

1 STATE OF MISSOURI
2 PUBLIC SERVICE COMMISSION
3
4
5
6 TRANSCRIPT OF PROCEEDINGS
7 Hearing
8 June 23, 2004
9 Jefferson City, Missouri
10 Volume 12
11
12 In the Matter of Missouri Gas)
13 Energy's Tariffs to Implement a)
14 General Rate Increase for Natural) No. GR-2004-0209
15 Gas Service)
16
17 MORRIS L. WOODRUFF, Presiding,
18 SENIOR REGULATORY LAW JUDGE.
19
20 STEVE GAW, Chairman,
21 CONNIE MURRAY,
22 ROBERT M. CLAYTON,
23 LINWARD "LIN" APPLING,
24 COMMISSIONERS.
25
26 REPORTED BY:
27
28 CHRISTINE A. SIMPSON, CRR, CCR, RPR, CSR
29 MIDWEST LITIGATION SERVICES
30

1 APPEARANCES:

2 ROBERT J. HACK, Attorney at Law
3 Missouri Gas Energy
3420 Broadway
4 Kansas City, MO 64111
(816) 360-575

5 JAMES C. SWEARENGEN, Attorney at Law
Brydon, Swearengen & England, P.C.
6 312 East Capitol
P.O. Box 456
7 Jefferson City, MO 65102-0456
(573) 635-7166

8 ERIC HERSCHMANN, Attorney at Law
9 Kasowitz, Benson, Torres & Friedman, LLP
1633 Broadway
10 New York, NY 10019-6799
(212) 506-1700

11 FOR: Missouri Gas Energy, a Division
12 of Southern Union Company.

13 CRAIG PAULSON, Attorney at Law
AFLSA/ULT
14 139 Barnes Drive, Suite 1
Tyndall AFB, FL 32403
15 (850) 283-6350

16 FOR: Federal Executive Agencies.

17 DOUGLAS E. MICHEEL, Senior Public Counsel
200 Madison Street, Suite 650
18 P.O. Box 2230
Jefferson City, MO 65102-2230
19 (573) 751-4857

20 FOR: Office of the Public Counsel and
the Public.

21 ROBERT FRANSON, Senior Counsel
22 ROBERT BERLIN, Assistant General Counsel
200 Madison Street
23 P.O. Box 360
Jefferson City, MO 65102
24 (573) 751-3234

25 FOR: Staff of the Missouri Public
Service Commission

1 PROCEEDINGS

2 JUDGE WOODRUFF: All right. Good
3 morning, everyone. We're back for day three of the
4 hearing in GR-2004-0209. It's now approximately 8:30
5 on June 23rd, I believe it is. When we left off
6 yesterday we had just finished cross-examination of
7 -- whoever we cross-examined. Miss Wisenheimer, I
8 guess it was.

9 So at this time we're ready for Mr.
10 Tuck, I believe, for Public Counsel.

11 MR. MICHEEL: Your Honor, the Office
12 of Public Counsel will call John A. Tuck.

13 JUDGE WOODRUFF: Counsel for Public
14 Counsel has offered me the errata sheet for Mr.
15 Tuck's testimony.

16 MR. BERLIN: What is it, 218?

17 JUDGE WOODRUFF: It will be No. 218.

18 Mr. Tuck, if you would raise your
19 right hand, I'll swear you in.

20 (Witness sworn.)

21 JUDGE WOODRUFF: You may inquire.

22 JOHN A. TUCK, testified as follows:

23 DIRECT EXAMINATION BY MR. MICHEEL:

24 Q. Would you state your name?

25 A. John A. Tuck.

1 Q. And how are you employed?

2 A. I'm employed by the Office of Public
3 Counsel as an independent financial consultant.

4 Q. And are you the same John A. Tuck who
5 caused to be filed your surrebuttal testimony in this
6 proceeding which has been marked for purposes of
7 identification as Exhibit 203?

8 A. Yes, I am.

9 Q. And are you the same John A. Tuck who
10 has caused to be filed an errata sheet in this
11 proceeding with some changes to that testimony as
12 Exhibit 218?

13 A. Yes, I am.

14 Q. And if I asked you those same
15 questions contained in your surrebuttal testimony as
16 modified by your errata sheet, Exhibit 218, would
17 your answers be the same or similar?

18 A. That's correct.

19 MR. MICHEEL: With that, Your Honor,
20 I would offer the admission of Exhibits 203 and 218
21 and tender Mr. Tuck for cross-examination.

22 JUDGE WOODRUFF: All right. Exhibits
23 203 and 218 have been offered into evidence. Are
24 there any objections?

25 MR. HERSCHMANN: Yes. Your Honor, we

1 previously filed a motion to exclude Mr. Tuck's
2 testimony based on being improper surrebuttal and not
3 complying with 498.065. I just renew that objection
4 now. And I understand based on your prior rulings
5 what the response will be.

6 JUDGE WOODRUFF: Yes, as expected the
7 response is that the Commission will take that motion
8 under advisement and rule on it at a later date.

9 MR. MICHEEL: Your Honor, I believe
10 that's a misstatement with respect to the motion to
11 strike Mr. Tuck's surrebuttal testimony. It's not
12 based on 498.065, but it's based on the Commission's
13 rule with respect to surrebuttal testimony. I don't
14 think there's been any challenge made at this time to
15 Mr. Tuck's credentials as an expert.

16 JUDGE WOODRUFF: I believe that is
17 correct. Is that --

18 MR. HERSCHMANN: I'm not going to
19 contradict that -- I'm not challenging that.
20 Whatever the motion says, it says.

21 JUDGE WOODRUFF: All right. Thank
22 you. Subject to that motion, then 203 and 218 will
23 be admitted into evidence.

24 And for cross-examination, we begin
25 with Staff.

1 MR. BERLIN: I have no questions, Your
2 Honor.

3 JUDGE WOODRUFF: All right. I don't
4 believe the City of Kansas City is here or the City
5 of Joplin. Federal agencies have any questions?

6 MR. PAULSON: No, sir.

7 JUDGE WOODRUFF: Thank you. I don't
8 see Jackson County or Midwest Gas here, so we'll go
9 to MGE.

10 MR. HERSCHMANN: Your Honor, as I
11 indicated off the record before I actually begin my
12 inquiry, I'll say good morning to Mr. Tuck and good
13 morning to my children who are watching, Michael,
14 Alex, and Rachel.

15 It may get me in trouble here, but
16 I'll definitely win kudos at home.

17 CROSS-EXAMINATION BY MR. HERSCHMANN:

18 Q. Good morning, Mr. Tuck.

19 A. Good morning.

20 Q. My name is Eric Herschmann, we just
21 met a couple minutes ago.

22 A. We did.

23 Q. When were you first retained by the
24 OPC to assist in this matter?

25 A. I was first retained by the Office of

1 Public Counsel sometime in the middle of March to
2 meet with Mr. Allen, who is a fairly new employee of
3 the Office of Public Counsel, to just talk in
4 generally -- general terms about cost of capital
5 testimony. And then the Public Counsel retained me
6 to file surrebuttal testimony, and I believe that was
7 late May, roughly May 25th or 26th.

8 Q. Now, when you were first hired in
9 March, did your employment have any duration?

10 A. I believe that I put in the letter
11 that I wrote to the Public Counsel a maximum number
12 of hours that I would spend either meeting with Mr.
13 Allen or talking with Mr. Allen on the phone, but it
14 did not specifically have a date in that letter.

15 Q. How many hours did you agree to work
16 for them?

17 A. I believe it was 20 hours.

18 Q. And how many hours did you spend
19 talking to Mr. Allen?

20 A. When I submitted a final billing
21 statement to the Public Counsel for that engagement,
22 I believe that I showed a total of 26 hours that I
23 had spent either talking with Mr. Allen on the phone
24 or meeting with Mr. Allen or in some cases probably
25 reviewing some material so that I could speak on some

1 issues with Mr. Allen.

2 Q. And did you have occasion to speak
3 with Mr. Allen on certain issues?

4 A. Yeah, we met on a certain date, I
5 don't recall what that date was exactly, but it was
6 roughly the middle of March, and we talked for about
7 six hours about filing rate of return testimony and
8 some of the issues that are involved in filing rate
9 of return testimony. And then after that, we had a
10 number of phone conversations.

11 Q. And the information that's contained
12 in your surrebuttal testimony, is that information
13 that you believe Mr. Allen was capable of submitting
14 to this Commission?

15 A. I think that every cost of capital
16 witness has different views or different things that
17 they pick up on on the body of evidence in a
18 proceeding. And Mr. Allen filed surrebuttal
19 testimony, and I would imagine that, and you would
20 have to ask Mr. Allen this, but I'm sure that he was
21 probably told to address the issues that he thought
22 were most relevant.

23 And I was also retained by the Public
24 Counsel to file surrebuttal testimony. And there's a
25 large body of evidence in this proceeding and there's

1 different ways to look at issues. So I think that by
2 that very nature, the testimonies would be different.
3 They would talk about different things.
4 Philosophically, a lot of things might line up with
5 each other, but there would be differences.

6 Q. Let me ask you this: Did you find
7 that much of your testimony was simply in agreement
8 with the process that Mr. Allen used in submitting
9 his prepared testimony?

10 A. Well, in rebuttal testimony John Dunn
11 had described the direct testimony of Mr. Allen as
12 being mechanistic and contrived and arbitrary and
13 canned. And I think more specifically he says not
14 the product of a genuine analytical effort, because
15 he lacks the required expertise. And even went so
16 far as to say that it was an improper strategic
17 effort designed to produce a specific desired result.

18 And so the Public Counsel requested
19 that I look at the testimony of Mr. Allen and respond
20 to those claims in Mr. Dunn's rebuttal testimony.

21 Q. So would the answer to my question be,
22 yes, the majority of your testimony is designed to
23 say that you agree with Mr. Allen?

24 A. I agree with the general methodologies
25 that Mr. Allen employed. I didn't necessarily take a

1 final look at his determination and make an
2 assessment of that. But I looked at the conclusions
3 that he drew along the way and made some assessments
4 of those. And for the most part, I do agree with
5 those.

6 Q. And one of the reasons you agree with
7 what Mr. Allen did is because he consulted with you
8 before he submitted his testimony; right?

9 A. Mr. Allen asked me questions about
10 certain issues, and I'm sure that some of that was
11 relevant to the work that he was performing to file
12 direct testimony in this case.

13 Q. Do you know if he was working on
14 anything else other than submitting testimony in this
15 case?

16 A. Well, I think he was also studying the
17 issues of cost of capital and rate of return.

18 Q. Do you mean general --

19 A. In general, yes.

20 Q. In generally. And when you say cost
21 of capital generally, how much experience do you have
22 dealing with cost of capital in the utility field?

23 A. I was employed by the Office of Public
24 Counsel from June of 1992 through February of 1995,
25 and I filed testimony in 14 cases before the Missouri

1 Public Service Commission during that time.

2 After I left employment with the
3 Office of Public Counsel, a significant period of
4 time had lapsed and the Public Counsel was unable to
5 find or retain the services of another cost of
6 capital analyst. And there was a case that was
7 ongoing, and the Public Counsel had desired to file
8 testimony in that case.

9 So I agreed to file testimony. It was
10 a Missouri American case, and it took place in the
11 summer of 1995. So that represents the 15th case
12 that I filed testimony before the Missouri Public
13 Service Commission on issues of cost of capital.

14 Q. Dealing with utilities; right?

15 A. Yes.

16 Q. And can you tell us, what's the
17 difference in utility regulatory finance compared to,
18 say, general finance?

19 A. Could you be more specific?

20 Q. Well, is there a difference? Is
21 utility regulatory finance something that you learned
22 when you came to the Commission here?

23 A. Well, I think what's important to know
24 specifically on the issue of cost of capital is not
25 necessarily the specific methods that certain

1 witnesses believe are most relevant in the utility
2 regulatory environment, but instead what's most
3 relevant specifically with the issue of determining
4 the cost of equity capital is what do investors do,
5 how do investors determine what rate of return they
6 require on investments in a public utility.

7 And in this proceeding and generally
8 in the utility regulatory environment, the discounted
9 cash flow method is one of the most commonly used
10 methods. And the question about how do investors do
11 that is germane to not only utilities, but across the
12 broader spectrum of stocks.

13 Q. So you mean the DCF model is a
14 standard used model in cost of capital?

15 A. It is a standard used model, yes.

16 Q. And you have used it in the past;
17 right?

18 A. I have.

19 Q. And there are different inputs that go
20 into the DCF model; right?

21 A. That is correct.

22 Q. When you speak about what investors
23 expect, does it matter at all, do you have some
24 experience in dealing with any investors or reviewing
25 any business plans or any understanding of the

1 companies that you are considering, or is it just you
2 have a DCF model, plug in the numbers, and off you
3 go?

4 A. I think that a basic understanding of
5 the models and the type of inputs that are reviewed
6 are important. Does experience matter? Certainly in
7 the investment management community, I think as
8 professional investors look at these things and I
9 think it's probably appropriate across the broad
10 spectrum of the way investors look at things,
11 experience is helpful.

12 Q. So is training, isn't it?

13 A. Yes.

14 Q. And during your years at the OPC and
15 after you left the OPC, you continued your education
16 and training; right?

17 A. That is correct.

18 Q. And have you learned more about --
19 well, withdrawn.

20 During the years that you were with
21 the OPC, did you get a greater understanding of
22 regulatory utility finance?

23 A. I think I was a more experienced cost
24 of capital witness when I left the OPC than when I
25 started.

1 Q. And do you recall being deposed
2 actually two days ago in relationship to this matter?

3 A. Yes, I do.

4 Q. And do you recall when you were
5 testifying in the deposition this week that you said
6 that you went back and read your testimony that you
7 filed between 1992 and 1995 before this Commission?

8 A. I didn't read every piece of
9 testimony, but I read a couple of pieces of testimony
10 that I had filed.

11 Q. And where did you obtain copies of
12 that testimony?

13 A. They were in the basement of my house.

14 Q. And did you maintain copies of the 15
15 cases that you mentioned beforehand?

16 A. I didn't have all of them. I kept
17 some of them.

18 Q. Is there any point in which you
19 submitted testimony before this Commission previously
20 where you believe that testimony was false?

21 A. Could you please rephrase that
22 question?

23 Q. Sure. Is there anytime between 1992
24 and 1995 where you submitted testimony that you now
25 believe was false?

1 A. False in terms of intentional error or
2 false in terms of now I have some insights where if I
3 was doing it again today, I might do things
4 differently in terms of the application of models?

5 Q. Let's start with the first one.
6 Anything intentionally false?

7 A. Not that I'm aware of, no.

8 Q. Did you file anything that you now
9 believe was incorrect?

10 A. Again, if incorrect would imply false,
11 no.

12 Q. Did you in your conversations with Mr.
13 Allen inform him that, listen, I filed testimony in
14 this case back in either somewhere between 1992 and
15 1995, and I have thought about it and that's
16 completely wrong, don't use that?

17 A. One thing that we had talked about was
18 --

19 Q. I'm sorry --

20 A. -- the risk-free rate.

21 Q. If you could just give me first a yes
22 or no, if you had the conversation, and then I'll get
23 more specific.

24 A. Okay. Incorrect is -- I don't agree
25 with that characterization. With inputs into models,

1 there's always some degree of subjectivity and
2 there's usually pros and cons associated with a lot
3 of different variables, but I've probably changed my
4 views about the weight that I would assign to those
5 pros and cons somewhat.

6 Q. So the issues that you would have
7 discussed with Mr. Allen would have dealt with what
8 changes you would make in the inputs into the models,
9 but not your general methodologies; is that correct?

10 A. I had a lot of conversations with Mr.
11 Allen, so --

12 Q. Did you have any conversations where
13 you said that the methodologies that I have submitted
14 before the -- before this Commission previously I no
15 longer agree with or I don't think this applies any
16 longer?

