraordinary items reported in the company's quarterly or  
18 annual consolidated statement of income included in the  
19 applicable quarterly report on Form 10-Q, in the case of a  
20 fiscal quarter, or annual report on Form 10-K, in the case  
21 of a fiscal year, as filed with the Securities and  
22 Exchange Commission pursuant to the act of 1934, as  
23 amended.

24 MR. BERLIN: Your Honor, this document is  
25 Appendix A of the 2003 proxy statement of Southern Union

1 Company pertaining to executive incentive bonus plan, and  
2 I would like to offer it into evidence.

3 JUDGE WOODRUFF: All right. Exhibit 854  
4 has been offered into evidence. Are there any objections  
5 to its receipt?

6 (No response.)

7 JUDGE WOODRUFF: Hearing none, it will be  
8 received into evidence.

9 (EXHIBIT NO. 854 WAS RECEIVED INTO  
10 EVIDENCE.)

11 BY MR. BERLIN:

12 Q. Mr. Noack, has MGE to your knowledge  
13 prepared or have caused to prepare any studies that are  
14 relating to wage levels for those MGE employees eligible  
15 for performance bonuses?

16 A. I did not prepare any studies. Deborah  
17 Hayes in human resources would have to address that.

18 Q. Would you know if MGE employees that are  
19 eligible for performance bonuses are paid at a level above  
20 or below the market?

21 A. We're talking about performance bonuses and  
22 not incentive compensation there?

23 Q. Yes.

24 A. It's my understanding just from discussions  
25 with Ms. Hayes that we are no higher than the market, and

1 in a lot of cases below.

2 Q. And how do you know that?

3 A. Just from my discussions with Ms. Hayes.

4 Q. Does weather have an impact on revenue for

5 MGE?

6 A. Absolutely.

7 Q. And no one in your company controls the

8 weather, correct?

9 A. I don't believe so.

10 Q. Okay. Did the company determine the impact

11 that weather had on bonuses that were paid out in the

12 past?

13 A. I don't believe the calculation is adjusted

14 to come up with a normalized weather, no.

15 Q. Is the target level of pre-tax earnings, to

16 the best of your knowledge, higher in 2003 than in 2002?

17 A. That I can't remember. In fact, I'm not

18 sure that -- in 2003 I'm not even confident that any of

19 the incentive comp was paid out, based on Missouri Gas

20 Energy's level of earnings. I don't think it was.

21 Q. And who would benefit the most from

22 increases in pre-tax earnings? Would it be the company,

23 the stockholders or the customers?

24 A. It's probably a combination of company,

25 customers and employees.

1 Q. What is the major O&M cost at MGE?

2 A. Natural gas purchases.

3 Q. Where would payroll fit into that?

4 A. Payroll would be -- if you take all of

5 payroll in total that's charged to O&M expense, it would

6 probably be second or third, I would imagine. Probably

7 the second.

8 Q. So it's pretty high?

9 A. Absolutely, yes.

10 Q. On page 16 of your rebuttal testimony, you

11 state that by achieving earnings that are reasonable, MGE

12 is less likely to file rate cases seeking general rate

13 increases; is that correct?

14 A. That's what my testimony says, yes.

15 Q. Did the incentive compensation payouts

16 related to financial goals prevent MGE from seeking a

17 general rate increase in Missouri?

18 A. I think, as I just said a minute ago, the

19 Missouri Gas Energy piece of that was not paid out. We

20 didn't achieve those goals.

21 Q. Going to page 18 of your surrebuttal

22 testimony, line 8, you state that --

23 A. I'm sorry. What page?

24 Q. Page 18.

25 A. 18? Under bad debt expense? Surrebuttal?

1 I apologize.

2 Q. Yes, surrebuttal.

3 A. I don't have a page 18 in surrebuttal.

4 Q. Just a minute, please. It's my mistake.

5 It was actually page 16, line 8. You state, moreover,

6 cost savings and efficiencies generated between rate cases

7 should reduce the magnitude of a subsequent rate increase

8 request to the benefit of customers; is that a correct

9 statement?

10 A. In my surrebuttal? I don't have that in

11 surrebuttal, no.

12 Q. I'm sorry. It is in your rebuttal

13 testimony.

14 A. Okay. Page 16 of my rebuttal testimony?

15 Q. Yes.

16 A. Line 8?

17 Q. Yes.

18 A. And your question again was, Mr. Berlin?

19 I've read the line.

20 Q. All right. With regard to that statement,

21 my question is, how do you measure your proposed customer

22 benefits?

23 A. Well, if we have cost savings and

24 efficiencies between cases, obviously the length of time

25 between cases is going to increase. We will not be here



1 for a rate case. Obviously, as indicated by this case,  
2 it's very expensive to both company and shareholder and  
3 ratepayer to have a rate case. So any way that we can  
4 generate cost savings efficiencies which would reduce our  
5 number of rate cases or the frequency of them is  
6 definitely a benefit to ratepayers.

7 Q. Is one opportunity for cost savings a  
8 reduction in payroll expense?

9 A. Any -- any reduction. I mean, you can look  
10 at any expense and say, sure, you can cut costs and  
11 probably it would help the bottom line, yes.

12 Q. So isn't customer service payroll cost a  
13 significant part of MGE's overall payroll cost?

14 A. Customer service, we have -- we have a lot  
15 of employees in customer service, that's correct.

16 Q. And payroll cost certainly would be MGE's  
17 largest operating cost?

18 A. Yes, it would.

19 Q. Going back to incentive compensation plans,  
20 do you know how MGE incentive compensation plans were  
21 first developed?

22 A. No, I don't.

23 Q. Would you know if, in a situation of MGE's  
24 incentive compensation plan when it was first implemented,  
25 whether or not executive employee base salaries were

1 reduced?

2 A. I'm sorry. I don't understand your  
3 question there.

4 Q. I'd like to know if when MGE first  
5 implemented its incentive compensation plan, if executive  
6 employees' salaries were reduced?

7 A. Well, No. 1 is, when are you saying the  
8 plan was implemented? I mean, are you asking me if as a  
9 result of the plan they reduced the salaries of the  
10 executives?

11 Q. Yes, that's my question.

12 A. I have no idea.

13 Q. My example would be if an executive salary  
14 was \$200,000 and was reduced to, say, 175,000, the \$25,000  
15 difference would be considered the at risk amount, and  
16 then that employee would have to earn back that portion of  
17 their salary through improved performance.

18 A. Well, all I can say is, in my case and the  
19 case of 2000 -- I guess it would be in 2004 going forward,  
20 I have no salary at risk.

21 Q. So salary was not reduced?

22 A. My salary was not reduced, no.

23 Q. Now, when you say or when we use this term  
24 "at risk, " would you mean that it is at risk in the sense  
25 that there is an amount of money above and beyond the

1 employees' base salary that may or may not be paid out  
2 depending on whether incentive compensation goals are met?

3 A. Mr. Berlin, I didn't use the term "at risk,  
4 " you did.

5 Q. All right.

6 A. I don't -- I don't think there's anything  
7 at risk.

8 Q. Okay. So you believe that there is no  
9 amount of an employee's salary at risk?

10 A. I don't feel as any of my salary is at  
11 risk, no. I have -- I have an opportunity for some  
12 incentive. I have an opportunity to get a safety bonus.  
13 I have an opportunity for performance bonuses based on the  
14 level of my ability, how much I -- how my work product is.

15 Q. So there's no amount that is calculated  
16 that you are eligible for? In other words, when you look  
17 at the amount that you're eligible for based upon  
18 performance, is that amount based upon salary?

19 A. I don't believe so, no.

20 Q. How do the current incentive compensation  
21 Southern Union financial goals that are tied to pre-tax  
22 earnings differentiate between MGE and other regulated  
23 divisions of Southern Union?

24 A. I would need to -- I'd need to see a copy  
25 of the incentive plan to give you an accurate answer

1     there.

2             Q.       And of the current incentive compensation

3     Southern Union financial goals that are tied to pre-tax

4     earnings, are they -- you can't tell me if they're

5     different between MGE and the non-regulated activities of

6     Southern Union?

7             A.       I believe there's two pieces, but I can't

8     tell you what they are, how -- I can't give you details of

9     the two pieces, no.

10            Q.       And does MGE or Southern Union have

11     incentive compensation goals that are based upon a

12     measurement of the number of customers per employee or a

13     comparison of that measurement compared to other Missouri

14     gas utilities?

15            A.       No, it does not.

16            Q.       Mr. Noack, are you familiar with the term

17     "infrastructure replacement surcharge legislation"?

18            A.       Yes, I am.

19            Q.       Would you agree that no matter how

20     efficient MGE is, that because of the infrastructure

21     replacement surcharge legislation, that to keep the

22     surcharge MGE would have to file a rate case every three

23     years?

24            A.       If we filed for a surcharge after we do

25     that, yes, we have to file within three years of that

1 surcharge.

2 MR. BERLIN: Thank you, Mr. Noack. I have  
3 no further questions.

4 JUDGE WOODRUFF: All right. Then we'll  
5 come up for questions from the Bench. Commissioner Gaw  
6 has e-mailed me a question, so I'll go ahead and try to  
7 ask that on his behalf before we go on to the other  
8 Commissioners.

9 QUESTIONS BY JUDGE WOODRUFF:

10 Q. I believe you testified earlier that the  
11 efficiency that would come from having this sort of  
12 incentive compensation would mean that the company would  
13 have to come in for a rate case less often; is that fair  
14 to say?

15 A. Yes.

16 Q. And his question is, wouldn't that also  
17 mean that customers would not benefit from those savings  
18 until the company comes in for a rate increase or a rate  
19 adjustment?

20 A. Well, the way -- the way the regulation  
21 works is that we increase plant -- all things being equal,  
22 we increase plant, expenses do go up, and to the extent  
23 that we can generate some efficiencies and cost savings,  
24 we would like to hope that we can keep everything kind of  
25 level so that, while some costs might go up, others might

1     come down from the efficiencies we're generating, and the  
2     customer maintains a status quo, so to speak. The net  
3     savings to the customer would be close to zero, and thus  
4     we wouldn't have to come in for a rate case.

5                     JUDGE WOODRUFF: For questions,  
6     Commissioner Murray?

7                     COMMISSIONER MURRAY: No questions, thank  
8     you.

9                     JUDGE WOODRUFF: Commissioner Clayton?

10                    COMMISSIONER CLAYTON: No questions.

11                    JUDGE WOODRUFF: Commissioner Davis?

12                    COMMISSIONER DAVIS: No questions.

13                    JUDGE WOODRUFF: Commissioner Appling?

14     QUESTIONS BY COMMISSIONER APPLING:

15             Q.     I didn't know I was going to come up that  
16     quick, so I kind of lost the -- Mr. Noack, sooner or later  
17     here I'm going to have to render a decision on a fair and  
18     reasonable rate of return for MGE. Somewhere down the  
19     line here in the next few days I'm going to have to make  
20     that decision. So help me out with the rate of return I  
21     think you were talking about on the -- on the incentive  
22     program. How strongly do you feel about this incentive  
23     program for MGE?

24             A.     Well, the way that I look at this,  
25     there's -- Mr. Berlin said there were three, but to me

1   there's four.  There are performance bonuses that are paid  
2   to employees based on exceptional work that they might do  
3   during the year, on a task force, on a project, anything.  
4   Then there is customer service related goals of ASA and  
5   speed of answer and the like, and then there's safety  
6   goals.  Those are three, and then there is the earnings  
7   goal that we base the final level of incentive on.

8                   And to me, I've been told by Staff that  
9   it's not the level of incentive compensation that's at  
10  question here.  It's the method with which we calculate  
11  that incentive.  If we were to come up with the same  
12  amount of money in incentive compensation and give it all  
13  on the basis of safety, based on testimony that I've heard  
14  and conversations, they may recommend to have it all  
15  allowed in the case.  But since we say the words  
16  "financial incentive," they aren't going to allow that.