17 A. Can I give a specific example now?

18 Q. Is the answer to the question yes, and
19 then I'll ask you to give a specific example?

20 A. Okay. Again, I think there's certain
21 applications of the models where there's a degree of
22 subjectivity involved in how you interpret the pluses
23 and minuses where I have assigned -- changed probably
24 the weight that I would have assigned to those.

25 Q. Other than changing the weight that

1 you would assign in the models, is there any general
2 theories or methodologies that you told Mr. Allen I
3 no longer share these beliefs or do not think they're
4 applicable before the Commission any longer?

5 A. No, I never said that to Mr. Allen.

6 Q. What is the specific thing that you
7 said to Mr. Allen in relationship to what you changed
8 as far as the methodologies or the weight that you
9 gave it?

10 A. One that I remember specifically is
11 the risk-free rate to be used in the capital asset
12 pricing model. There's three generally used
13 alternatives, one is the three-month T bill, another
14 is the 10-year treasury bond, and another is the
15 30-year treasury bond. And there's pluses and
16 minuses associated with all of those.

17 The three-month treasury bill is
18 sometimes difficult to use in the CAPM because it's
19 very dependent upon where the fed has the current
20 discount rate set, and so it can sort of fluctuate in
21 such a way that would not really seem to imply that
22 it represents the fluctuations of what investors
23 really view as the risk-free rate, because that would
24 tend to be, I think, a little bit more of a stable
25 concept.

1 Likewise, with like the 10 and the
2 30-year treasury, there's disadvantages associated
3 with those, because built into the yield on those is
4 three components. One is the real rate of return
5 that investors require over time to lock up their
6 money.
7 Another is their expectation for what inflation is
8 going to be. And they build those two on top of each
9 other.

10 But there's a third component that
11 goes into the yield on a 10 or a 30-year treasury,
12 and that is the risk that investors assign to the
13 chances that inflation will actually turn out to be
14 something different than it really is.

15 And because of that, that's not a
16 risk-free component, that's actually a measure that
17 takes into investor's risk. So that's also a
18 drawback of using, let's say, the 10-year treasury in
19 the CAPM.

20 But when I was with the Office of
21 Public Counsel, I think I tended more towards the
22 three-month T bill. But I think now if I was doing a
23 capital asset pricing model, would probably gravitate
24 more towards the 10-year treasury, even though it has
25 this component built into it that's not a pure risk

1 free-rate.

2 But likewise, when I was with the
3 Public Counsel, I used the historic risk premium that
4 was calculated using the Ibbotson data. I wouldn't
5 use that anymore, I would use forward looking
6 estimates of what investors expect the risk premium
7 to be going forward.

8 And so I had shared that with Mr.
9 Allen, and I believe that he elected to use the
10 three-month T bill in his CAPM analysis.

11 Q. So after you gave him all the reasons
12 that you just articulated as to why you would have
13 hesitancy, he nonetheless said he was still going to
14 use it; is that right?

15 A. Yes, he did.

16 Q. Now, when you say after you left the
17 OPC, you gained some additional knowledge and then
18 made the changes, what additional knowledge did you
19 gain?

20 A. In my current job, I'm the senior
21 investment officer for a 23 billion dollar pension
22 fund and so I deal with investments on a daily basis.
23 And one of my jobs is to understand in a great level
24 of detail how institutional investment managers
25 actually make the decisions in portfolios regarding

1 actively purchasing stocks.

2 And so when you look at things like
3 what growth rate is applied in a DCF methodology, I
4 have a deeper understanding about how actual
5 investment practitioners and decision makers for
6 large pools of institutional assets make their
7 derivations of what sort of growth rate they expect
8 in the future.

9 Q. Where were you employed before the
10 OPC?

11 A. I was in college before the OPC.

12 Q. So is it accurate to say that your
13 training and education and experience as a rate of
14 return expert for the OPC came in your beginning
15 years between 1992 and 1995?

16 A. Well, my education took place when I
17 was in my undergraduate work and when I received my
18 Master's Degree with an emphasis in Finance.

19 Q. Right. I'm just trying to ask you if
20 your exposure to rate of return analysis in a
21 regulated utility industries came from when you first
22 came to the OPC or did you have professional
23 employment prior to that in that specific industry?

24 A. I had no prior professional employment
25 before the OPC.

1 Q. And once you left the OPC, you got
2 exposed to greater and broader areas of finance; is
3 that correct?

4 A. That's correct.

5 Q. And getting that exposure has now
6 caused you some, at least, pause in how you did
7 things when you were limited to just being -- working
8 at the OPC; right?

9 A. I think I have a greater level of
10 insight about the application of a lot of the models
11 that are used, yes.

12 Q. Do you think it would have been
13 beneficial to have done things, let's say, in reverse
14 order, have had this broad experience that you have
15 today and then came to the OPC as a cost of capital
16 expert versus starting at the OPC and then getting
17 the experience afterwards?

18 A. That would sort of depend on what the
19 end goal was. I think I was probably better at my
20 current job because of the experience that I had at
21 the OPC. But likewise, I probably would have had
22 some insights as a cost of capital witness that would
23 have been greater if I would have had my current job
24 first and then moved to the OPC.

25 Q. The criticism or the suggestion that

1 you made to Mr. Allen that he decided not to go with,
2 that was not the only thing that you told Mr. Allen
3 you thought he should not be doing in preparing his
4 testimony in this case; is that correct?

5 A. I -- I remember one other specific
6 example, yes.

7 Q. And what is the other specific example
8 that you told Mr. Allen based on your experience you
9 did not believe should be used in this proceeding by
10 Mr. Allen?

11 A. In Mr. Allen's development of a proxy
12 group, he had developed some rationale to exclude
13 Laclede Gas from his comparable group based on the
14 rationale that there's some level of circularity to
15 develop a cost of capital determination by the
16 Commission by looking at another Missouri regulated
17 utility.

18 And my point on this issue was that
19 the DCF analysis is a market-derived measure of cost
20 of capital, and so it breaks that chain of
21 circularity and it applies not just to the choice of
22 comparable companies, but also to a criticism that
23 the Company leveled in this case about the BR plus SV
24 methodology.

25 And Witness Dunn talks about this

1 circularity argument in his surrebuttal, and he notes
2 that by using a market-derived cost of equity method
3 like the DCF, it breaks that chain of circularity.
4 And so I had discussions with Mr. Allen that no
5 circularity arguments are really valid, and because
6 of that I thought it was probably more complete to
7 use Laclede Gas in the comparable group.

8 And then just as a practical matter,
9 it's then one area of where the Company and the OPC
10 aren't having a disagreement, and so for that reason,
11 it seemed reasonable to put it in.

12 Q. And so when you told that to Mr.
13 Allen, and that was based on the experience that you
14 had garnered between 1992 and this year as to be your
15 expert opinion; is that correct?

16 A. I know that there was some piece of
17 testimony that I filed when I was with the Office of
18 Public Counsel, and I don't remember what year it
19 was, but I know there was some year, some testimony
20 where I had excluded a Missouri based utility.

21 And I think I did that because I
22 believed that it was sort of precedent, unspoken
23 precedent in a way, just as, you know, the belief
24 that the DCF is probably the primary method to use in
25 these proceedings. But I would change that now if I

1 was filing direct testimony.

2 Q. So would the answer to the question be
3 yes?

4 A. Yeah.

5 Q. Okay. And you said the primary method
6 that has been used is the DCF method; is that
7 correct?

8 A. That's correct.

9 Q. And in your experience, that is the
10 method that this Commission has relied upon year in
11 and year out; is that correct?

12 A. It's my understanding that that's been
13 the method that's received the most amount of weight
14 when this Commission has made determinations about
15 the cost of equity.

16 Q. And two days ago when you were
17 deposed, you said that you utilized the DCF and CAPM
18 analysis in the cost of capital in every rate of
19 return proceeding except one; is that correct?

20 A. I said that I believed when I thought
21 back that I had the belief that I had done that and I
22 -- I made a change to my deposition.

23 Q. I'm going to get to that. What I
24 would really like to do is try to get you to answer
25 the questions and then I'll follow-up.

1 A. Sure.

2 Q. And I promise you that I will be
3 specific in the questions that I am asking, and the
4 answers, if you can answer me with a yes or no, and
5 then I'll follow-up. But I really want to get the
6 record straight as to how we proceed through it, if
7 that's okay.

8 A. I'll answer yes or no if it's
9 appropriate, sure.

10 Q. So at least two days ago you testified
11 that it was your belief that you did a DCF and CAPM
12 analysis in every single one of the 15 cases except
13 one; is that correct?

14 A. Yes.

15 Q. Today, this morning, or within the
16 last couple days, you had the chance to think about
17 it and realize that that was not correct testimony
18 and you have provide us with an errata sheet; is that
19 right?

20 A. That's correct.

21 Q. Now, as it turns out, what you did
22 primarily was to do a DCF analysis by itself; is that
23 correct?

24 A. I did a DCF analysis and a
25 market-to-book ratio analysis, and I did that in most

1 of the testimonies. And so that market-to-book ratio
2 analysis, which is a formula that's a bit of a
3 derivation of the DCF, but I did those two in
4 conjunction relying primarily on the DCF.

5 Q. But you didn't do the CAPM on the risk
6 premium analysis that's contained in Mr. Allen's
7 testimony; right?

8 A. I did some --

9 Q. Let me --

10 A. -- some CAPM's in one case that I
11 found in direct testimony as I looked through the
12 testimonies in the basement of my house, and then I
13 know I did the CAPM in rebuttal sometimes in response
14 to company witnesses.

15 Q. How did you know that you had made a
16 mistake in your testimony? Did you go back and
17 actually review the testimonies after the deposition
18 to see --

19 A. The night after my deposition I went
20 to my house and I pulled out what testimonies I did
21 have in my basement and I looked through those, and
22 that refreshed my memory about exactly what I had
23 done.

24 Q. And are there any cases that stand out
25 in your mind more than others that you handled as an

1 employee?

2 A. One that I -- I remember quite well
3 and it's one that I had read back in March was the
4 St. Joe Light & Power case. It was ER 9341.

5 Q. And did you submit testimony in that
6 case?

7 A. I did.

8 Q. And in submitting testimony in that
9 case, did you, when you reviewed it, did you find
10 anything that you thought, my God, I was really wrong
11 when I submitted this testimony?

12 A. No.

13 Q. You didn't tell Mr. Allen, oh, boy,
14 there's a big mistake in my prior testimonies here, I
15 need to start changing things?

16 A. No.

17 Q. Did you discuss that case with Mr.
18 Allen at any point?

19 A. One thing that I thought was important
20 for Mr. Allen was to read testimonies. And so he had
21 asked me what would be a good testimony to read, and
22 I had suggested that the St. Joe Light & Power one
23 would be a good one to read. I don't think we had
24 any specific conversations about it.

25 Q. Okay. And the St. Joe Power & Light

1 testimony, you mean your testimony?

2 A. My testimony, my direct testimony in
3 that case.

4 Q. And did you give a copy to Mr. Allen,
5 or did you ask somebody to provide it to him?

6 A. I assume that those testimonies would
7 be on file at the Office of Public Counsel.

8 Q. And do you know if Mr. Allen read your
9 testimony?

10 A. I believe that he did, yes.

11 Q. Did he come back to you at any point
12 and say, I don't understand what you were talking
13 about when you said this, or did he seem to
14 understand it and agree with it?

15 A. I don't know that -- I don't think we
16 ever had any follow-up discussion about the testimony
17 in that case.

18 Q. At the very least, he didn't come back
19 to you and say, I don't understand what you're
20 talking about; right?

21 A. Right.

22 Q. And do you know that, in fact, Mr.
23 Allen quotes from the St. Joe Power & Light case in
24 his testimony in this proceeding?

25 A. Yes, I'm aware of that.

1 Q. And did you have occasion to read all
2 of Mr. Allen's testimony in this proceeding?

3 A. I read Mr. Allen's direct and rebuttal
4 testimony. I gave a cursory glance to his
5 surrebuttal testimony.

6 Q. In reviewing his testimony, did you
7 find anything that you thought was completely
8 incorrect?

9 A. Completely incorrect, no. There's
10 probably some things that, if it was me, I would do a
11 little differently based sort of on philosophical
12 differences and views.

13 Q. Did you have occasion to talk to
14 either Mr. Micheel or Mr. Allen yesterday?

15 A. Yesterday? I spoke with Mr. Micheel
16 on the phone.

17 Q. And was that during the proceedings
18 yesterday or at the end of the day?

19 A. He called me towards the end of the
20 day, not -- not long before five o'clock.

21 Q. And did you speak with him in between
22 your deposition and yesterday afternoon?

23 A. We walked to our cars after the
24 deposition was over on Monday evening and I think we
25 just talked socially. And then we might have had a

1 short phone conversation before these proceedings
2 began yesterday morning.

3 Q. And did Mr. Micheel tell you that
4 yesterday on the witness stand in response to a
5 question from Commissioner Appling that Mr. Allen
6 actually acknowledged that your analysis of Laclede
7 and circularity argument was correct and that if he
8 had to do things again now, he wouldn't have removed
9 any Missouri companies?

10 A. I was not aware of that, no.

11 Q. But that was an opinion that you had
12 expressed to Mr. Allen early on in your discussions;
13 is that correct?

14 A. Yes, that's correct.

15 Q. Have you changed your view that
16 Missouri companies should be included in an analysis
17 in comparison to MGE?

18 A. Again, if I was filing direct
19 testimony in this case, I would have included Laclede
20 Gas or I specifically would not have excluded Laclede
21 Gas because it was a Missouri-regulated utility.

22 But I don't know whether or not it
23 being excluded makes a huge difference about the
24 outcome as far as the determination of the cost of
25 equity for a comparable group because it's just one

1 company.

2 Q. But as a general theory, you don't
3 think Missouri companies should be excluded from this
4 Commission's comparison and analysis of MGE; is that
5 correct?

6 MR. MICHEEL: I'm going to object.
7 It's been asked and answered on numerous occasions,
8 Your Honor.

9 JUDGE WOODRUFF: Overruled. Go ahead
10 and answer.

11 THE WITNESS: Again, I think the
12 rationale is based on the DCF and the fact that it's
13 a market-derived cost of equity measure. And by
14 looking at what investors expect through the market
15 price that's employed, it makes that circularity
16 argument not overly meaningful.

17 Q. (By Mr. Herschmann) So is the
18 answer --

19 A. So I would have included it.

20 Q. So the answer to the question would be
21 yes?

22 A. I would include it, yes.

23 Q. Now, did you have occasion to, at any
24 point, discuss with Mr. Allen Mr. David Murray's
25 testimony that was submitted in this proceeding?

1 A. We had talked briefly about it
2 somewhere along the way, yes.

3 Q. And yesterday Mr. Allen identified for
4 us various areas for which he believes Mr. Murray had
5 done his calculations and methodologies incorrectly.

6 And let me ask you, in reviewing Mr.
7 Allen's testimony in which he said that Mr. Murray
8 improperly calculated the long-term debt cost, did
9 you agree or disagree with Mr. Allen's position?

10 A. I'm sure mathematically he calculated
11 it properly, but as far as what position to take
12 about whether or not the debt of Panhandle Eastern
13 should be included in the calculation, again, I think
14 if I would have been filing direct testimony in this
15 case, I would have excluded it, yes.

16 Q. So you agree with what Mr. Allen and
17 disagree with Mr. Murray; is that correct?

18 A. Yes.

19 Q. And as far as the calculation of
20 short-term debt, did you also agree that -- with Mr.
21 Allen that Mr. Murray's calculation and methodology
22 in applying the short-term debt was incorrect?

23 A. If I remember the issue correctly, Mr.
24 Murray just looked at one point in time to see what
25 the level of short-term debt was, and I think it's

1 probably more reasonable to look at that over an
2 extended period of time, yes, so I think I would
3 agree with Mr. Allen's assessment.