17           Q.     Sir, talk to me a little bit more about  
18  safety and performance.  I'm a new Commissioner here and  
19  there's a lot that I don't know and I'm trying to pick up  
20  as I go down the road here.  But, you know, I've been in a  
21  lot of organizations.  Safety to me is -- as it's defined  
22  to me is something that we should be doing anyway.

23           A.     Exactly.

24           Q.     And that we should not be giving bonuses to  
25  people for operating a safety program.  Maybe I'm looking

1 at it from a different perspective.

2 A. Well, in this case, what it is is we have  
3 set out just, again, a goal of in this case 30 seconds --  
4 excuse me -- 30 minutes to respond to a leak call.

5 Q. Sure. And that's important.

6 A. And that is important. And we do much,  
7 much better than that. We are in the mid 20s, and  
8 that's -- that's where that goal comes into play. It's  
9 just being that much quicker than what a very good number  
10 is, and that's what we're trying to do, just actually even  
11 pick up the pace above, you know, what's good. And it's  
12 just a method of tying, you know, something to a goal.  
13 That's what we're trying to do.

14 COMMISSIONER APPLING: Okay. Sir, thank  
15 you.

16 JUDGE WOODRUFF: Thank you. Commissioner  
17 Davis?

18 QUESTIONS BY COMMISSIONER DAVIS:

19 Q. Following up on that question about the  
20 safety bonus, so safety bonus doesn't have anything to do  
21 with Workers' Compensation or anything of that nature,  
22 it's purely response time to gas leaks?

23 A. Yes. It's response time, it's -- exactly.

24 Q. And do the employees that go out and fix  
25 the lines, they qualify for that, everyone qualifies for



1 it?

2 A. I believe so.

3 Q. I've got somebody shaking their head no,  
4 I've got you saying I believe so. I'd like a definitive  
5 answer.

6 JUDGE WOODRUFF: If I could follow up on  
7 that, as I recall from the testimony yesterday or last  
8 week, the union employees are not eligible; is that  
9 correct?

10 THE WITNESS: I think that is correct.  
11 Yeah. That's why I was saying, I don't -- I'm not sure,  
12 Commissioner Davis.

13 BY COMMISSIONER DAVIS:

14 Q. So you're not sure. I'm just -- I'm just  
15 trying to reconcile that management becomes eligible for a  
16 safety response bonus, but it's not in the union's  
17 contract, so they don't get it?

18 A. That's correct.

19 Q. What -- I mean, obviously management should  
20 already have the incentive to -- I'm trying to think of  
21 how to phrase this. Shouldn't management already have  
22 enough incentive to be as quick and efficient as possible?  
23 I mean, I don't -- I mean, quite frankly, I'm just not  
24 seeing the benefit of management receiving the safety  
25 bonus. I can certainly see the benefit of giving your

1 front line workers a safety bonus or to encourage them to  
2 get out there, to get their trucks started and get over  
3 there as quickly as possible, but some guy that's sitting  
4 behind a desk all day?

5 A. Well, in the case of this particular bonus,  
6 it's not just management. I mean, it's all the non-union  
7 employees participate in this, in this particular bonus.

8 Q. Okay. Who are the non-union employees, are  
9 they the people that answer the telephones?

10 A. No, they're union.

11 Q. So these are all white-collar people?

12 A. They are white-collar people, but it's a  
13 method of -- it's -- it's kind of a method of coming up  
14 with a way to administer some of these bonuses. Since  
15 Staff doesn't want us to look at earnings, we have to come  
16 up with other performance measures to award these, and  
17 this --

18 Q. Okay. So okay. Let me just -- let me  
19 rephrase that and just say, so Staff doesn't want you to  
20 reward efficiency in administration?

21 A. Not if it's tied to the bottom line, no.  
22 Even though -- I mean, in some, I think, earlier testimony  
23 in response to a Commissioner question, there have been  
24 companies that have been given incentive programs that  
25 have been tied to the bottom line so long as, you know,

1     they can prove that the company's still being operated in  
2     an efficient and safe manner. But in our case, for  
3     incentive comp, if it's tied to bottom line, it's not  
4     allowed. It's recommended that it's not allowed.

5             Q.       It's recommended by Staff, correct?

6             A.       That's correct.

7             COMMISSIONER DAVIS: Thank you.

8             JUDGE WOODRUFF: All right. Thank you.

9     For recross, then, Federal Agencies?

10            MR. PAULSON: No questions, sir.

11            JUDGE WOODRUFF: Public Counsel?

12            MR. MICHEEL: Yes, I just have a couple to  
13     clear the record up.

14     RE CROSS-EXAMINATION BY MR. MICHEEL:

15            Q.       Commissioner Davis was asking you some  
16     questions about the eligibility for the incentive plans.  
17     Do you recall those questions?

18            A.       Yes.

19            Q.       And indeed, is the incentive plan attached  
20     as Schedule KKB-15 to Ms. Bolin's rebuttal testimony?

21            A.       Yes, it is.

22            Q.       And the incentive plan is highly  
23     confidential; is that correct?

24            A.       Yes, it is.

25            MR. MICHEEL: I guess just so I can clear

1 the record up for the Commissioner, because he was  
2 wondering where the evidence was in the record, I'd like  
3 to go in-camera, your Honor, and have him read  
4 specifically a portion from that incentive plan into the  
5 record.

6 JUDGE WOODRUFF: All right. At this time  
7 we will be going in-camera. Taking us off the Internet.  
8 If there's anyone in the room that needs to leave, please  
9 do so. Looks like familiar faces back there. We're  
10 in-camera at this time.

11 (REPORTER'S NOTE: At this point, an  
12 in-camera session was held, which is contained in  
13 Volume 18, pages 1810 through 1814 of the transcript.)  
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1 JUDGE WOODRUFF: While we were in  
2 in-camera, counsel for the OPC indicated that they had  
3 concluded their cross-ex-- or recross, so we'll move to  
4 Staff.

5 MR. BERLIN: No questions, your Honor.

6 JUDGE WOODRUFF: All right. Thank you.  
7 And redirect?

8 MR. SWEARENGEN: Thank you.

9 REDIRECT EXAMINATION BY MR. SWEARENGEN:

10 Q. Mr. Noack, in following up to Mr. Micheel's  
11 question about the personnel that operate the phone center  
12 and drive the trucks not being under this compensation  
13 plan, let me ask you this question. Can those people  
14 successfully operate their telecommunications equipment if  
15 it doesn't work?

16 A. No, they cannot.

17 Q. Can those servicemen respond within  
18 30 minutes if their motor equipment doesn't work?

19 A. No.

20 Q. Mr. Berlin asked you a question about  
21 incentive compensation being paid out for reaching  
22 financial goals, and I believe you told him that that's  
23 how the plan is supposed to work, but no such money had  
24 been paid out for Missouri Gas Energy. Do you recall that  
25 question and your answer?

1           A.       Yes, I do.

2           Q.       First of all, what periods were you  
3       referring to when you said that no financial incentive  
4       compensation had been paid to MGE employees?

5           A.       Well, it's for the test year, but it's --  
6       it's the piece that's tied to Missouri Gas Energy earnings  
7       or employees that was not met and thus not paid out.

8           Q.       So if no amount was paid out under this  
9       incentive compensation program for meeting financial goals  
10      in the test year, how did the \$200,000 revenue requirement  
11      that's at issue here, how was that amount derived?

12          A.       Well, there were goals met at the corporate  
13      level, and some of those, those incentives were met and  
14      some of that incentive compensation was paid out, but  
15      there was also a number of performance goals that --  
16      they're called spot bonuses, also, for employees that do  
17      an exceptional job on a project, and they were paid out.

18          Q.       In the past, has the company paid out  
19      incentive compensation to MGE employees for meeting  
20      financial goals?

21          A.       I am -- I don't believe so, but I haven't  
22      been an employee for that terribly long, so I have not  
23      received any.

24          Q.       In the past few years, has MGE had  
25      difficulty in achieving its financial goals?

1           A.       It has, yes.

2           Q.       I think also in response to Mr. Berlin's

3 question, and also possibly from the question from the

4 Bench, you were talking about the components of the

5 incentive compensation plan. There's more to it than just

6 the financial incentive; isn't that true? You mentioned

7 safety and customer service?

8           A.       Yes.

9           Q.       Are those the other two components?

10          A.       Those are the other two components along,

11 again, with the spot bonuses, that those aren't for sure

12 that -- you never know when you might get one of those,

13 but it's based on your performance.

14          Q.       With respect to the customer service and

15 safety components of the plan, have monies been paid out

16 to MGE employees in the test period in connection with

17 those aspects of the plan?

18          A.       In the test year ended June 30, '03, yes,

19 they were paid out.

20          Q.       With respect to the unions, do you know

21 whether or not the unions have asked for incentive bonuses

22 to be included as part of their compensation packages?

23          A.       I don't know.

24                   MR. SWEARENGEN: Thank you. That's all I

25 have.

1 JUDGE WOODRUFF: Thank you. Then you can  
2 step down.

3 COMMISSIONER APPLING: Judge, can I ask one  
4 more question, please?

5 JUDGE WOODRUFF: Go ahead.

6 FURTHER QUESTIONS BY COMMISSIONER APPLING:

7 Q. Can you isolate, Mr. Noack, for me the  
8 amount of money that you paid out in the last year or the  
9 year before then to the management staff for incentive  
10 bonus, or can you tell me how much you paid out total for  
11 your employees and what percentage of that went to  
12 management?

13 I'm just having a hard time. I've been  
14 managing for 40 years, and I'm having a hard time getting  
15 my arms around management.

16 A. Commissioner, after lunch I can bring you a  
17 schedule that will -- that can break all of that out for  
18 you. I just can't off the top of my head tell you how  
19 much it is by category, but I do have that as a work  
20 paper, and for the test year I can give you every bit of  
21 that information.

22 Q. That will be good if you will, not that --  
23 I'm pro-employee. I just want you to know that.

24 A. I understand.

25 Q. And I think anything that we can do to



1 build the morale in our organization and pay people for  
2 what they're doing is okay with me. However, the level  
3 that I've been at for the last 20 years or 30 years has  
4 been at the management level, and I would just like to  
5 know the answer to that question.

6 A. Well, just so I clarify what I'm going to  
7 give you, I'll give you a worksheet that shows incentive  
8 comp, the safety, the customer service, and then I'll mark  
9 on those which ones are management, which ones are regular  
10 employees.

11 Q. Thank you very much. I think you told me  
12 it was four things you categorized?

13 A. And I will give you a spot performance  
14 bonuses, also.

15 COMMISSIONER APPLING: Thank you very much,  
16 sir.

17 JUDGE WOODRUFF: Thank you, Mr. Noack.  
18 We'll bring you back right after lunch and you can talk  
19 about that. We'll give you a chance to cross-examine  
20 redirect on that also. All right. It's time for lunch.  
21 We'll break until one o'clock.

22 MR. FRANSON: Your Honor, if Mr. Hack could  
23 come up, I think we'd like to talk scheduling for just a  
24 moment, if we could.

25 Judge, I'll make a proposal. I think

1 Mr. Hack is in agreement with it. Right now we are on the  
2 incentive compensation pension expense, M&A reporting,  
3 time reporting.

4 Judge, it is our intent to -- and we  
5 believe we have an agreement in principle on pension  
6 expense, all of the things regarding bad debts, the  
7 depreciation, and I believe there's one more.

8 MR. HACK: Cost of removal/salvage and the  
9 earlier announced item, alternative minimum tax.

10 MR. FRANSON: What this is coming down to,  
11 Judge, what we're proposing is that today, after this  
12 current subject is over, that we stop for the day, that it  
13 is our belief we can very promptly have a partial  
14 Stipulation & Agreement.

15 Now, I have not been involved with  
16 communication on the other parties, but it's my belief  
17 that that is progressing, and anyway, where that would  
18 bring us is starting tomorrow morning with the  
19 environmental response funds, and so our proposal would  
20 be, if there's no objection, to stop today after the  
21 current subject is up.