4 Q. And would it be relevant to you as to
5 what the specific company was considering doing in
6 the future in relationship to short-term debt?

7 A. Yeah, I think that's in some ways a
8 difficult issue because, you know, when do you stop
9 the clock? I certainly --

10 Q. I just want to know if you think it's
11 relevant. I may or may not follow-up on the next
12 part, but I want to know if you think it's relevant
13 first.

14 A. I think it should be considered, yes.

15 Q. Okay. And if there is a true update,
16 what do you understand a true update to mean?

17 A. A true update is a date when the
18 parties can look again at the circumstances of the
19 Company's position and then make some alterations to
20 the numbers that are the basis for their
21 recommendations.

22 Q. Is it like a reconciliation date?

23 A. It's similar, yeah. It's that, yes.

24 Q. Now, Mr. Allen also mentioned that he
25 disagreed with Mr. Murray's use of negative growth

1 rates. Do you agree with that criticism?

2 A. Again -- yes, I agree.

3 Q. What is the reason -- well, withdrawn.

4 You said you oversee how much money?

5 A. Twenty-three billion.

6 Q. Would you look to be investing today

7 in companies that have negative growth rates?

8 A. Well, a company could --

9 Q. Just start with a yes or no.

10 A. Yes, it's possible, yes. I'm sure

11 that we have -- we own stocks of companies where

12 earnings for some period of time are going to

13 decrease.

14 Q. Starting today, if you saw that the

15 future was negative growth rates for a specific

16 company, would you invest the money that you oversee

17 in that company? That's also a yes or no.

18 A. It unfortunately is a two-part answer.

19 Q. Okay.

20 A. If it was negative for some period of

21 years and then expected to turn positive, yeah, I

22 think there's other than reasons to do that. If it

23 was a indefinite or forever sort of situation, then

24 that would probably seem to be a investment that

25 would not be worthwhile.

1 Q. You don't think you'd be keeping your
2 job if you were investing in companies that had
3 sustained negative growth rates; right?

4 A. Well, if it ultimately meant that they
5 went into bankruptcy and there were no assets left
6 over at the end for equity investors, no, that would
7 not be a good investment.

8 Q. How about if the balance of your fund
9 went from 23 billion to 4 billion because you kept on
10 investing in funds that had negative growth rates?
11 Wouldn't you think it's going to impact investors'
12 expectations in review of your job?

13 A. Right, yeah, sure.

14 Q. Okay. Do you think it's appropriate
15 to use negative growth rates in a DCF modeling?

16 A. I would not use them, no.

17 Q. So you agree with Mr. Allen and Mr. --
18 that he criticizes Mr. Murray for the use of negative
19 growth rates in this proceeding; right?

20 A. I don't remember the exact rationale
21 that Mr. Allen laid out for why he wouldn't use them,
22 but I would not incorporate them.

23 Q. Do you think it's appropriate in
24 trying to predict what investors are expecting in the
25 future that you should use the most timely, relevant

1 information that's available to you?

2 A. Sure.

3 Q. And do you know that Mr. Allen
4 criticized the fact that Mr. Murray decided to cut
5 off the financial information in 2002 versus using
6 the 2003 information that was available?

7 A. I remember that Mr. Allen addressed
8 that in his rebuttal testimony.

9 Q. Did you agree with the criticisms that
10 it's inappropriate to cut off at 2002, if 2003
11 financial information is available?

12 A. If it's available to the analyst, then
13 I believe it should be used.

14 Q. In your experience, how did the market
15 perform between 2002 and 2003?

16 A. Well, the market has been pretty
17 volatile. But generally there's been a rebound in
18 the equity markets since the lows of '01 and '02.

19 Q. So you expect that information that
20 encompassed 2003 would show higher returns; is that
21 correct? Just based on your experience?

22 A. It would be different -- it would be
23 different information, yes, it would be more timely.

24 Q. And in your experience, when you say
25 the market rebounded, is it safe to say that in your

1 experience overseeing these funds the prices of
2 stocks have increased?

3 A. That's correct.

4 Q. Now, do you also agree with the
5 criticism by Mr. Allen that Mr. Murray's use of
6 historic market premium in his CAPM was
7 inappropriate?

8 A. I think that there's a number of ways
9 to use the risk premium method, but I think to the
10 extent that you can use forward-looking estimates of
11 what you think the equity risk premium is going to
12 be, and it's probably a fairly contentious issue, but
13 I think it's a superior way to try to replicate what
14 investors are actually looking at.

15 Q. So you would agree with Mr. Allen and
16 disagree with Mr. Murray's methodology; is that
17 correct?

18 A. I think there's probably a better way
19 to do the analysis, yes.

20 Q. And the better way is Mr. Allen's way
21 versus Mr. Murray's; right?

22 A. Well, Mr. Allen used a historic risk
23 premium in his CAPM, so I think his comments on that
24 are not necessarily reflective of what he actually
25 did. I think it still is based on a historic risk

1 premium, but I think a projected risk premium is a
2 superior methodology.

3 Q. And did Mr. Murray, to your knowledge,
4 use the projected risk premium?

5 A. No, he did not.

6 Q. Which risk premium did he use?

7 A. He used a historic risk premium that's
8 based on information in the Stocks, Bonds, Bills, and
9 Inflation book produced by Roger Ibbotson.

10 Q. And did you have occasion to discuss
11 with Mr. Allen his belief that Mr. Murray improperly
12 calculated the growth rate?

13 A. Yeah, we had a discussion about that.

14 Q. And did you agree with Mr. Allen?

15 A. For -- yes, I believe I agreed with
16 his -- his thoughts on that, yes.

17 Q. And did you also discuss the fact that
18 Mr. Murray improperly used criteria to select his
19 comparable companies for his analysis?

20 A. I had no discussion with Mr. Allen
21 about Mr. Murray's selection of proxy companies.

22 Q. Do you believe the more appropriate
23 method would be to use comparable companies that get
24 90 percent of their income from natural gas
25 distribution or 60 percent?

1 A. I think one of the important things is
2 to make sure that you have a proxy group that is as
3 wide as possible, but is still somewhat reflective of
4 the Company that's being examined. So there was a
5 time in the past when you could apply a criteria like
6 90 percent of revenues and you could still derive a
7 proxy group that would have plenty of companies.

8 But the industry's changed and a lot
9 of companies have diversified their operations, and
10 so I think it can become a little restrictive to
11 apply that 90 percent. I think you have to balance
12 those interests of having a proxy group that's
13 representative, but also the other interest of
14 casting a fairly wide net in terms of the companies
15 that you look at.

16 So I think given the changes that have
17 taken place in the industry and the fact that a lot
18 of companies today have diversified somewhat, I think
19 it's probably more reasonable to lower that -- that
20 threshold somewhat.

21 Q. So you would agree with Mr. Allen to
22 lower the threshold to what he did was 60 percent; is
23 that right?

24 A. Yeah, I don't disagree with that.

25 Q. Now, have you heard of the term a

1 hypothetical capital structure?

2 A. Yes.

3 Q. And do you have any opinion as to
4 whether or not in using a hypothetical capital
5 structure or looking at the short-term debt of a
6 company whether there are any percentages of
7 short-term debt to total capital that would reflect
8 either to include it or exclude it from the
9 hypothetical capital structure?

10 A. I'm sorry, you're going to have to ask
11 that question again.

12 Q. When do you believe it would be
13 appropriate to include a company's short-term debt in
14 a hypothetical capital structure, if ever?

15 A. Well, if a company has the history of
16 using short-term debt for something more than just
17 construction work in progress, then I think it
18 certainly is reasonable to look at how they have used
19 short-term debt in the past. And if you're using an
20 actual capital structure, then I think it's
21 reasonable to put that in.

22 But then if you move into hypothetical
23 space in terms of a capital structure recommendation
24 in a regulatory proceeding, I think it's still
25 appropriate to look at how a company's used their

1 short-term debt in the past in making a determination
2 whether or not to include short-term debt, whether it
3 be in an actual or a hypothetical capital structure.

4 Q. Have you ever heard or read in -- let
5 me withdraw that.

6 Have you ever read a textbook or a
7 cited authority that says that short-term debt should
8 be excluded from rate of return analysis only if it
9 is less than two percent of the capital structure
10 after construction work in progress is subtracted?

11 A. No, I've never read that anywhere.

12 Q. Have you ever even heard it before?

13 A. Mr. Allen had that comment in his
14 testimony.

15 Q. Other than reading it in Mr. Allen's
16 test --

17 A. No.

18 Q. And so in all the years of your
19 experience, you have never heard of that rule or
20 standard; is that correct?

21 A. I've never -- I've never read that
22 anywhere, no.

23 Q. Did you have a copy of the report and
24 order in the St. Joseph Power & Light case?

25 A. Do I have a copy with me now?

1 Q. Did you have one in your home or
2 somewhere?

3 A. No, I did not.

4 Q. I guess it's a good point. Is it in
5 your basement?

6 A. No.

7 Q. Do you know if the order is available
8 on the internet?

9 A. No, I do not.

10 MR. HERSCHMANN: If you could give me
11 one second.

12 (An off-the-record discussion was
13 held.)

14 Q. (By Mr. Herschmann) Now you told us a
15 little while ago that you prepared testimony in the
16 St. Joe Power & Light case; is that correct?

17 A. In ER-93-41, yes, I filed direct
18 testimony in that case.

19 Q. And what is the case GR-93-42; do you
20 know that?

21 A. Did you say GR-93-42? Yeah, that's
22 the other part of the St. Joe Light & Power case.

23 JUDGE WOODRUFF: We'll take a break
24 then, certainly. Let's go ahead and take a 5-minute
25 break until 9:30.

1 (A recess was taken at this time.)

2 JUDGE WOODRUFF: Okay. We're back
3 from our break and the court reporter's equipment is
4 working, so you may continue.

5 MR. HERSCHMANN: Thank you, Your
6 Honor.

7 Q. (By Mr. Herschmann) Mr. Tuck, do you
8 have your surrebuttal testimony with you?

9 A. I do, yes.

10 Q. And can you turn to page 7?

11 A. Yes.

12 Q. Now, I'm sorry, if you could first
13 turn to page 8, do you see the paragraph that says,
14 the methodology used by Witness Allen to develop an
15 appropriate hypothetical capital structure
16 alternative is based on, and therefore consistent
17 with, methodologies employed by the Office of Public
18 Counsel and adopted by this Commission in past St.
19 Joseph Power & Light Company Case No. ER-93-41.

20 In that proceeding the Commission
21 explicitly recognized the validity of the approach
22 developed by the OPC to determine a, quote unquote,
23 zone of reasonableness in establishing an appropriate
24 hypothetical capital structure.

25 Do you see that --

1 A. Yes.

2 Q. -- paragraph?

3 A. Yes.

4 Q. And that's your testimony in this
5 proceeding; is that correct?

6 A. Yes.

7 Q. And who was the OPC witness in that
8 proceeding?

9 A. I was.

10 Q. And was it -- for lack of a better
11 term, were you the founding father in this Missouri
12 Commission on the zone of reasonableness?

13 A. I believe that I was, yes.

14 Q. And you actually made a recommendation
15 that was subsequently adopted by this Commission; is
16 that correct?

17 A. That's my understanding, yes.

18 Q. And that's the testimony that you
19 provided to Mr. Allen that you thought would be most
20 helpful in his preparing his testimony in this case;
21 is that correct?

22 A. Yes.

23 Q. Now, on page 7 you mention that the
24 words, in order to limit the controversy with the
25 Company, do you see those words, sir?

1 A. Could you point to a line?

2 Q. Sure, line 18.

3 A. Yes.

4 Q. I'm going to take a step back with the
5 controversy with the Company because, obviously, you
6 understand there's disagreements in positions between
7 the Company and the OPC and the Staff; correct?

8 A. Mm-hmm.

9 Q. You have to answer verbally.

10 A. Yes.

11 Q. Now, in dealing with the hypothetical
12 capital structure, do you believe that in trying to
13 create that, it is important to look at comparable
14 companies to the Company at issue?

15 A. Yes, I do.

16 Q. Do you believe to comply with
17 Bluefield and Hope decisions by the United States
18 Supreme Court, it is imperative that you look at
19 comparable companies?

20 A. I think the definition of comparable
21 is fairly wide, but in most analyses I think it's
22 most appropriate in order to follow the sort of
23 spirit of Bluefield to make an effort to determine
24 companies that are comparable or as comparable as
25 what can practically be expected.

1 Q. When you say what can practically be
2 expected, you mean expected in a comparable group
3 compared to the company at issue; correct?

4 A. Yeah. No two companies are exactly
5 alike. They all deviate in many different ways that
6 are complex to understand. But in order to sort of
7 cast a net that's wide enough to sort of have some
8 meaning to it in developing comparable companies, I
9 think it's important to -- to make a good faith
10 effort to -- to look at those comparabilities.

11 Q. And that's why in your prior
12 testimonies and Mr. Allen's testimony in this case
13 there were criteria to select comparable companies to
14 MGE; is that correct?

15 A. I had done that. I applied that
16 methodology in the past, and Mr. Allen did as well,
17 yes.

18 Q. And when you reviewed Mr. Allen's
19 direct testimony in which you selected his comparable
20 companies, did you at any time contact him and say,
21 these are the wrong companies, these are not
22 companies that are comparable to MGE?

23 A. When Mr. Allen was developing what he
24 thought were the criteria for comparable companies, I
25 had expressed the view that casting the widest net

1 possible and still remaining within the spirit of
2 what's comparable is a good idea.

3 But I had expressed that view to him
4 and he made the decisions that he made. So at the
5 time that I looked at a draft of his direct
6 testimony, I made no further comments about his
7 selection of comparable companies.

8 Q. So that's another area in which you
9 made a suggestion to Mr. Allen, but he subsequently
10 decided to go with his selection criteria and his
11 selection of comparable groups; is that right?

12 A. This really wasn't a suggestion, it
13 was just something that I thought that he should
14 think about as he sort of developed his positions in
15 cases in general.

16 Q. And when you made the suggestion or
17 put in his mind the idea that he should look at a
18 wide group of companies, we know at least he excluded
19 Laclede; right?

20 A. Right.

21 Q. And at the very least, he came to the
22 conclusion that the correct comparable group of
23 companies were the ones that he selected and used in
24 the testimony in this case; is that correct?

25 A. Yeah, he would believe those were

1 comparable, yes.

2 Q. And in the past when you used
3 hypothetical capital structures --

4 A. Mm-hmm.

5 Q. -- did you try to use companies that
6 you thought were comparable to the company at issue?

7 A. Again, it's the trade-off between
8 casting a wide enough net to increase sort of the
9 reliability of your data set. The more data points
10 you have in a data set, the more reliable the
11 information.

12 But again, there's another trade-off,
13 that is, you sort of change criteria or loosen them,
14 you lose a little bit of comparability. So I think
15 it's striking that right balance between a wide
16 enough data set and applying criteria that keep the
17 comparability issue reasonable.

18 Q. So when you ran your hypothetical
19 capital structures, you used the companies that you
20 thought were comparable; right?

21 A. Yeah, that struck that balance, yes.

22 Q. You didn't sit there and say, well,
23 there are 500 companies out there that are in this
24 industry and I'm going to pick all 500 because
25 they're in the industry, you actually limited that

1 group to the ones that you thought were applicable;
2 right?

3 A. That's correct.

4 Q. That's what an expert should do
5 correctly; right?

6 A. Yeah, that would seem to be a
7 reasonable approach.

8 Q. Do you have your testimony in front of
9 you from the St. Joe Light & Power Company case?

10 A. No, I do not.

11 Q. But before the break you were looking
12 at something and you read an ER number and that said
13 the GR number also?

14 A. Yeah, it was -- I was looking at my
15 surrebuttal testimony, the schedule JT-1, it lists
16 the cases in which I had filed testimony.