22 JUDGE WOODRUFF: Will that get us pretty  
23 close to being on schedule then?

24 MR. FRANSON: Actually it will get us right  
25 back on schedule.

1 JUDGE WOODRUFF: Sounds good to me.

2 MR. FRANSON: And also there's witness  
3 availability matters, particularly for MGE, in terms of  
4 that they won't have those available until 8:30 in the  
5 morning.

6 JUDGE WOODRUFF: That sounds good. All  
7 right. Then we will break for lunch until one o'clock.

8 (A BREAK WAS TAKEN.)

9 (EXHIBIT NO. 45 WAS MARKED FOR  
10 IDENTIFICATION BY THE REPORTER.)

11 JUDGE WOODRUFF: We're back on the record.

12 Mr. Noack, during lunch I believe you  
13 prepared an exhibit in response to Commissioner Appling's  
14 question; is that correct?

15 THE WITNESS: That's correct.

16 JUDGE WOODRUFF: We marked that as  
17 Exhibit 45, as an MGE exhibit. Mr. Swearengen, do you  
18 wish to offer it at this time?

19 MR. SWEARENGEN: Yes, your Honor, I would  
20 offer the Exhibit 45 into evidence, and perhaps Mr. Noack  
21 could give a little explanation as to what this document  
22 is intended to show.

23 JUDGE WOODRUFF: I think that would be  
24 helpful. Mr. Noack?

25 THE WITNESS: Yes, your Honor. At the

1 request of Commissioner Appling, I prepared a schedule  
2 detailing the incentive compensation for the test year  
3 ended June 3, 2003, and I split that compensation up into  
4 management, which I have entitled directors and above, and  
5 other employees, which I have entitled managers and other  
6 employees.

7 And I further detailed all of those bonuses  
8 and incentive compensation by category, those categories  
9 being incentive compensation, Christmas bonus, sales  
10 commission, performance or spot bonuses, and a relocation  
11 bonus. This is what Commissioner Appling requested, and  
12 hopefully this fulfills his request.

13 JUDGE WOODRUFF: Okay. That relocation is  
14 bonus and not just expenses for relocating?

15 THE WITNESS: Well, it is a bonus paid to  
16 an employee who came from out of state to relocate, yes.

17 JUDGE WOODRUFF: Okay. Exhibit 45 has been  
18 offered into evidence. Are there any objections to its  
19 receipt?

20 (No response.)

21 JUDGE WOODRUFF: Hearing none, it will be  
22 received into evidence.

23 (EXHIBIT NO. 45 WAS RECEIVED INTO  
24 EVIDENCE.)

25 JUDGE WOODRUFF: Now, I believe, Mr. Noack,

1     you can step down. Sorry. I want to give everybody a  
2     chance to respond to this yet. Is there any  
3     cross-examination based on this document?  
4                     (No response.)  
5                     JUDGE WOODRUFF: Hearing none, any redirect  
6     on this document?  
7                     MR. SWEARENGEN: No, your Honor. Thank  
8     you.  
9                     JUDGE WOODRUFF: Thank you. Then you can  
10    step down, Mr. Noack.  
11                    THE WITNESS: Thank you.  
12                    JUDGE WOODRUFF: Then I believe the next  
13    witness will be Dana Eaves for the Staff.  
14                    (Witness sworn.)  
15                    JUDGE WOODRUFF: You may inquire.  
16    DANA EAVES testified as follows:  
17    DIRECT EXAMINATION BY MR. BERLIN:  
18             Q.     Mr. Eaves, did you cause to be prepared and  
19    filed in this proceeding certain written direct and  
20    surrebuttal testimony in a question and answer format?  
21             A.     I have.  
22             Q.     That would be direct testimony, Exhibit  
23    No. 808, and surrebuttal testimony, No. 809?  
24             A.     That's correct.  
25             Q.     Do you have any corrections to make to your

1 testimony at this time?

2 A. I have one slight correction. That's in my  
3 direct testimony, page 14, line 4 middle ways of the page,  
4 the word "is" needs to be removed, and that is between  
5 goal and defined. And that's all the corrections I have.

6 Q. Would your answers to the questions in your  
7 testimony be the same today as they are in your written  
8 testimony?

9 A. Yes, they would.

10 Q. And have you answered the questions in your  
11 testimony truthfully, to the best of your knowledge,  
12 information and belief?

13 A. Yes, I have.

14 MR. BERLIN: I pass the witness.

15 JUDGE WOODRUFF: Do you wish to offer 808  
16 and 809?

17 MR. BERLIN: Yes, I do.

18 JUDGE WOODRUFF: Is this the only time  
19 Mr. Eaves will be testifying?

20 THE WITNESS: Yes.

21 JUDGE WOODRUFF: Exhibit 808 and 809 have  
22 been offered into evidence. Are there any objections to  
23 their receipt?

24 MR. SWEARENGEN: Company has none.

25 JUDGE WOODRUFF: Hearing none, they will be

1 received into evidence.

2 (EXHIBIT NO. 808 AND 809 WERE RECEIVED INTO  
3 EVIDENCE.)

4 JUDGE WOODRUFF: And for cross-examination,  
5 again, with Public Counsel?

6 MR. MICHEEL: No questions.

7 JUDGE WOODRUFF: Kansas City and Joplin are  
8 not here. Federal Agencies?

9 MR. PAULSON: No questions, sir.

10 JUDGE WOODRUFF: Jackson County and Midwest  
11 Gas are not here. MGE?

12 MR. SWEARENGEN: Thank you, Judge.

13 CROSS-EXAMINATION BY MR. SWEARENGEN:

14 Q. Mr. Eaves, am I correct that with respect  
15 to Southern Union Company, there is incentive compensation  
16 that's paid out at two levels, one at the corporate level  
17 and the second at the MGE or divisional level?

18 A. That's correct.

19 Q. Would you agree that the purpose of  
20 compensation, generally speaking, is to pay an employee  
21 for doing his or her job?

22 A. Yes.

23 Q. And would you agree that with respect to an  
24 organization such as a public utility, in particular MGE,  
25 that job is to provide safe and reliable utility service?

1           A.       Yes, I would agree.

2           Q.       You are not making any claim, are you, in  
3 your testimony that MGE is somehow not providing safe and  
4 reliable gas utility service to its customers?