17 Q. And did you file testimony in, as well
18 as ER, but GR-93-42?

19 A. Right, those two cases were
20 consolidated.

21 Q. Do you recall -- well, I'll withdraw
22 it for a moment.

23 When you submit direct testimony in
24 this proceeding in writing, do you believe that to be
25 similar to the testimony you are giving here under

1 oath?

2 A. Excuse me?

3 Q. Sure. The written testimony that you
4 give, you know you're submitting under oath; right?

5 A. Not me personally, I didn't do direct
6 testimony.

7 Q. No, I'm saying --

8 A. The witness?

9 Q. The witness.

10 A. Right.

11 Q. And in the past when you submitted
12 direct testimony before this Commission, it was under
13 penalties of perjury; right?

14 A. I'm not familiar with that, but I know
15 that you are supposed to tell the truth here, yes.

16 Q. I want to make sure that you don't
17 have a distinction if you prepared written testimony
18 and the standards or the truthfulness that you would
19 apply to whether you are sitting here in front of the
20 Commissioners?

21 A. It would seem that if you became aware
22 of some sort of material error in your testimony that
23 it should be made known.

24 Q. Other than doing an errata or making a
25 correction, there are occasions in which you have

1 submitted testimony in which, I think, today someone
2 offered your testimony into evidence; right?

3 A. Yeah, Mr. Micheel offered my testimony
4 into evidence.

5 Q. And do you recall being asked if he
6 would ask you the questions here today under oath,
7 would it be similar to the answers you gave in the
8 written questions and answers?

9 A. Right.

10 Q. That's pretty standard policy at the
11 Commission on how to get written testimony into
12 evidence; right?

13 A. That's my understanding, yes.

14 Q. Now, do you agree that to develop a
15 hypothetical capital structure, it should be based on
16 an analysis of utilities with operating in risk
17 characteristics similar to the company at issue?

18 A. Yes.

19 Q. And in your opinion, does the use of a
20 hypothetical capital structure benefit both the rate
21 payers and the company shareholders in certain
22 circumstances?

23 A. Could it benefit both together?

24 Q. Yes.

25 A. Maybe it could under certain

1 circumstances, not in some sort of direct way, but
2 maybe in some sort of more subtle, indirect way.

3 Q. In the St. Joseph Light & Power case,
4 did you give the opinion that both groups, meaning
5 the captive rate payers and the company shareholders,
6 would benefit from the adoption of a hypothetical
7 capital structure?

8 A. I don't have that testimony before me,
9 but that sounds reasonable. And the reason that I
10 said that was based on the belief that the adoption
11 of a hypothetical capital structure for St. Joe,
12 which had a equity ratio that was way above all other
13 companies in its industry, might finally encourage
14 that company to lower its equity ratio. And by doing
15 so, I believe that that would potentially be
16 beneficial to both shareholders and rate payers.

17 Q. Do you recall saying these words on
18 page 16 of your testimony, in my opinion, both
19 groups, referring to captive rate payers or the
20 company shareholders, will benefit from the adoption
21 of a hypothetical capital structure based upon an
22 analysis of the capital structures of companies
23 similar to St. Joseph Light & Power?

24 A. Could you provide me a copy of that
25 testimony so I could take a look?

1 Q. Sure.

2 MR. HERSCHMANN: May I approach the
3 witness?

4 JUDGE WOODRUFF: You may.

5 Q. (By Mr. Herschmann) The question on
6 the bottom of the page?

7 A. Yeah, again, my rationale was that I
8 thought that St. Joe Light & Power needed some sort
9 of incentive or characteristic, whatever you want to
10 call it, to change its equity ratio because it seemed
11 horribly out of line with what other similar
12 utilities were doing. And a capital structure that
13 has too much equity results in a -- potentially a
14 higher weighted average cost of capital, and that
15 affects shareholders and rate payers alike.

16 So I thought to the extent that having
17 a capital structure that was adopted by the
18 Commission that was different than its actual might
19 sort of provide the carrot or the stick for St. Joe
20 to then bring its capital structure more in line with
21 what other comparable companies were doing at that
22 time, because it was considerably out of whack
23 relative to what us utilities were employing.

24 Q. Are you finished?

25 A. Yes.

1 MR. HERSCHMANN: I'll move to strike
2 as nonresponsive. If you could read back the
3 question. I think the question was, did he state
4 that opinion. He asked to see the testimony. It
5 required a yes or no and not --

6 JUDGE WOODRUFF: I am going to grant
7 the motion to strike. And there is -- you have a
8 tendency to want to go ahead and explain everything.
9 And when your counsel asks -- or when your counsel or
10 the cross-examining counsel asks you to explain, then
11 you get a chance to do that. Otherwise, if he's just
12 asking a yes or no question, just answer yes or no.

13 THE WITNESS: Okay.

14 MR. HERSCHMANN: Could you read back
15 the question, please.

16 THE REPORTER: Do you recall saying
17 these words on page 16 of your testimony, in my
18 opinion, both groups, referring to captive rate
19 payers or the company shareholders, will benefit from
20 the adoption of a hypothetical capital structure
21 based upon an analysis of the capital structures of
22 companies similar to St. Joseph Light & Power?

23 THE WITNESS: Again, I'm not sure if
24 you paraphrased what was in my testimony exactly
25 correctly, so if you'll hand me the testimony back, I

1 will look at it and agree that what's in that
2 testimony is what I said.

3 MR. HERSCHMANN: May I approach the
4 witness?

5 JUDGE WOODRUFF: You may.

6 THE WITNESS: What my testimony states
7 is, in my opinion, both groups will benefit from the
8 adoption of a hypothetical capital structure based on
9 an analysis of the capital structures of companies
10 similar to St. Joe Light & Power. That was my
11 testimony, yes.

12 Q. (By Mr. Herschmann) Do you agree with
13 this statement: It is a well accepted tenet of
14 financial theory that every financial manager should
15 strive for the optimal or most efficient capital
16 structure. From most purposes the optimal capital
17 structure is defined as the combination of long-term
18 debt, preferred stock, and common equity that
19 minimizes the weighted average or overall cost of
20 capital.

21 For all firms, finding the optimal
22 capital structure helps ensure that shareholder
23 wealth is maximized. For public utilities, finding
24 this optimal capital structure both maximizes the
25 wealth of current shareholders and affords the rate

1 payer an opportunity to secure the lowest utility
2 rates.

3 Do you agree with that opinion, sir?

4 A. I agree with that.

5 Q. And that's actually an opinion that
6 you shared back in 1993 as well; is that correct?

7 A. That certainly sounded like it was
8 read from my testimony in that case, yes.

9 Q. Do you agree that it is generally
10 believed the optimal capital structure for a set of
11 companies with similar operating and risk
12 characteristics actually exists as a range of debt
13 versus equity trade-offs or as a zone of
14 reasonableness?

15 A. Yes, I believe that.

16 Q. And as we discussed a little while
17 ago, this is the first time that you suggested or
18 anyone suggested to this Commission that it adopted a
19 zone of reasonableness back in the St. Joe Power &
20 Light case; is that correct?

21 A. That is my understanding, correct.

22 Q. And when you say a set of companies
23 with similar operating and risk characteristics, you
24 mean companies that are comparable to the company at
25 issue; right?

1 A. Yes.

2 Q. So in this case it would be companies
3 that the OPC, at the very least, feels are comparable
4 to MGE; right?

5 A. That was Mr. Allen's best assessment
6 of developing a comparable group, yes.

7 Q. And you agree with what you stated
8 previously that that is the best selection of
9 criteria to get within the zone of reasonableness;
10 right? Companies with similar operating and risk
11 characteristics?

12 A. Yes.

13 Q. Now, do you agree that the comparable
14 company or similar sample group approach is based
15 upon the economic concept of opportunity cost which
16 maintains that the true cost of owning an asset is
17 the best alternative use of the funds that were
18 originally used to purchase the asset?

19 A. Yes.

20 Q. And that's actually cited by Mr.
21 Parcell in his book; is that correct?

22 A. I am not familiar with that.

23 MR. HERSCHMANN: May I approach the
24 witness for a moment?

25 JUDGE WOODRUFF: You may.

1 MR. MICHEEL: Could you tell me what
2 page?

3 MR. HERSCHMANN: It's 22.

4 Q. (By Mr. Herschmann) Do you have the
5 testimony in front of you?

6 A. Do I have my testimony in front of me?
7 Yes, I do.

8 Q. And when you wrote Parcell -- I'm
9 sorry, (Parcell, 1991), what were you referring to?

10 A. The cost of capital manual prepared by
11 the National Society of Rate of Return Analysts,
12 1991, David Parcell.

13 Q. Are you aware of whether or not Mr.
14 Allen had reviewed that book?

15 A. I was under the impression that Mr.
16 Allen had read Mr. Parcell's manual, yes.

17 MR. HERSCHMANN: One moment, please.

18 JUDGE WOODRUFF: Sure.

19 MR. HERSCHMANN: Are the Commissioners
20 able to see the board? I'll move it forward.

21 Q. (By Mr. Herschmann) Did Mr. Micheel
22 just hand you a copy of your testimony?

23 A. He did, yes.

24 Q. Okay. Thank you very much, it may
25 actually help us. Do you see what's on the board in

1 front of you? It may be difficult for you to see,
2 but it's on page 22, beginning on line 15.

3 A. Okay.

4 Q. And Mr. Allen testified that when he
5 was asked to prepare testimony in this proceeding, he
6 was given a, quote unquote, blank canvas. Were you
7 likewise provided with the opportunity to choose the
8 words that you wanted to use in your testimony before
9 submitting it?

10 A. Yes.

11 Q. And did you do that?

12 A. Did I take advantage of the
13 opportunity to choose my own words? Yes.

14 Q. And prior to submitting testimony in
15 your prior 15 cases, did you show the testimony to
16 any attorneys at the OPC to see if they thought there
17 was anything improper or legally incorrect in your
18 testimony?

19 A. I believe that my testimony before it
20 was filed was reviewed by an attorney at the Office
21 of Public Counsel, and they would provide me with
22 feedback if they had any typographical errors or
23 suggested changes.

24 Q. Do you believe that if you were
25 stating something that was legally incorrect or

1 improper, they would tell you such or preclude you
2 from filing that testimony?

3 A. I would certainly expect that to be
4 the case, yes.

5 Q. That did not happen in the St. Joe
6 Light & Power Company case; is that correct?

7 A. That's correct.

8 Q. Now, do you see where you say in
9 developing this hypothetical capital structure, you
10 say, quote, my analysis began with the development of
11 a group of similar or comparable companies with
12 operating and risk characteristics resembling those
13 of St. Joe Light & Power in order to determine a
14 reasonable capital structure for use in this
15 proceeding?

16 A. Yes, I see that.

17 Q. And did you do that in that
18 proceeding?

19 A. I believe I did, yes.

20 Q. Then you continued, the comparable
21 company or similar sample group approach is based
22 upon the economic concept of opportunity cost, which
23 maintains that the true cost of owning an asset is
24 the best available alternative use of the funds that
25 were originally used to purchase the asset (Parcell,

1 1991).

2 The, quote unquote, opportunity cost
3 principle is consistent with the fundamental
4 principle of utility regulation, that it is intended
5 to act as a surrogate for competition.

6 Further, the comparable company
7 approach yields a more accurate determination of the
8 cost of equity capital than does the analysis of the
9 data of just one individual company since it has the
10 tendency to, quote unquote, smooth the data and
11 remove the harsh effects of, quote unquote, unusual
12 numbers that might exist within one company.

13 A. Yes.

14 Q. And the one individual company that
15 you were referring to in that case was St. Joe; is
16 that correct?

17 A. That's correct.

18 Q. And using the information from other
19 companies was the comparable company group that you
20 had selected; right?

21 A. Could you say that again, please?

22 Q. Sure. When you were talking about not
23 limiting it to one individual company, you were
24 saying that the Commission should look at the
25 comparable group of companies that you had selected;

1 right?

2 A. Correct.

3 Q. And you say that's because St. Joe had
4 unusual numbers compared to the comparable group;
5 right?

6 A. That's correct.

7 Q. And you thought the unusual numbers
8 were outside the zone of reasonableness; right?

9 A. That is correct.

10 Q. And if a company's actual numbers are
11 outside the zone of reasonableness, you believe a
12 hypothetical capital structure should be used as you
13 swore under oath and told this Court previously --
14 told this Commission previously; right?

15 A. I believe it's appropriate to use it,
16 and in that specific case, I believe that it should
17 be used, yes.

18 Q. And you told us beforehand that you
19 were the founding father of the zone of
20 reasonableness term; right?

21 A. I don't know that I coined the term.

22 Q. I may have coined it and you adopted
23 it, I'll accept it that way.

24 A. All I will say is I don't know of any
25 other case where the Commission used this concept of

1 a zone of reasonableness to determine a capital
2 structure.

3 Q. But at least, you still hold the
4 theory that you told us beforehand that the zone of
5 reasonableness applies; right?

6 A. I believe that it is an appropriate
7 methodology, yes.

8 Q. Do you know that Mr. Allen testified
9 that it would be an appropriate methodology in this
10 case to use a hypothetical capital structure since
11 MGE is outside the zone of reasonableness?

12 A. I think in his -- are you referring to
13 on the stand yesterday?

14 Q. Yes.

15 A. I -- I was not aware of what Mr. Allen
16 said on the stand yesterday.

17 Q. But you understand that Mr. Allen did
18 quote from this case in his prepared testimony before
19 this Commission; right?

20 A. That he quoted from the report and
21 order?

22 Q. Yes.

23 A. He did in his rebuttal testimony
24 report from the -- quote from the report and order,
25 yes.

1 Q. And do you know that he quoted from
2 the report and order the specific provision dealing
3 with the zone of reasonableness that you had
4 established?

5 A. Yes, he quoted a portion of the report
6 and order that deals with that, yes.

7 Q. And you continue in your testimony
8 that in addition, the comparable, quote unquote,
9 company approach is consistent with the concepts
10 promulgated in the Bluefield and Hope cases; right?

11 A. Right.

12 Q. And the Bluefield and Hope cases are
13 the United States Supreme Court cases that deal with
14 rates of return for regulated utilities; is that
15 correct?

16 A. That's correct.

17 Q. Specifically, you continue, these
18 cases established the comparable earnings standard
19 (i.e., a utility is entitled to a return similar to
20 that being earned by other enterprises with similar
21 risks) and the financial integrity/capital attraction
22 standard.

23 By looking to the results of similar
24 companies, the comparable company approach embraces
25 both the comparable earnings standard and the

1 financial integrity/capital attraction standard
2 detailed in Bluefield and Hope by creating results
3 that will ultimately allow a utility to earn a return
4 that insures both financial soundness and the ability
5 to attract new capital.

6 A. That's my testimony in that case, yes.

7 Q. And that testimony was as truthful as
8 it was in 1993 as it is today; is that correct?

9 A. I'm not aware of anything that has
10 changed that would cause these statements to somehow
11 be inappropriate.

12 Q. Did you provide copies of any other
13 testimonies or suggest -- I'm sorry, let me withdraw
14 that.

15 You told us that you suggested that
16 Mr. Allen get a copy of this testimony. Did you
17 suggest that he take any other testimony of yours as
18 a sample?

19 A. I think I had mentioned that the last
20 case I had performed, the Missouri -- excuse me, let
21 me refer to it -- the Missouri American Water Company
22 case might be one worth reading, too. And the only
23 reason I had said that is that it was just the last
24 one that I had performed.

25 Q. Other than it being the last one that

1 you performed, this is the one case that you had
2 selected that he tried to get a copy of and review;
3 is that correct?

4 A. This St. Joe one?

5 Q. Yes.

6 A. Yes.

7 MR. HERSCHMANN: Can I have one
8 moment, please?

9 JUDGE WOODRUFF: Sure.

10 MR. HERSCHMANN: Can you read what's
11 on that board? I believe we've previously offered
12 this, I'm just not sure of the numbers, I apologize.

13 Q. (By Mr. Herschmann) Mr. Tuck, I'm
14 going to read to you from the Commission's order in
15 this case, and let me just ask you a foundational
16 question. Were you the cost of capital witness, or
17 the only cost of capital witness in the St. Joe Light
18 & Power case?

19 A. The companies --

20 Q. I'm sorry, for --

21 A. For the OPC?

22 Q. Yeah.

23 A. Yes.

24 Q. And when you were employed by the OPC
25 between 1992 and 1995, was that your primary

1 responsibility to submit that testimony?

2 A. Yes.

3 Q. And did you subsequently learn that
4 the Commission agreed with your recommendations as to
5 establishing a zone of reasonableness and applied
6 your hypothetical capital structure in the St. Joe
7 Light & Power case?

8 A. Was that a question, or could you
9 rephrase that, please?

10 Q. Sure. Subsequently, did you learn
11 that the Commission had actually not adopted the
12 position of the company St. Joe Power & Light and not
13 adopted the position of the Staff, but actually had
14 gone with your suggestions as to how to handle a zone
15 of reasonableness?

16 A. Yes, I was -- when I worked for the
17 Office of Public Counsel, I was aware of the report
18 and order that was issued in the case.

19 Q. And do you recall the Commission said
20 -- pardon me -- the Commission in other cases has
21 utilized the actual capital structure whenever the
22 debt/equity ratio has not been shown to be outside
23 the zone of reasonableness. However, when, as in
24 this case, the actual capital structure is so
25 entirely out of line with what the Commission

1 considers to be a reasonable range, a hypothetical
2 capital structure must be adopted to balance properly
3 the interest of the shareholder and rate payer.

4 Do you recall that being the
5 conclusion of the Commission in the St. Joe Light &
6 Power case based on your position that the zone of
7 reasonableness was outside the similar comparable
8 groups?

9 A. That's my understanding, yes.

10 Q. And the zone of reasonableness that
11 they were talking about or you were discussing was
12 the capital structure of St. Joe Power & Light;
13 right?

14 A. I don't know that the statement what
15 the Commission considers to be a reasonable range was
16 necessarily what I consider to be a reasonable range.
17 I don't know that that -- I don't know that I can
18 infer that from the statements that are in this
19 report and order. It may be true or it may not be
20 true, but what you just read says with what the
21 Commission considers to be a reasonable range.

22 I had put together what I called a
23 zone of reasonableness in my testimony. But I don't
24 know that that is explicitly -- I don't know that
25 it's not true, but I don't know that it is true that

1 the Commission's reference to what the Commission
2 considers to be a reasonable range is the same thing.

3 Q. Well, tell me if this helps you, and
4 I'm reading from page 5 of the order, therefore, the
5 Commission finds that the hypothetical capital
6 structure as proposed by public council should be
7 used in setting rates in this proceeding.

8 The Commission is aware that each
9 party in this proceeding developed a proxy group with
10 the criteria it believes to be the most relevant.
11 The Commission finds the Public Counsel's
12 hypothetical capital structure the more reasonable
13 alternative to the other proposals.

14 You were the one that put together the
15 proposed hypothetical capital structure; right?

16 A. That is correct.

17 Q. And you were the one that recommended
18 that St. Joe's Power & Light's actual numbers were
19 outside the zone of reasonableness; right?

20 A. Outside of what I consider to be a
21 zone of reasonableness, yes.

22 Q. And you did a good job in convincing
23 the Commission that they should go with your
24 position; right?

25 A. They adopted my hypothetical capital

1 structure recommendation, it's my understanding, yes.

2 Q. Over the other witnesses'; right?

3 A. Yes.

4 Q. So it was based on your calculations
5 in your opinion that the Commission subsequently
6 adopted that St. Joe Power & Light's capital
7 structure was outside the zone of reasonableness,
8 meaning their leverage was different and dissimilar
9 to the comparable group; right?

10 A. There could have been potentially, I'm
11 not saying there was or was not, but there could have
12 potentially been other evidence that the Commission
13 considered in deriving what they consider to be a
14 reasonable range. I would have to believe that my
15 testimony was the lion's share of that, maybe all of
16 it, but maybe not.

17 I don't know that I can absolutely
18 infer that that was the only evidence that they
19 considered to develop what -- to make the statement
20 what the Commission considers to be a reasonable
21 range. There was other testimony that they examined,
22 there were other -- there was other evidence in that
23 record.

24 Q. Okay. Was there any other evidence in
25 that record, to your knowledge, that suggested the

1 use of a hypothetical capital structure using the
2 term a zone of reasonableness other than yours?

3 A. No.

4 MR. HERSCHMANN: I have no further
5 questions at this time.

6 JUDGE WOODRUFF: Thank you. Then
7 we'll call for questions from the bench beginning
8 with Commissioner Murray.

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

11 JUDGE WOODRUFF: Commissioner Clayton.

12 BY COMMISSIONER CLAYTON:

13 Q. Good morning, Mr. Tuck.

14 A. Good morning.

15 Q. Mr. Tuck, I want to ask you a couple
16 of very quick questions that relate to your
17 experience and your knowledge with regard to utility
18 regulation in your time at OPC. What, briefly, what
19 was your educational background?

20 A. I received my undergraduate degree in
21 accounting and I received a Master's Degree with an
22 emphasis in Finance subsequent to that.

23 Q. Are you a CPA?

24 A. I am not a CPA.

25 Q. But you're one with an undergraduate

1 degree in accounting and then the emphasis in finance
2 at the graduate level; correct?

3 A. That is correct.

4 Q. And how many years did you serve at
5 OPC?

6 A. I worked for the Office of Public
7 Counsel for two years and nine months.

8 Q. So almost three years?

9 A. Yes.

10 Q. And I think you testified that you
11 prepared and offered testimony in 15, 18 cases,
12 something like that?

13 A. Yeah, it was 14 cases while I was an
14 employee of the Office of Public Counsel and one case
15 as an independent financial consultant.

16 Q. Okay. And that's -- is that the role
17 that you are acting today, are you an independent --

18 A. That is correct, yes.

19 Q. Can you explain to me what the
20 ultimate goal that we should be looking to in making
21 this return on equity and capital structure decision?
22 What is the ultimate goal of -- of this
23 determination? Do you understand that question? And
24 we are crunching numbers, we are using a lot of
25 formulas --

1 A. Yes.

2 Q. -- we have to make a determination of
3 a number of variables, but in the end what is the
4 goal that we are trying to reach as a Commission?

5 A. I think there's a couple parts to that
6 answer. But I think specifically related to one
7 component of the overall cost of capital, the cost of
8 equity, I think the key criteria is to accurately
9 make an assessment of what investors require when
10 they make investments in natural gas distribution
11 utilities.

12 And what the witnesses have done in
13 this case is they have created comparable companies,
14 and there's differences in the comparable companies
15 chosen by the three witnesses. But unfortunately,
16 there's no way to do a DCF analysis on Southern Union
17 because it does not declare a dividend, and so it's
18 not appropriate or it's not reasonable to expect to
19 use a DCF. So every witness is forced to use the
20 comparable company approach.

21 But in looking at that, I think the
22 key criteria to set just and reasonable rates is to
23 measure what investors expect at this point in time
24 on their investments in those companies. And I think
25 --

1 Q. So the ultimate goal is looking into
2 the mind of the investor?

3 A. That's correct.

4 Q. And then using numbers to rationalize
5 what an investor would be looking for?

6 A. To emulate that, yes.

7 Q. Okay. Now, what is your current
8 position?

9 A. I'm the senior investment officer of
10 the Missouri Public School Retirement System, and
11 it's located here in Jefferson City. It's a 23
12 billion dollar pension fund that covers the majority
13 of teachers here in the State of Missouri.

14 Q. You seem to emphasize the word billion
15 every time you say that.

16 A. I think it's just out of habit, but I
17 think sometimes if I don't emphasize that, it could
18 be perceived that it's million because it's an
19 astronomical number.

20 Q. I understand that. What are your
21 duties? What does that type of position do?

22 A. I have responsibility for the
23 investment of the assets of the retirement system.
24 I'm not the only person that has those
25 responsibilities, but I share those responsibilities

1 with a team of people.

2 Q. Are you the head of the department?

3 You say senior, is there someone above you?

4 A. I am senior -- there is a chief
5 investment officer at the retirement system. I am
6 the number two person, the senior investment officer
7 there.

8 Q. Okay. Are you doing a good job over
9 there? I've got a vested interest.

10 A. Well, it was a tough market in 2000
11 and 2001, but the retirement system is very solid and
12 it's very well funded. And investment returns have
13 been much better as of late.

14 Q. Okay. At some point during your
15 testimony, you indicated that a financial manager or
16 the CFO of a company should have a goal of achieving
17 the most efficient or the most proper balance of
18 financing between -- a proper ratio between equity
19 and debt. Do you recall making that statement?

20 A. Yeah, I believe that should be the
21 goal in capital structure theory, yes.

22 Q. And in -- is that in achieving the
23 most efficient cost of capital? Is it in terms of --
24 what other factors go into that --

25 A. Well, I think it's --

1 Q. -- analysis?

2 A. -- an issue of minimizing the weighted
3 average cost of capital. If a company at one extreme
4 uses just equity, it probably would result in a cost
5 of capital overall for the company that's higher than
6 necessary, because companies have a fairly stable
7 revenue stream, can issue debt and lower that cost of
8 capital.

9 Likewise, companies that use an
10 unusual amount of debt, may be far different from
11 what their peers are using, run the risk of having a
12 higher weighted average cost of capital in some
13 regards because the debt that they issue is required
14 to have a higher return expectation in order for
15 investors to be willing to -- to make a purchase of
16 those debt securities.

17 And then likewise, too, equity
18 investors, knowing that they don't get paid or
19 receive any dividends or any wealth accumulation
20 until after the debt investors have been paid,
21 require a higher return on their investment as well.

22 So I think this idea of finding the
23 optimal capital structure is one that kind of weighs
24 the trade-offs of the two. Introducing debt in a
25 prudent way so that you're lowering the cost of

1 equity, but with the overall cost of capital because
2 that is a cheaper source than equity.

3 But to not go so far as to result in a
4 situation where the risk profile of the company
5 becomes so high that investors demand higher rates
6 for those investments.

7 Q. Why is a company more risky when it is
8 -- when it has a higher debt ratio, all things being
9 equal?

10 A. It is a higher risk to the investors
11 because they don't share in any of the wealth of the
12 company until after debt investors have been paid.
13 So to the extent there's more debt that has to be
14 paid, more interest that has to be paid on debt, it
15 means that it's -- particularly in times when
16 earnings are volatile or lower than usual, it
17 decreases the likelihood that there will be anything
18 left over for equity investors.

19 Q. Where in a very similar fashion it
20 would be much like the difference between a preferred
21 stock and a common stock, the preferred is going to
22 be paid first?

23 A. Paid first.

24 Q. Okay. So the return for the common
25 equity holder would have to be higher because of that

1 enhanced risk?

2 A. That is correct.

3 Q. Is that a fair statement?

4 A. That's a fair statement.

5 Q. Now, in this discussion regarding
6 capital structure and return on equity, discussion
7 regarding comparable companies, the discounted cash
8 flow model, and the various other models in
9 determining how to determine this return on equity,
10 it seems like every time a path is chosen, a method
11 is chosen to come up with a proper structure and
12 return, that it has to be compared somewhere else to
13 see whether it's in some zone of reasonableness.

14 And I wonder why the numbers are not
15 more certain. And when I say the numbers aren't more
16 certain, why is there -- why do we need to go to
17 several different methods? Why isn't there just one
18 method? Why don't we always use the actual capital
19 structure rather than possibly look at a hypothetical
20 structure? Do you understand my question? It was
21 kind of rambled.

22 A. I think I do, and I'm going to
23 probably respond on the issue of capital structure,
24 at least first.

25 I think in this particular case, the

1 use of the company's consolidated capital structure
2 is an option because that is the capital structure of
3 the company. That capital structure exists in the
4 marketplace, and Southern Union is able to go about
5 their business and finance their operations and raise
6 capital based on that capital structure.

7 And when investors look at Southern
8 Union and they assess the risks embedded into that
9 company, that's what they look at. So it is a market
10 tested capital structure.

11 So I think in that regard, given that
12 it exists in the marketplace, the company maintains
13 an investment grade rating based on it, it is the
14 explicit result of decisions that the company's made,
15 it is an alternative for this Commission to use the
16 company's actual capital structure.

17 Where the difficulty comes in is that
18 Southern Union does not pay a dividend, and
19 therefore, a cost of equity determination for
20 Southern Union specifically is very difficult to
21 make. So then it becomes necessary to look at a
22 group of comparable companies to make that cost of
23 equity determination.

24 This would be a much simpler process
25 if Southern Union paid a dividend and we could all

1 look at that and make a cost of equity determination
2 for that company and you could match the capital
3 structure with the cost of equity estimation.

4 Q. Does the lack of a dividend increase
5 the cost for a common equity?

6 A. Not necessarily.

7 Q. Not necessarily.

8 A. It's just a choice by management to
9 not pay a dividend. It's just an elective management
10 decision. Some companies pay dividends and some
11 don't.

12 But the difficulty comes in when
13 you're deriving a cost of equity estimate for this
14 comparable group, and then you have a capital
15 structure that you're trying to apply it to to come
16 up with an overall weighted average cost of capital
17 and the capital structure of the comparable group is
18 different to the capital structure of the company
19 that you're trying to apply it to.

20 So one thing the Commission can think
21 about in this case is the reason why it's different.
22 The reason why the Southern Union capital structure
23 has so little equity compared to comparable companies
24 is the result of explicit decisions on the part of
25 management to lever up that capital structure and

1 invest in companies like Panhandle Eastern for the
2 benefit of -- of shareholders.

3 That's a way to try to increase the
4 wealth maximization for them. It does result in
5 extra risks for the company, but if shareholders
6 don't like that, they can sell their shares. Rate
7 payers, on the other hand, are captive customers.

8 But I think the idea of the
9 hypothetical capital structure is a way to sort of
10 bring those in line. Because by developing this zone
11 of reasonable for the comparable group of companies,
12 then you are sort of within the range of what
13 everyone else is doing, and then I think you can have
14 a greater degree of comfort that the cost of equity
15 for those comparable companies is appropriate to
16 match to the capital structure.

17 Q. Did you do an analysis to determine
18 whether the capital structure in the overall return
19 submitted in each -- let me rephrase the question.

20 Did you do an analysis of determining
21 whether or not the capital structure and the return
22 using the actual capital structure was within the
23 zone of reasonableness in this case? In your zone of
24 reasonableness?

25 A. Right. Now, the only zone of

1 reasonableness that's been calculated in this case is
2 this zone of reasonableness of equity ratios for the
3 group of comparable companies of Witness Dunn that
4 Mr. Allen calculated.

5 I don't think there's been any effort
6 on the part of any witness, and certainly not on the
7 part of myself, to see if the overall recommendation
8 that results from taking the cost of equity and the
9 capital structure and putting them together is
10 similar to what would be kind of within the zone.

11 Q. But don't both components have to be
12 evaluated together to see what the end result is and
13 see what that result is, see if it is within a
14 certain zone of -- of comparable companies or --

15 A. I think where the comfort, that that
16 all works out, is increased is by probably using the
17 hypothetical capital structure theory that kind of
18 puts you in this belief that the capital structure
19 you are using is within the zone of reasonableness.
20 So then it matches up, it's a more direct match to
21 the cost of equity estimation based on a comparable
22 group.

23 So I think you can sort of rely on
24 that to a greater extent that you have matched two
25 things that go together. You know, the difficulty in

1 looking at the consolidated capital structure for
2 Southern Union and applying the cost of equity of a
3 comparable group is that there is a risk difference
4 that's associated with the use of leverage. And
5 granted, that risk difference was created by the
6 company by their own volition in this case, but there
7 still is a mismatch there.