5           A.       I am making no such claim.

6           Q.       As far as you know, MGE's employees are  
7 doing their job, is that correct, or their jobs?

8           A.       Based on what I know, yes, that is a  
9 correct statement.

10          Q.       Would you agree with me that who a company  
11 such as MGE hires is a matter left to the discretion of  
12 management?

13          A.       Yes, I'm sure they have certain hiring  
14 practices that they follow and guidelines that they  
15 follow.

16          Q.       And those hiring practices or guidelines  
17 are matters that the company gets to decide; is that true?

18          A.       That is correct.

19          Q.       Would you also agree that what a company  
20 such as MGE pays its employees is a matter for management  
21 prerogative?

22          A.       Yes, I would.

23          Q.       And would you also agree that how the  
24 company pays its employees is within the discretion of  
25 management?



1           A.       Yes, I would.

2           Q.       Staff Witness Chuck Hyneman is also a Staff  
3 witness on this issue; is that correct?

4           A.       That's correct.

5           Q.       Are you generally familiar with  
6 Mr. Hyneman's surrebuttal testimony on this topic?

7           A.       I have read it.

8           Q.       Do you have a copy of it in front of you?

9           A.       I do not.

10          Q.       If I told you that on page 18 of his  
11 surrebuttal testimony, Mr. Hyneman is asked the question,  
12 is the Staff opposed in theory to all forms of incentive  
13 compensation, and his answer is, no, the Staff has  
14 supported and continues to support well-designed incentive  
15 compensation plans that are based on measures that promote  
16 the provision of safe and adequate service at reasonable  
17 rates, would you agree with that statement?

18          A.       Yes. If he's made that statement in his  
19 surrebuttal testimony, I would agree with that, yes.

20          Q.       Is it true that in this case the Staff is  
21 allowing in rates in cost of service some level of  
22 incentive compensation?

23          A.       Yes.

24          Q.       So to the extent that the Staff is, in  
25 fact, doing that, to the extent the Staff is allowing rate

1 recovery of incentive compensation, would I be correct in  
2 assuming that the Staff believes the company's incentive  
3 compensation plan is based on measures that promote the  
4 provision of safe and adequate service at reasonable  
5 rates, as indicated by Mr. Hyneman?

6 A. I don't think I'd be able to answer that  
7 question yes or no. I'd have to explain about the plan  
8 and explain what the Staff is allowing and what the Staff  
9 has proposed to disallow.

10 Q. Well, my question is, with respect to what  
11 the Staff is allowing in the way of incentive  
12 compensation -- and when I say is allowing, I'm talking  
13 about is allowing to be passed on through rates, would you  
14 agree that to that extent the company's plan meets the  
15 standard set by Mr. Hyneman in his surrebuttal testimony?

16 A. Only part of the plan, in my opinion, would  
17 meet the guidance of prior rulings by the Commission.

18 Q. Well, my question is, to the extent that  
19 you are allowing the pass through of some of those costs  
20 in rates, to that extent, does the plan promote the  
21 provision of safe and adequate service at reasonable  
22 rates?

23 A. The portion of the plan that I am  
24 recommending to be -- or have not proposed any adjustments  
25 to is the customer service, which is based on speed of

1     answer, average speed of answer, and a safety goal. Those  
2     two areas I have not proposed any adjustments to.

3             Q.       And so the answer would be yes?

4             A.       With that qualifier, yes.

5             Q.       Well, what I'm trying to get at is, you're  
6     qualifying it, and all I'm talking about is those costs  
7     you are allowing to be passed on through rates. Are you  
8     saying that some of those costs actually should not be  
9     passed on, is that what you're saying?

10            A.       What I'm saying is the plan, MGE's  
11   incentive plan is composed of four components. The  
12   divisional component, which is tied to pre-tax earnings, I  
13   have made a disallowance for that. The safety portion and  
14   the customer service portion, I have not proposed a  
15   disallowance.

16            Q.       And that's because the safety portion and  
17   the customer service portion, at least in your judgment,  
18   promote the provision of safe and adequate service at  
19   reasonable rates; is that true?

20            A.       I think it's headed in the right direction,  
21   yes.

22            Q.       But you do oppose rate recovery of any  
23   incentive compensation which is based on or tied to  
24   financial goals or objectives; is that true?

25            A.       That is true.

1           Q.       And is that because, as you say at the top  
2 of page 3 of your surrebuttal testimony -- if you have  
3 that, you might want to turn to it -- there I understand  
4 you to say that if incentive compensation plan goals are  
5 financially driven, there's a risk that they may be  
6 achieved at the expense of customer service; is that your  
7 testimony?

8           A.       It is.

9           Q.       Would you agree that, as a general  
10 proposition, utilities should be efficient?

11          A.       I would.

12          Q.       And would you also agree that this  
13 Commission should encourage those utilities under its  
14 jurisdiction to be efficient?

15          A.       Yes, I think that's correct.

16          Q.       And is that because efficiency ultimately  
17 benefits customers?

18          A.       Yes, I think efficiency would lead to  
19 decreased costs, thereby benefiting the ratepayers. Yes.

20          Q.       And being efficient would encompass  
21 financial efficiency, would it not?

22          A.       Yes.

23          Q.       Would you agree that MGE should encourage  
24 its employees to meet the financial objectives of the  
25 company?

1           A.       Yes.

2           Q.       If there's a problem with respect to the  
3       provision of safe and adequate service by MGE, or for that  
4       matter any utility under the Commission's jurisdiction,  
5       are you aware of anything that the Staff could do to seek  
6       to remedy that situation?

7           A.       I'm sorry. I missed the first part of your  
8       question.

9           Q.       If there's a problem with respect to the  
10       provision of safe and adequate service by MGE or any  
11       utility under the Commission's jurisdiction, is there  
12       something the Staff can do to seek to remedy that  
13       situation?

14          A.       I'm sure there is.

15          Q.       And what would that be?

16          A.       At the moment, I wouldn't have a  
17       recommendation. I think it would be based on the  
18       situation, what the problem was and what the Commission  
19       could do to address those issues.