8 I think by looking at a capital
9 structure that's reasonable and within that zone of
10 reasonableness for a comparable group of companies in
11 matching it to the cost of equity determination, as
12 long as you believe that cost of equity determination
13 has been made appropriately, I think provides a
14 pretty high level of comfort that the two match up
15 and that it is appropriate and would result in just
16 and reasonable rates.

17 Q. Is it your opinion that if we were to
18 use the actual consolidated capital structure with a
19 very low equity component, that that would -- that
20 the investment community -- or that it would cause
21 the cost of capital overall for the company to be
22 increased?

23 A. I think the investment community
24 realizes that, you know, whatever's utilized by this
25 Commission, it's just utilized for a rate making

1 purpose and it just results in an overall revenue
2 requirement and it's not necessarily something that
3 has a lot of ramifications outside of that.

4 Now, I think the investment community
5 certainly is aware when they analyze a utility --

6 Q. So --

7 A. Making recommendations.

8 Q. Let me ask you this, before you go on
9 in that, though, so would the investment community,
10 the investors that would be putting up capital to buy
11 stock or buy debt or whatever it may be --

12 A. Mm-hmm.

13 Q. -- is going to look at the number that
14 is proposed to come out in rates, for an increase in
15 rates rather than the actual analysis; correct?

16 A. I think they're primarily concerned
17 with what the end result is, what the actual rates
18 are, what it actually does for the revenue stream of
19 the company.

20 Q. So it's a matter, just show me the
21 money from that standpoint?

22 A. I think that's the starting place,
23 yes.

24 Q. Okay. Okay. You read the testimony
25 that's been filed by Witness Murray, Allen, and Dunn?

1 A. I have, yes.

2 Q. You have read through each direct,
3 rebuttal, surrebuttal, cross surrebuttal, and every
4 other --

5 A. I haven't looked at all of the
6 depositions page by page --

7 Q. Okay.

8 A. -- and I did give some cursory glance
9 to some of the surrebuttal, but I consider myself to
10 be familiar with the testimony filed -- the written
11 testimony filed in this case.

12 Q. In reviewing that testimony, in
13 reviewing the education, the experience, and the
14 presumed knowledge of each of those witnesses, have
15 you found that any of them lacks a sufficient amount
16 of expertise to be providing testimony on this
17 particular subject?

18 A. I think all of the witnesses in this
19 case are qualified to submit recommendations to this
20 Commission.

21 Q. Okay. Is it possible for you to
22 identify just very briefly the items that you -- that
23 you disagree with in Witness Allen's testimony as
24 part of his analysis?

25 A. Yeah, I will --

1 Q. Could you summarize those differences?

2 A. I think I can talk about a few. As
3 had been mentioned during the cross-examination of me
4 earlier, Mr. Allen excluded Laclede Gas kind of based
5 on this idea of circularity. And --

6 Q. I recall that issue. And I just want
7 to go through them, you don't have to explain --

8 A. Okay.

9 Q. -- each one, because I know you talked
10 about each one, but I wasn't able to make -- make my
11 list. And I may have a question on each one, but if
12 you could just go through those just real quickly for
13 me.

14 A. Okay. Again, I think it's reasonable
15 to think about in the capital asset pricing model
16 what the inputs are there. And there's pluses and
17 minuses associated with each one. But if I would
18 have filed direct testimony and if I would have
19 performed a capital asset pricing model analysis, my
20 inputs would have been a little different than what
21 Mr. Allen's were.

22 Q. Which inputs specifically?

23 A. As far as a risk-free rate, instead of
24 using the three-month T bill, I would have most
25 likely utilized the 10 year -- the yield on the

1 10-year treasury bond. But then -- and that would
2 have tended to have made my findings a little higher
3 than his.

4 But then in terms of the risk premium,
5 which is the other component or another component of
6 the capital asset pricing model, I would not have
7 used the historic data based on Ibbotson.

8 Because for professional analysts who
9 look at the risk premium, and the risk premium to a
10 certain -- it attracts a lot of attention in the
11 investment world because it's a very important issue.
12 People look at what it has been in the past, but they
13 make estimations of what they think it will be in the
14 future.

15 Q. So you would be forward thinking on
16 the risk premium?

17 A. I would be forward thinking.

18 Q. Okay. What else?

19 A. And I don't know that this one had
20 come up, but I think Mr. Allen had suggested that if
21 the ISRS issue was approved, that that might form
22 some sort of rationale to -- it's a risk lowering
23 mechanism, and that might be some rationale to use a
24 lower cost of equity estimate.

25 Q. Okay.

1 A. Which is -- you know, Witness Dunn for
2 the Company makes a lot of kind of one comparison
3 analyses of risk differences between MGE and
4 comparable companies. And he uses that rationale to
5 ratchet up the return, and he does it again and again
6 and again.

7 And I don't think I agree, really,
8 with either one, with Mr. Allen's or Mr. Dunn's,
9 because no witness in this case has done what I would
10 consider to be a complete and thorough analysis of
11 all the risk differences of the comparable companies.

12 And if anyone really tried to do that,
13 it would just be mind-boggling. Because every
14 company has its differences. Some of these
15 differences are a lower risk indicator, some are a
16 higher risk indicator.

17 Q. Mind-boggling and expensive.

18 A. And expensive. And I think nearly
19 impossible to do. I think it's a better assumption
20 that when you net it all out, comparable companies
21 are comparable. And so I think that's an issue where
22 I would disagree with the approach of both Witness
23 Dunn and just in that one issue of the ISRS with Mr.
24 Allen.

25 Q. Okay. You mentioned forward looking

1 in terms of -- terms of risk analysis. Should each
2 component of the -- on the -- on the rate of the
3 return on equity issue, should each component be
4 forward looking?

5 A. Well, I think that the key element of
6 the DCF is the determination of the growth rate. The
7 DCF equation is basically the dividend yield plus
8 investor expected growth.

9 And the dividend yield is for the most
10 part a relatively straightforward calculation.
11 There's a few differences that can make minor changes
12 to what witnesses find to be appropriate, but really
13 that determination of growth is what's most
14 important.

15 And the only thing that is important
16 to investors is what growth rate that they expect to
17 incur for a very long period of time in the future.
18 By using the single DCF form, the Gordon model of the
19 DCF, there's only one growth rate. And that growth
20 rate has to be the growth rate that investors expect
21 for a 30-plus year time horizon.

22 So looking at historical growth rates
23 of a company is a reasonable starting place, because
24 it's an indication of what --

25 Q. So you can look at historic growth

1 rate? You can look backward in terms of --

2 A. Absolutely.

3 Q. -- determining the growth rate?

4 A. And professional investors do that
5 because it's the starting place. And a lot of times
6 it's fairly reflective of what's going to happen in
7 the future.

8 Q. What formula -- are there various
9 formulas for determining the growth rate?

10 A. There are. You can look at historic
11 growth rates in earnings per share, dividends per
12 share, and book value per share. And you can also
13 look at what's called the retention growth rate or
14 the product of the retention ratio of the company
15 versus its return on equity. All of those measures
16 can also be looked at on a forward looking basis.

17 Q. Let me ask you this: Which witness,
18 in your opinion, used the most accurate growth rate,
19 the most accurate formula to achieve a more accurate
20 result, in your opinion?

21 A. I think Mr. Allen both utilized the --
22 the best methods to determine expected growth, which
23 is to look at -- I think he placed the most reliance
24 on the projected retention growth rate method and
25 projected earnings per share.

1 And I think he also casted the widest
2 net in terms of the types of growth rates that he
3 looked at, and I think that's important as well. I
4 don't think any other witness looked at as many
5 different types of growth rates as Mr. Allen.

6 Q. Okay.

7 A. Because he specifically used that
8 retention method.

9 Q. In terms of capital structure, should
10 it be forward looking or historic or a snapshot?

11 A. I think the capital structure, the
12 starting place is the snapshot. And it's probably
13 relevant to look at what it has been historically.
14 What it's going to be in the future is going to be
15 very difficult to determine, because the Company's
16 going to make specific -- any company's going to make
17 specific active decisions that are based on a whole
18 lot of different things. It may be an acquisition
19 strategy or some other thing --

20 Q. But you can say that about any
21 component. So I mean, it sounds to me like it's not
22 consistent whether we look forward, take a snapshot,
23 or look backward on either -- on looking at all of
24 the components.

25 It seems like we are -- should be

1 forward looking in terms of a growth rate, but the
2 historic growth of the Company is also important. We
3 should take a snapshot of the -- of the capital
4 structure to determine that component.

5 It seems like we're all over the place
6 when it comes to making this analysis, and in what
7 point in time should the decision be made.

8 A. Right. You know, there has to be a
9 reasonable cut off period for looking at things that
10 are more oriented towards a snapshot. And I think
11 April 30th is the -- considered to be that cutoff
12 point in this case.

13 But I think the differentiating factor
14 between measuring investors' required rate of returns
15 and looking at capital structure is that the goal of
16 the cost of equity, the DCF model or any cost of
17 equity estimation, is to look at what investors
18 expect on their returns going forward. And that is
19 the measure --

20 Q. Which is the final number; right?

21 A. Yes, that's the final number.

22 Q. Investors are looking at the final
23 number?

24 A. The final number. They may look at
25 what happened in the past, but it's relevant only to

1 the extent that it shapes their view as to what is
2 going to happen, what they expect to happen --

3 Q. I asked this question of Witness Dunn
4 yesterday or the day before, I asked whether or not,
5 in preparation of these testimonies by each of the
6 witnesses and the positions of each of the parties,
7 whether or not they picked a number in terms of how
8 much investors would need for the confidence of -- to
9 put up more capital and then work backwards in the
10 process and justify that figure.

11 It almost seems like if that's the
12 number that's most important, shouldn't the analysis
13 start there?

14 A. Start with what investors --

15 Q. With this number that you make
16 reference to that investors would be looking to.

17 A. That absolutely is the starting place.
18 It's not the job of the analyst, for -- for me or for
19 Mr. Allen or for Mr. Dunn, to say what the cost of
20 equity is. We are just a flow-through from the
21 investment community. Because what you're measuring
22 is what investors expect and require on their
23 investments, and that's the appropriate cost of
24 equity determination.

25 We just flow through information and

1 models to you to help you decide what that number is.
2 So it's not the job of any of us to say what that
3 number -- what we think it should be. It's our job
4 to measure what investors believe that it is.

5 COMMISSIONER CLAYTON: I don't think I
6 have any other questions. Although, I want to know
7 how long you're going to be keeping all that
8 testimony down in your basement. Because my wife
9 wants to know how long I'm going to be keeping the
10 criminal briefs I wrote in law school down in the
11 basement.

12 THE WITNESS: My wife tried to
13 convince me to throw it away one time, and I just
14 wouldn't do it. It's here to stay.

15 COMMISSIONER CLAYTON: I understand.
16 Thank you.

17 JUDGE WOODRUFF: Commissioner Gaw, do
18 you have any questions?

19 COMMISSIONER GAW: See if -- Mr.
20 Appling is first.

21 JUDGE WOODRUFF: Okay. Commissioner
22 Appling, do you have any questions?

23 BY COMMISSIONER APPLING:

24 Q. Mr. Tuck, I have two questions. This
25 is zone of reasonableness is new to me, so would you

1 in relationship as close as you can to this case
2 define that for me, please?

3 A. Okay. That idea of a zone of
4 reasonableness is related to capital structures of,
5 in this instance, gas distribution utilities. And,
6 you know, what we find is that different companies
7 select different measures of equity and debt to
8 finance their operations. But there is sort of a
9 tendency for there to be something that is generally
10 considered to be reasonable for those types of
11 companies, companies with similar risk
12 characteristics.

13 And if you look at, let's say, Witness
14 Dunn's 15 proxy companies, because that's the 15
15 companies that Mr. Allen looked at to calculate the
16 zone of reasonableness, you see that the equity
17 ratios range from, I think, a low of 21 percent to a
18 high of 64 percent. And there's an average of that
19 group, and it's somewhere in the low to mid 40s.

20 But you say, okay, these are all over
21 the map, it ranges from 21 percent to 64 percent,
22 that's a huge difference. But you know 21 and 64,
23 those are the two extreme ends. One is sort of a
24 measure of what's kind of a reasonable range that's
25 typically employed by gas distribution utilities.

1 And the way that Mr. Allen did that in
2 this case is he calculated what's called the standard
3 deviation of the different equity ratios in this
4 case.

5 And what's kind of inherently elegant about that
6 methodology is the range that incorporates plus or
7 minus one standard deviation from an average is
8 considered to, under statistical principles, capture
9 two-thirds of the data points.

10 And to me, there's nothing that's --
11 there's a little bit of art and science involved in
12 this, but it seems reasonable that a -- a measure
13 that captures two-thirds of the data points becomes
14 sort of the zone that represents what's reasonable
15 for gas distribution utilities in terms of their
16 equity ratios.

17 So that's how that zone of
18 reasonableness was determined. And I think what Mr.
19 Allen would say about that zone of reasonableness is
20 it's a good representation of the -- the reasonable
21 range of equity versus debt trade-offs typically
22 employed by gas distribution utilities.

23 Q. Second question -- and thank you for
24 that. Where is MGE in this zone as you see it?

25 A. The consolidated capital structure for

1 Southern Union, which is the only market-tested,
2 market-derived capital structure for the Company, is
3 with the inclusion of that short-term debt, about 26
4 percent equity. And without short-term debt being
5 included, it's about 28 or 29 percent equity based on
6 numbers at December 31.

7 So it falls below the zone of
8 reasonableness calculated by Mr. Allen, which had a
9 range from the low of about mid 30s to a high
10 somewhere, I think, I would have to look at the
11 testimony again, but it's somewhere maybe in the low
12 50s. So it falls below that zone of reasonableness.

13 But I think what's important for --
14 and financial theory would sort of indicate that that
15 lower equity ratio would be an indication of higher
16 risk for the Company and a higher cost of equity
17 because of that.

18 But I think the thing that the
19 Commission has to think about when it sort of weighs
20 whether the consolidated capital structure with that
21 low equity ratio is more appropriate or the
22 hypothetical is the fact that the Company wound up in
23 that position because of decisions that it explicitly
24 made to acquire companies like Panhandle Eastern.

25 Q. Thank you, sir. Third question. From

1 Mr. Murray, you read that testimony, and Mr. Allen,
2 and just in a simple term, is they inside the ball
3 park or is they outside?

4 A. I think that the methodology that Mr.
5 Murray used to determine the low end of his cost of
6 equity range is not a method that would likely be
7 employed by investors and professional,
8 sophisticated, institutional investors.

9 And that number could potentially be
10 within a range because -- I know I certainly look in
11 my own profession at the kind of equity returns we
12 expect going forward. Those numbers are in the
13 eights, and we make important decisions about how we
14 invest our assets based on this belief that equities
15 are going to give us something like eight percent
16 going forward.

17 But I think the methodology that Mr.
18 Murray used to derive that is probably not reflective
19 of the way that investors would really do that. Now,
20 the high end of his growth rate range, which then
21 becomes the higher end of his cost of equity range, I
22 think is based on methods that you can reasonably
23 expect that investors would rely on.

24 So between the low end of his range
25 and the higher end of his range, I would have a

1 greater comfort with something from the midpoint to
2 the high end of his range as opposed to the low end.

3 COMMISSIONER APPLING: Thank you, sir.
4 Judge, I have no further questions from me.

5 JUDGE WOODRUFF: Thank you. Chairman
6 Gaw, do you have any questions?

7 COMMISSIONER GAW: Thank you, Judge.

8 BY COMMISSIONER GAW:

9 Q. Commissioner Clayton was asking you
10 some questions about comparing or -- or saying what
11 you would have done differently, if anything, with
12 Witness Allen's testimony.

13 A. Yes.

14 Q. I'd like for you to do the same thing
15 with Witness Murray's and then with Witness Dunn's.

16 A. Okay. I think with Mr. Murray's
17 testimony, I think probably the thing that I would do
18 differently, and I just refer to it, and that is sort
19 of the methodologies used to calculate the growth
20 rate that's used in the DCF model.

21 And again, I think, too, it's the job
22 of the analyst to kind of look at all of the data,
23 and the low end of that range is sort of just based
24 on an average of all the information that he looked
25 at. And I think to reasonably capture what investors

1 expect, you have to apply a little bit more judgment
2 as an analyst as to what's more likely to be relied
3 upon by analysts.

4 And I think Mr. Murray did that, did a
5 good job of that in -- in the higher end of his
6 range. But I think the low end, it's more based on
7 sort of just looking at the average of everything, is
8 not reflective of what investors would be doing.

9 And after all, that's the job that any
10 cost of equity witness has, is to -- to make a
11 reasonable estimation of what investors expect and
12 the way they derive those expectations.

13 Q. Well, other than -- other than that, I
14 understand that's a major factor, but what -- what
15 would you have done differently in the process
16 specifically and -- if anything, other than that one
17 factor that you just mentioned?

18 A. Right. I think the issue of capital
19 structure, you know, is another big issue in this
20 case. And Mr. Murray used the consolidated capital
21 structure, which I think is reasonable, but I think
22 the -- the decision that has to be made by the
23 Commission is whether to employ that or the
24 hypothetical.

25 And if you employ the consolidated

1 capital structure, what's a reasonable increase to
2 the return on equity found for those comparable
3 companies to account for that difference in risk?

4 Because financial theory would
5 certainly indicate that when you look at a group of
6 companies with 40 percent equity, it's going to have
7 a lower cost of equity expectation than a company
8 with 25 percent equity. So I think making some
9 determination of that or considering that issue is
10 important.

11 But the other component of that is the
12 -- the way in which this company got to that 25
13 percent or 26 percent equity ratio. It wasn't
14 through issuing debt to fund necessary additions to
15 -- you know, investments in the State of Missouri.

16 It was to -- to swallow another very
17 large company and to assume that additional \$1.2
18 billion in debt, which is an act that increases risk
19 for rate -- or for shareholders, but it also
20 increases risk in some circumstances or potentially
21 increases the risk for rate payers in the state. So
22 I think that's a difficult issue.

23 If that capital structure is employed,
24 what's an appropriate magnitude of increase in the
25 cost of equity for the comparable group? And I think

1 Mr. Murray came up with something like 32 basis
2 points, which is -- I mean, I haven't really made a
3 determination of what that should be.

4 But I think it's important to keep in
5 mind that it can't be overly large, because if you
6 think we live in a world where we expect something
7 like eight percent return on equities in general over
8 a long period of time, and you look at Southern
9 Union, which is a company that has a beta of .9,
10 which implies it is less risky than the market as a
11 whole.

12 Some increase to that cost of equity
13 for those comparable groups of, you know, 200 basis
14 points or higher would imply that when we look at
15 Southern Union, we're looking at a company that's
16 distressed and far out at the very end of the risk
17 spectrum.

18 And that's not the case, because you
19 can look at their investment rate bond rating, and
20 for that matter, the beta of the company which is
21 less than the market which would imply less risk for
22 investors.

23 Q. Is that because of the type of
24 investment that Southern Union has and the companies
25 that they have invested in?

1 A. The beta?

2 Q. Yes.

3 A. Yeah.

4 Q. When you're looking at the debt/equity
5 ratio, if you look at that alone, you already said
6 that it would imply -- it could imply --

7 A. Right.

8 Q. If you look at that alone, this is a
9 risky company to invest in.

10 A. Right.

11 Q. But there -- obviously, your -- your
12 statement indicates that you have to look further
13 than that.

14 A. Yeah.

15 Q. So what is it that causes that beta to
16 be in a position where the -- that the investors view
17 this company as being less risky than average?

18 A. Okay. Yeah, two parts to that. One,
19 the issue of -- I lost my train of thought on that.

20 The beta is -- and it's, you know,
21 wrapped in financial theory, but it is considered to
22 be under modern portfolio theory a one single measure
23 that captures the systematic risk of a company or a
24 risk that can't be diversified away. And that is,
25 after all, to investors the risk that really matters.

1 And so it's considered to be a broad measure that
2 encompasses all factors that are related to the risk
3 of the company under that financial theory.

4 Q. I understand the theory. I guess what
5 I'm asking you is why is it that, in this case,
6 Southern Union's beta is lower than the average when
7 you --

8 A. Because --

9 Q. -- when you see the debt/equity ratio
10 being what it is?

11 A. Right. Gas distribution utilities in
12 general tend to be less risky than the stock market
13 as a whole.

14 Q. All right.

15 A. Because it's a more stable revenue
16 stream.

17 Q. And when you're talking about that
18 with Southern Union, are you mainly talking about its
19 investment in Panhandle?

20 A. Well, certainly the operations here --

21 Q. Or the whole operation itself?

22 A. The operations here in Missouri is a
23 -- it's a regulated natural gas distribution company,
24 is indicative of generally a lower level of risk
25 compared to the market as a whole.

1 Q. Okay. And what about Panhandle itself
2 as a pipeline company?

3 A. Right. I haven't made an in-depth
4 analysis of the business --

5 Q. All right.

6 A. -- of Panhandle.

7 Q. That's fine. Okay. So let me ask you
8 about Witness Dunn. Tell me what you would have done
9 differently than he did.

10 A. I'll start with the DCF analysis that
11 was employed by Mr. Dunn. Mr. Dunn goes to some
12 lengths in his testimony to state his view that
13 historic returns or returns in dividend growth are
14 not relevant to investors' expectations anymore. And
15 that is really the growth in future earnings of the
16 company that is the primary factor that investors
17 look at to determine the growth rate, to determine
18 the DCF cost of equity.

19 And he looks at Value Line's projected
20 earnings growth rates, and then he also looks at a
21 compilation of growth rates from professional
22 industry analysts that's summarized by a company
23 called Thompson.

24 And what Thompson does is they look
25 out across all of the Wall Street firms and they find

1 analysts who are covering a specific stock and
2 analysts that are making a five-year earnings
3 projected growth rate.

4 And for most of the utility stocks in
5 Witness Dunn's group, there would be anywhere from
6 two to seven professional Wall Street analysts that
7 would be making these five-year earnings estimates.

8 And in his testimony he shows that
9 that average for his comparable companies is 4.9
10 percent. And again, that's the -- the average of --
11 of all of these analysts that follow the companies.

12 But he seems to -- even though he
13 states that he believes that it's projected earnings
14 growth is most important going forward, he ignores
15 that 4.9 percent average that's indicated by Thompson
16 and goes with the growth rate that's 6 to 7 percent.

17 And I think that there's sort of a
18 logical disconnect between the data that he looked at
19 and the recommendation that he had. And it's
20 certainly true that the Value Line earnings per share
21 projections are higher than what's shown by Thompson,
22 but the Value Line numbers represent just one number,
23 where the Thompson's information represents the
24 summary of anywhere between two to seven analysts.

25 So if you believe that the idea is to

1 capture that consensus number that sort of is the
2 average of all analysts, you wouldn't toss out the
3 Thompson's, you would place a much greater emphasis
4 on that Thompson's.

5 So I think there's a logical
6 disconnect, because his testimony would indicate
7 something like 4.9. The average of the Thompson's
8 would be the reasonable expectation. And if you
9 applied that to his dividend yield without flotation
10 cost adjustment, that would be a 9.5 percent cost of
11 equity determination.

12 So that disconnect between his six to
13 seven and sort of the data that's in his testimony is
14 something that I don't completely understand. But if
15 you take that projected earnings growth from
16 Thompson's, which is what the witness would seem to
17 indicate is the most important factor to look at in
18 the 4.6 percent dividend yield, you are at a 9.5
19 percent cost of equity estimation, which then becomes
20 very similar to Mr. Allen's and very similar to the
21 higher end of Mr. Murray's.

22 And then beyond that -- and I have not
23 made any sort of analysis of the -- the very specific
24 detailed risk differences between Southern Union or
25 MGE and the comparable companies used by the

1 witnesses, but Mr. Dunn pitched certain issues and
2 states his belief that those issues are specific to
3 MGE or specific to Southern Union, and cause it to be
4 riskier than the comparable group. And then he makes
5 upward adjustments to his market-derived cost of
6 equity to account for these risks.

7 But as I had said before, I don't
8 think any analyst in this case has done the sort of
9 all encompassing analysis of all the risk differences
10 between these companies to make an assessment as far
11 as which one in total has more or less business risk.
12 And I think it would be mind-boggling if anyone tried
13 to do that. It would be incapable of understanding
14 what those results are.

15 So I think it's reasonable to believe
16 that if the comparable companies seem to have been
17 rationally chosen, believe that those comparable
18 companies are indeed comparable. That when you net
19 out all of those risk differences, that net, they're
20 going to be about the same.

21 Q. Is that the reason that it's generally
22 accepted practice to used comparables, because it is
23 so difficult to assess all of the different risk
24 factors that would have to be employed to do this
25 without -- without --

1 A. That assumption of comparability, I
2 believe that's one of the very important reasons,
3 yes.

4 Q. Anything else in his analysis that you
5 want to mention? That you haven't --

6 A. As far as capital structure, he uses a
7 capital structure in his direct testimony that is the
8 capital structure of Southern Union less the
9 long-term debt of Panhandle Eastern, the company that
10 they recently acquired.

11 And you know, this is maybe somewhat
12 of a more art than science issue, but that's not a
13 market-tested capital structure, and I don't think
14 it's really reflective of a lot of the considerations
15 that Southern Union employs when they determine what
16 debt they issue or what equity they issue.

17 And at least in his direct testimony,
18 it would seem that he removed the debt and made no
19 sort of accommodation to remove some of the equity
20 that clearly could have been tied to that. And in
21 his surrebuttal, he makes some changes and he removes
22 pieces of -- of equity as well. And I think his
23 recommendation drops from something like 43 to 41
24 percent.

25 But it's my belief that the

1 market-tested capital structure, the one that exists
2 in the marketplace that investors base their
3 decisions on, is -- is absolutely the starting place
4 for looking at capital structures.

5 And there may be good reasons to move
6 up to a hypothetical like the one Mr. Allen
7 suggested, but I don't believe the starting place is
8 a capital structure that's hypothetical in the sense
9 that it doesn't exist in the marketplace.

10 Q. Okay. Anything else that you want to
11 mention?

12 A. I cannot think of any others at this
13 time.

14 Q. All right. Now, let me ask -- there
15 was -- at the beginning, and I know you were -- I
16 don't think you were -- I'd be surprised if you were
17 here. In opening statements, there was some
18 reference to chart or something, and I'm not going to
19 say anything about the chart unless it was marked as
20 an exhibit, but it had to do with references to other
21 states' determinations of return on equity and
22 perhaps rate of return, I can't remember, that -- and
23 it was presented by MGE, if I recall correctly, that
24 suggested that the -- that MGE had been given either
25 through -- in its last rate cases, either through

1 stipulation or otherwise, a lower return than -- than
2 what other states had been awarding to -- to
3 companies.

4 Do you see anything about that or do
5 you recall anything about -- about seeing other
6 states comparisons?

7 A. There was a comparison in the written
8 testimony of Dr. Morin and there was some discussion
9 of that in the testimony of Mr. Dunn, too. So I
10 certainly didn't see what was presented to the
11 Commission earlier this week, but I'm sort of aware
12 of that issue.

13 Q. Do you have any -- do you have
14 anything to add or any opinion to give to us about
15 what you saw in the testimony --

16 A. Sure. I think --

17 Q. I'm just trying in a broad brush kind
18 of way get an idea of how important or relevant you
19 think that is.

20 A. I think one of the keys is to look at
21 some of the language that's included in the Bluefield
22 case.

23 And part of that language says that
24 the public utility is entitled to such rates as will
25 permit it to earn a return on the value of the

1 property which it employs for the convenience of the
2 public equal to that generally being made at the time
3 and at such general part of the country on
4 investments in other business undertakings which are
5 attended by corresponding risks and uncertainties,
6 but it has no constitutional right to profits that
7 are realized or anticipated by highly profitable
8 enterprises.

9 But there's another component of the
10 Hope case, too, that says a rate of return may be
11 reasonable at one time and become too high or too low
12 by changes affecting opportunities for investments,
13 the money market and business conditions generally.

14 I think you have to tie those two
15 things together. And the way to do that is to not
16 base your decision on what other commissions have
17 authorized in the way of returns in the past under
18 different -- vastly different sets of circumstances,
19 but instead to look at that last component and
20 recognize that rates of return change over time with
21 opportunities affecting investments and business
22 conditions generally.

23 And the way to do that, I think, is to
24 use a market-derived cost of equity estimation
25 technique, like the discounted cash flow method.

1 And I think even Dr. Morin in his
2 deposition had made the statement that I think every
3 commission should have a mind of its own. We have a
4 potential circularity problem if we focus strictly on
5 what other commissions are doing. The authorized ROE
6 is but one piece of a giant puzzle here. If we were
7 just to look at what other commissioners were doing,
8 we'd be looking at sort of multiple mirror images of
9 one another and nothing would ever change.

10 So I think you have to go a little bit
11 beyond that and look at capital market data as well
12 as authorized rates of return.

13 I think it certainly is reasonable for
14 this Commission to look at authorized rates of return
15 from other states, but as Dr. Morin points out, if
16 that's all everyone ever did, nothing would ever
17 change. It would not reflect what current capital
18 costs are and it wouldn't reflect the circumstances
19 that are specific to this case.

20 Q. Let me ask you another question. What
21 -- what -- if I were to want to know what, without --
22 without analyzing a particular company --

23 A. Mm-hmm.

24 Q. -- but I'm going to say that this is a
25 company that is an average range of risk.

1 A. Mm-hmm.

2 Q. Okay. But it was a utility company,
3 and I wanted to know what -- what investors expect on
4 equity investments in that company.

5 How do you make that determination?

6 A. I think that the DCF method, which is
7 a market-derived cost of equity technique, is the
8 reasonable starting point.

9 Q. But when you look at that, you produce
10 a result with the DCF method; right?

11 A. Right.

12 Q. And you go through and you factor in
13 things that are related to a particular company?

14 A. Yeah.

15 Q. I'm just talking about the average
16 investor out there, and they're looking around,
17 they're not going to use a DCF model to figure out.

18 A. Right.

19 Q. You know, when you -- do you use a DCF
20 model when you decide what you're going to invest in
21 yourself as in your current position?

22 A. Specifically myself, one of the most
23 important things we do as a pension fund is to make a
24 decision on asset allocation and to make the decision
25 on how much we should have in stocks or how much we

1 should have in bonds and other asset classes.

2 Q. Okay.

3 A. We determine what we think we're going
4 to earn on those asset classes and what we think the
5 risks are to those asset classes and how they
6 correlate to each other. And so in terms of trying
7 to make an estimation of what we think the equity
8 markets are going to do going forward --

9 Q. Right.

10 A. -- we take a pretty long-term
11 approach. Because, as we all know, anything could
12 happen next week or next month or next year, and I
13 don't think there's anyone that has the foresight to
14 be able to predict that. So you have to take that
15 long run approach.

16 Then you start with ideas of looking
17 at what the markets have done historically using
18 modern portfolio theory, using the capital asset
19 pricing model, developing a risk premium estimate,
20 what you think is -- the return to equities is going
21 to be over stocks, and looking at what you think
22 other investors are expecting by applying models like
23 the DCF.

24 And one of the, you know, important
25 things that we look at is this idea of what is the

1 return going to be to stocks over like 10-year
2 treasuries. And that's an important decision because
3 it has a lot to do with, you know, how stocks and
4 bonds are going to behave over time with each other.