20          Q.       Have you ever been involved in a situation  
21       where for some reason the Staff filed a complaint against  
22       a utility?

23          A.       I don't think I've been involved in a  
24       complaint case.

25          Q.       Are you aware that the Staff has ever filed

1 a complaint against a utility?

2 A. Yes.

3 Q. Are you aware that the Staff has ever filed

4 a complaint against a utility for failure to provide safe

5 and reliable service?

6 A. Yes.

7 Q. The portion of the compensation plan here

8 that the Staff objects to was in effect during the test

9 year, was it not?

10 A. Yes, it was. The 2003 plan was within the

11 2002 or 2003 test year; however, no payments were made on

12 that plan in 2002.

13 Q. And why was that, do you know?

14 A. I'm assuming, because it's a new plan, that

15 it was not in effect.

16 Q. Is the plan still in effect, as far as you

17 know?

18 A. As far as I know, yes.

19 Q. Does the Staff want the company to

20 eliminate those portions of its incentive compensation

21 plan that are tied to financial goals?

22 A. Staff is not requesting that the -- that

23 the company eliminate the incentive plan, just not to pass

24 through those costs on to the ratepayers.

25 Q. You're not saying that to the extent the

1 company has compensated its employees under this plan,  
2 that those dollars weren't spent, are you?

3 A. I'm not saying that MGE did not pay out  
4 some level for incentive compensation during the test  
5 year.

6 Q. And the company paid their employees in  
7 this fashion because that's the way the company decided to  
8 compensate its employees; is that a fair statement?

9 A. It's the company's decision, yes.

10 Q. If the dollars that are at issue here were  
11 not the result of an incentive compensation plan but  
12 rather were built into the base pay of MGE's employees,  
13 would the Staff propose the adjustments it's proposing in  
14 this case?

15 A. I think we would have to take -- if there  
16 was a salary increase during the test year, and even in  
17 prior periods, that would affect the test year levels, I  
18 think Staff would definitely take a look at those pay  
19 increases, yes.

20 Q. So -- and what would the Staff do? Does  
21 the Staff traditionally look at pay increases and then  
22 recommend a disallowance?

23 A. I don't know as a general rule. We'd have  
24 to take it on a case-by-case basis. I'm sure that there's  
25 been times where we propose disallowances to wage level

1     increase for some factor.

2             Q.       And are you aware of any case where the  
3     Staff has done that?

4             A.       I'm aware for out-of-period proposed  
5     adjustments, those type issues.

6             Q.       What if it's not out of period? Are you  
7     aware of any instance when the Staff has recommended that  
8     a wage increase that's within the period not be allowed?

9             A.       I'm not aware of any.

10            MR. SWEARENGEN: That's all I have.

11     Thanks.

12            JUDGE WOODRUFF: We'll come up for  
13     questions from the Bench. Commissioner Clayton?

14            COMMISSIONER CLAYTON: No questions.

15            JUDGE WOODRUFF: Commissioner Appling?

16            COMMISSIONER APPLING: No questions.

17            JUDGE WOODRUFF: I have no questions, so no  
18     recross. Any redirect?

19            MR. BERLIN: I have some, your Honor.

20            JUDGE WOODRUFF: Go ahead.

21     REDIRECT EXAMINATION BY MR. BERLIN:

22            Q.       Mr. Eaves, Mr. Swearengen asked you a  
23     question regarding page 3 of your surrebuttal testimony.  
24     What did you mean by the statement, quote, achieve  
25     financial goals at expense of customer service, close



1 quote?

2 A. For any organization, and MGE's not alone,  
3 payroll is one of the largest expenses that a company will  
4 incur. In fact, I think Mr. Noack stated that it probably  
5 ranks No. 2 after gas costs. So if the company wanted to,  
6 they could lower the employee levels, say, in the customer  
7 service department, which is rather large, therefore  
8 impacting customer service levels, decreasing the amount  
9 of employees in that department.

10 That would be a -- I don't know if a  
11 windfall, but that would certainly be a cost reduction for  
12 the company and would not currently be reflected in rates  
13 until the next rate case.

14 Q. If a company meets a financial goal  
15 according to its incentive compensation plan, does that  
16 factor alone mean that the company was efficient?

17 A. Not necessarily. There's a lot of factors  
18 that the company doesn't -- that the company doesn't have  
19 input on. A major impact is weather. It could be colder  
20 than normal and the company would possibly see greater  
21 revenue during that period.

22 Q. Mr. Eaves, earlier Mr. Swearingen asked you  
23 about incentive compensation, the plan at the corporate  
24 level, and that it paid employees to do their jobs. Could  
25 you explain for me what employees that incentive

1 compensation plan at the corporate level applies to?

2 A. At the corporate level, I don't know if I  
3 have a listing of the employees, but they would be senior  
4 management. I'm assuming the CEOs, CFOs, vice presidents  
5 and higher would be eligible for the plan.

6 Q. How much does the corporate level plan  
7 entail with regard to the entirety of the incentive  
8 compensation plan program?

9 A. From the -- from the documentation that  
10 I've reviewed and the contracts with those employees, each  
11 employee that's eligible for the plan receives 5 percent  
12 for safety, 5 percent for customer service. If they're at  
13 the divisional level, a percentage, 20 percent, 25 percent  
14 is probably the range. And then the remaining would be  
15 the Southern Union Company incentive plan. So  
16 approximately 60, 65, 70 percent would encompass the  
17 Southern Union incentive plan.

18 MR. BERLIN: I have no further questions.  
19 Thank you.

20 JUDGE WOODRUFF: All right. Thank you.  
21 And you may step down.

22 I believe it would be Mr. Hyneman again.  
23 Welcome back, Mr. Hyneman. You are still under oath. And  
24 for direct, then. I believe we have one more appearance  
25 yet; is that correct?

1 MR. BERLIN: Yes.

2 JUDGE WOODRUFF: All right. Is there any  
3 direct testimony or you just wish to offer him for  
4 cross-examination?

5 MR. BERLIN: Just a minute, your Honor. I  
6 want to clarify this.

7 JUDGE WOODRUFF: Okay.

8 MR. BERLIN: Your Honor, I believe that his  
9 testimony has already been admitted, or offered rather.

10 JUDGE WOODRUFF: Yes, I believe it has been  
11 offered. I believe he's coming up on one more issue yet,  
12 I believe, on lobbying costs.

13 MR. BERLIN: Yes, your Honor.

14 JUDGE WOODRUFF: Do you tender him for  
15 cross-examination at this point, then, on these issues?

16 MR. BERLIN: Yes, I do.

17 JUDGE WOODRUFF: Thank you. For  
18 cross-examination beginning with Public Counsel?

19 MR. MICHEEL: No.

20 JUDGE WOODRUFF: Kansas City and Joplin are  
21 not here. Federal Agencies?

22 MR. PAULSON: No questions, sir.

23 JUDGE WOODRUFF: Jackson County and Midwest  
24 Gas are not here, so MGE?

25 MR. SWEARENGEN: I pass the witness,

1 please.

2 JUDGE WOODRUFF: Come up to the Bench.

3 Commissioner Clayton, do you have any questions?

4 COMMISSIONER CLAYTON: No.

5 JUDGE WOODRUFF: Commissioner Appling?

6 I have no questions either. So there's no

7 need for recross or redirect, and I believe you can step

8 down.

9 (Witness excused.)

10 MR. MICHEEL: We would call Ms. Bolin, your

11 Honor.

12 JUDGE WOODRUFF: Welcome, Ms. Bolin. I

13 believe you have testified earlier as well, so you are

14 still under oath.

15 MR. MICHEEL: Your Honor, she just has a

16 couple typographical corrections in her rebuttal

17 testimony.

18 KIMBERLY BOLIN testified as follows:

19 DIRECT EXAMINATION BY MR. MICHEEL:

20 Q. And I would ask that she tell us where

21 those are and let us know what they are.

22 A. My corrections are both on page 19 of my

23 rebuttal testimony, and line 22 should read, "the

24 Commission finds that the cost of MGE's incentive

25 compensation."

1                   And then on line 23, in front of the letter  
2 N, there should be a word "I" to make it read "in MGE's  
3 revenue requirement."  
4                   Q.       And are those the only corrections that you  
5 have on that portion of your testimony?  
6                   A.       Yes, they are.  
7                   MR. MICHEEL: I would tender the witness,  
8 your Honor.  
9                   JUDGE WOODRUFF: Thank you. And for  
10 cross-examination, then, we will begin with Staff.  
11                   MR. BERLIN: No questions, your Honor.  
12                   JUDGE WOODRUFF: Kansas City and Joplin are  
13 not here. Federal Agencies?  
14                   MR. PAULSON: No questions, sir.  
15                   JUDGE WOODRUFF: Jackson County and Midwest  
16 Gas are not here. MGE?  
17                   MR. SWEARENGEN: No questions, thank you.  
18                   JUDGE WOODRUFF: Coming up to the Bench,  
19 then. Commissioner Clayton, do you have any questions?  
20                   COMMISSIONER CLAYTON: No.  
21                   JUDGE WOODRUFF: All right. Commissioner  
22 Appling?  
23                   COMMISSIONER APPLING: No questions.  
24                   JUDGE WOODRUFF: All right. I have no  
25 questions. So no recross and no redirect. You may step

1 down.

2 (Witness excused.)

3 JUDGE WOODRUFF: And I believe from what we  
4 discussed this morning we've now reached an end, an end  
5 for the day. I will indicate that we want to try and  
6 avoid going late on Friday, and I know there are several  
7 issues on Friday. If we finish early on tomorrow or  
8 Wednesday, we may want to try and take some of those up.

9 I just want to ask, I know that -- well,  
10 let's see. Class cost of service and rate design, I  
11 believe, is on Thursday, and I don't think we can move  
12 that up, based on what Mr. Conrad had requested earlier.  
13 I also see lobbying and legislative costs on Friday and  
14 the low income proposals. Would we be able to move either  
15 of those issues up to Tuesday or Wednesday if we have  
16 time?

17 MR. HACK: It seems to me like the best  
18 candidates for perhaps moving up would be the late payment  
19 charge Friday morning and the lobbying legislative  
20 materials. Those are the fewest witnesses and -- and I  
21 will talk with our folks about that as a possibility.

22 JUDGE WOODRUFF: And I know that, for  
23 instance, the City of Kansas City is interested in low  
24 income proposals and will probably want to be here for  
25 that.

1                   MR. HACK: Correct. Correct. So we will  
2   kind of check with our folks on that, and I honestly don't  
3   know how long the environmental issue is going to go  
4   tomorrow morning, and then we have -- we have actually the  
5   better part -- well, more than a day set for the revenue  
6   issues, so it may be that Wednesday would pose an  
7   opportunity for either or both late payment charge and  
8   lobbying and legislative.

9                   JUDGE WOODRUFF: Okay. Very good. Any  
10  other matter anyone wants to bring up while we're still on  
11  the record?

12                  MR. MICHEEL: I would just concur with what  
13  Mr. Hack said about the possibility of moving things up.  
14  The lobbying and late payment charge are good candidates.  
15  The other two, I don't think they are.

16                  JUDGE WOODRUFF: Okay. Mr. Berlin?

17                  MR. BERLIN: Your Honor, late payment, I  
18  didn't catch if Mr. Hack was asking to move it up to what  
19  day, Thursday or Wednesday?

20                  JUDGE WOODRUFF: I think he said Wednesday  
21  would be a possibility if we finish early.

22                  MR. HACK: I thought Wednesday would be the  
23  most likely.

24                  MR. BERLIN: Okay.

25                  JUDGE WOODRUFF: Okay. We just want to

1     avoid having to go late on Friday afternoon.

2                     MR. BERLIN:  I understand, and our late

3     payment witness is not available on Thursday.  So thank

4     you.

5                     JUDGE WOODRUFF:  Okay.  Anything else?

6                     (No response.)

7                     JUDGE WOODRUFF:  All right.  Then we are

8     adjourned until 8:30 tomorrow morning.

9                     WHEREUPON, the hearing of this case was

10    recessed until June 29, 2004.

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