5 And I think that when you look at the
6 bond market, you can look at what the current yield
7 is on a 10-year treasury, and unless market forces
8 change or interest rates go up or go down, that's --
9 if you hold those bonds to maturity, that's what
10 you're going to earn.

11 Q. Okay.

12 A. And then when we look at what is a
13 reasonable risk premium over that, we look at what --
14 the studies that's being conducted in academia, what
15 other professional investors are doing, what other
16 professional investors say, what makes sense from a
17 financial theory standpoint.

18 And at least for the retirement
19 system, the equity premium that we use is three
20 percent over 10-year treasuries.

21 Q. Okay. Three percent. And that's for
22 -- is that an average that you use --

23 A. It's -- it's the compilation of all of
24 the information that we look at, and some sources
25 would suggest something higher and some would suggest

1 something lower.

2 Q. All right. But that's what you're
3 shooting for?

4 A. That's what we think is a reasonable
5 expectation --

6 Q. All right.

7 A. -- going forward.

8 Q. Okay. And what's 10-year treasury
9 rate now?

10 A. The current 10-year treasury is 4.7
11 percent.

12 Q. 4.7 percent. So you're trying to get
13 a 7.7 -- no, excuse me -- yeah, 7.7?

14 A. That's what we think --

15 Q. Currently?

16 A. And to be completely fair, that's our
17 estimation of what we think equities are going to do
18 over the next ten years.

19 Q. All right.

20 A. And we have -- and that's the model
21 that we have used to develop our asset allocation.
22 We have another number that we use that is considered
23 an equilibrium, very long-term 30-plus year number --

24 Q. All right.

25 A. -- which is sort of less dependent on

1 where we are right now with valuations of equities in
2 the market cycle, and that number is nine percent.

3 Q. Nine percent. Now, are those numbers
4 at all significant if I were to say -- I'm looking
5 forward to make sure that we're falling in a range of
6 reasonableness for a company like this.

7 Can I look at these numbers to see
8 whether or not those -- that we're way far afield
9 from those? Or should I even pay attention to those
10 figures you just gave me?

11 A. Right. All I can say is that -- you
12 know, those are numbers that -- that's utilized by
13 the retirement system. You know, but I think --

14 Q. Is that unusual for -- for --

15 A. Most of what I've seen -- most of the
16 sort of projected equity returns that I have seen
17 that are based on risk premium and all those sorts of
18 things are kind of falling around the nine percent
19 number.

20 Q. Okay.

21 A. But, you know, I think in the utility
22 regulatory world, I still think, you know, DCF
23 analyses and the capital asset pricing model that are
24 typically employed by cost of capital witnesses is
25 still something that you can look at and use to -- to

1 develop your comfort level.

2 Q. I'm not suggesting that this is the
3 substitute.

4 A. Right.

5 Q. I'm just trying to see if this -- you
6 know, how this relates. And what would -- and what
7 numbers did we have from -- from the three witnesses
8 on cost of equity?

9 A. I know that Mr. Dunn didn't do a risk
10 premium or CAPM type analysis, so there's no sort of
11 risk premium built into that.

12 Q. All right.

13 A. Mr. Allen used the historic return of
14 the stock market as measured by the publication
15 called Stocks, Bonds, Bills, and Inflation.

16 Q. Right.

17 A. And I think that number is kind of
18 similar, sort of in the seven percent range.

19 Q. Okay.

20 A. But that's just purely a historic
21 number and it hasn't, you know, gone through any sort
22 of analysis to determine whether it's appropriate
23 going forward.

24 Q. All right.

25 A. There was a paper written by a

1 gentleman named Ivo Welch, and he's with Yale. And
2 he sent out requests to 500 leading academics and
3 college professors, and this was done in 2001, and
4 asked them what they thought the equity risk premium
5 would be going forward. So, in other words, the risk
6 premium over treasuries. And this was done in 2001.
7 And that number was between 5 and 5.5 percent.

8 Q. That's over the amount of the
9 treasury?

10 A. Yes. Yes.

11 Q. Okay.

12 A. So you could take what's the current
13 10-year treasury of 4.7 and add that 5.25 to it, and
14 that would sort of be the estimation for that
15 long-term expected return for equities in general.

16 Q. Okay. And what number would that
17 compare to then on -- on our numbers that we have, be
18 talking about? Is that comparable to the return on
19 equity number?

20 A. That would be -- that would be, if I
21 did my calculation right, ten percent for the market
22 as a whole.

23 Q. Now, would it be -- were you talking
24 about -- purely about utilities there or about all
25 investments?

1 A. That would be for the stock market as
2 a whole, the entire stock market.

3 Q. Would that be a case that, as I think
4 you said earlier, that the return expected on -- on
5 utilities would tend to be less?

6 A. Yeah, and a good way to measure that
7 is to look at the beta coefficient which is part of
8 the capital asset pricing model.

9 Q. Okay. How much discount would that
10 give?

11 A. Well, I think a typical natural gas
12 distribution utility would have a beta of, let's say,
13 .8. And I'm trying to be a little conservative. I
14 think it might be lower.

15 Southern Union has a beta of .9 as
16 measured by Value Line in one of their most recent
17 publications. But I think typical gas distribution
18 utility, again, to overstate it, if anything, I think
19 would be about .8.

20 Q. All right.

21 A. Which would suggest an eight percent
22 return.

23 Q. Yeah. And just so I'm not confusing
24 myself here, which is easy for me, that's the number
25 that we're looking at would be somewhat of a

1 comparable to the return on equity? Correct or not
2 correct?

3 A. I want to make sure I understood you.

4 Q. I'm not sure if I'm asking it
5 correctly, so go ahead.

6 A. I think that kind of using that type
7 of risk premium analysis and seeing numbers in the
8 high single digits, it certainly lends a lot of
9 confirmation to the fact that the DCF analyses are
10 kind of coming in in the low nines area.

11 Q. Yeah, so it's giving more confidence
12 to those figures, perhaps?

13 A. I think it should be viewed as giving
14 more confidence, absolutely.

15 Q. Okay. Now, you mentioned these
16 changes that you might have done differently with
17 Witness Allen's --

18 A. Right.

19 Q. -- and you have not run those numbers
20 with the changes that you might have done --

21 A. I have not. And the thing about the
22 ISRS, that's easy, you just don't make any
23 adjustment, you just stick with the numbers that Mr.
24 Allen had.

25 Q. Okay.

1 A. Because he didn't make a downward
2 adjustment for that. He just hypothesized it at the
3 Commission, adopted it.

4 Q. Oh, I see. So it was a suggestion for
5 --

6 A. Yeah, it's just -- it's not embedded
7 in his analysis in any way.

8 Q. Okay.

9 A. I have not done an analysis to see
10 what the exclusion of Laclede did, but you know, it's
11 just one company and I don't think it would make a
12 material impact on the results of his analysis as to
13 whether or not it was in or out.

14 Q. Okay. Was there any other suggestion
15 on changes to his computations?

16 A. I feel like we're forgetting one, but
17 --

18 Q. I do, too, but I didn't write them
19 down at the time that Commissioner Clayton was going
20 through --

21 A. Oh, it was related to the capital
22 asset pricing model.

23 Q. Okay.

24 A. And I said that I -- there's probably
25 two things if I was doing the analysis I'd do

1 differently. He used the three-month T bill instead
2 of the 10-year treasury rate. So that three-month T
3 bill is lower than the 10-treasury rate, so that
4 would tend to make his cost of equity determination
5 using the CAPM lower.

6 But he used the historic risk premium,
7 which is -- that's shown in the Ibbotson study that
8 just represents stock returns from 1926 to the
9 present. And I said I would probably use a more
10 forward looking risk premium method. All else the
11 same, that would tend then to make my application of
12 the CAPM result in something lower than what he
13 found.

14 Q. So yours would come down to even lower
15 than -- than Witness Allen's?

16 A. I would go with something like the
17 five percent or 5.25 percent indicated in the Welch
18 study from Yale, and apply that to the current
19 10-year treasury, which was the -- which was the ten
20 percent.

21 Q. If -- how difficult would it be to run
22 that calculation?

23 A. In a -- in a pure CAPM format?

24 Q. To make the changes that you
25 suggested.

1 A. Okay, let me see if I can do that.

2 Q. I'm not trying to force you to do it
3 while you're on the stand, I'm just wondering whether
4 you might be able to do it if we gave you some time.

5 A. If you're willing to just bear with
6 me, I think I could -- for a minute or two, I think I
7 could do that.

8 Q. I'm fine.

9 JUDGE WOODRUFF: Actually, we're about
10 due for a break. Let's go ahead and take about a
11 ten-minute break. We'll come back at 20 minutes
12 after 11.

13 THE WITNESS: Thank you.

14 (A recess was taken at this time.)

15 JUDGE WOODRUFF: Let's come to --
16 we're back live on the internet again. And when we
17 left off, Commissioner Gaw was questioning the
18 witness. And you can go ahead and proceed.

19 COMMISSIONER GAW: I think, Judge, if
20 I recall correctly, Mr. Tuck was going to do some
21 calculation for us.

22 Q. (By Commissioner Gaw) And what have
23 you found, Mr. Tuck?

24 A. I completed those calculations, and,
25 again, using the capital asset pricing model, if you

1 assume that the 10-year treasury rate is the
2 appropriate risk-free rate, and if you use the
3 midpoint projected risk premium that was found in the
4 study entitled the Equity Premium Consensus Forecast
5 Revisited by Ivo Welch, which was a survey of 500
6 leading economists and financial -- finance
7 professors, that midpoint was 5.25.

8 So if you apply that to the market as
9 a whole, that's a resulting CAPM expectation for the
10 entire stock market of 9.95 percent. Because that
11 beta is 1.0 for the entire market.

12 If you look at the comparable group
13 used by Mr. Allen in this case, I made a calculation
14 of the average beta for that group of eight
15 companies, and that average beta was .74. So, again,
16 if you apply the capital asset pricing model, you use
17 the 4.7 percent 10-year treasury yield, the 5.25
18 expected risk premium, and the beta of .7, that
19 results in a cost of equity estimation of 8.6
20 percent.

21 And then if you were to look at, let's
22 say, just the beta of Southern Union, which is .9, a
23 little higher than Mr. Allen's proxy group, that
24 would result in a CAPM estimate of 9.43.

25 I also looked at the proxy group used

1 by Mr. Murray in this case.

2 Q. Yes?

3 A. And the companies are a little bit
4 different. And he shows on schedule 19 of his direct
5 testimony that the average beta calculated by Value
6 Line for his comparable group is .68. And if you
7 take that .68 beta and, again, apply it to the 5.25
8 percent projected risk premium and the 4.7 percent
9 10-year treasury yield, that results in a cost of
10 equity estimation of 8.27.

11 Now, Witness Dunn has a comparable
12 group of 15 companies, and I did not locate beta
13 information for that group. I would suspect it's
14 probably, you know, somewhere between the .68 of Mr.
15 Murray's and the .9 of Southern Union's. I'm sure
16 the average for his group would fall somewhere in
17 that range, but I don't have that information.

18 Q. Okay. Are those calculations
19 something that you -- that you have done just on
20 scratch paper or --

21 A. Yeah, it is actually just something
22 that I have done on scratch paper.

23 Q. Okay. Is it --

24 MR. MICHEEL: Commissioner, we'd be
25 happy to prepare an exhibit, if that is what you wish

1 --

2 COMMISSIONER GAW: That's what I'm
3 looking for.

4 MR. MICHEEL: -- to memorialize those.
5 We can do that on the lunch hour.

6 COMMISSIONER GAW: That would be
7 great, Judge, if it's satisfactory.

8 JUDGE WOODRUFF: That would be fine.
9 We'll let the parties take a look at it before we
10 receive it as evidence.

11 MR. HERSCHMANN: Can I just address
12 that point?

13 JUDGE WOODRUFF: Sure.

14 MR. HERSCHMANN: The witness was
15 deposed two days ago. He did not do any CAPM
16 analysis at the time as prepared in his regular
17 testimony and did not ever discuss his methodologies
18 for using it. And we have not had the chance at all
19 to inquire.

20 I think what his testimony had been
21 previously earlier today was he didn't do CAPM's on
22 most occasions and did a different analysis. So I
23 don't know what methodologies he has or has not used,
24 to whether he has ever done that in the past for
25 liability or any of that information.

1 JUDGE WOODRUFF: Just give you an
2 opportunity to inquire about that one.

3 MR. MICHEEL: I'd like to respond to
4 that.

5 JUDGE WOODRUFF: I think we'd have to.

6 MR. HERSCHMANN: I'm not prepared to
7 respond to it today since he obviously hasn't laid
8 that out. So I think that we'd have to wait to a
9 certain point, see what he submits, and that if need
10 be, have us follow-up on question -- a deposition or
11 something.

12 JUDGE WOODRUFF: Yes, Mr. Micheel.

13 MR. MICHEEL: Your Honor, they had
14 every opportunity to ask him any question that they
15 wanted in his deposition, and they didn't ask him
16 these questions, number one.

17 Number two, we have a special setting
18 for this witness, and what Mr. Herschmann is
19 suggesting is that, you know, we're going to bring
20 him back here. And as I have indicated to you, Your
21 Honor, this witness is unavailable next week due to
22 professional commitments and other personal
23 commitments. And I don't know how long, you know,
24 this is going to drag out.

25 He did a calculation in response to

1 Commissioner Gaw. This -- Mr. Herschmann is going to
2 get every opportunity to do recross based on that.
3 If he wants to ask him what method he utilized to
4 calculate it, he can do that and Mr. Tuck will tell
5 him. But I don't see any need to drag these
6 proceedings out any further.

7 This isn't any more unfair surprise
8 than any other time a witness is asked a question and
9 gives an answer. I mean, that's what happens when
10 you try cases. And I can't help the fact that they
11 chose not to ask him these questions in their
12 depositions. I don't drive that bus.

13 MR. HERSCHMANN: Could I address that?

14 JUDGE WOODRUFF: Sure.

15 MR. HERSCHMANN: And I think it will
16 be right on point. This witness testified two days
17 ago that in every case except one he did a CAPM
18 analysis. The errata sheet today corrects that to
19 say that he didn't do it. And I don't want to debate
20 the point to a quantity, but the point is this, this
21 witness came in a surrebuttal to address criticisms
22 of Mr. Dunn, okay?

23 The thing that we asked Mr. Allen to
24 do yesterday was a methodology that he had previously
25 done, just asked him to use his companies versus Mr.

1 Dunn's companies. Now we have a witness on the stand
2 who hasn't been working with the OPC, you know, for
3 almost ten years now and is asked to do a
4 calculation, and I don't know the methodology.

5 It may be perfectly acceptable, it may
6 not be, but I think I'm entitled like in any other
7 circumstance to take discovery. It may not be
8 something that we ever need to raise before the
9 Commission. It won't delay the proceedings because
10 we won't do it on a date -- or while the hearing is
11 ongoing, you know, at the same time.

12 I think that addresses the point.

13 MR. MICHEEL: I think my objection is
14 still valid, Your Honor. He has every opportunity to
15 recross-examine this witness right now, ask him the
16 methodologies he used. He asked him extensively in
17 his cross-examinations what methodologies did Mr.
18 Tuck feel were appropriate to utilize in conducting a
19 capital asset pricing, you know, methodology.

20 With respect to what happened in his
21 deposition two days ago, Mr. Tuck got that deposition
22 last night, quickly reviewed it, noted that he had
23 misspoken, because people make mistakes, and first
24 thing this morning when I walked into the hearing
25 room I provided Mr. Herschmann with the errata sheet.

1 I got the errata sheet this morning
2 from Mr. Tuck when he came to my office to prepare to
3 testify at 8:30. So I think it's totally
4 inappropriate, I would object. He can ask every
5 question he wants of this witness on recross.

6 JUDGE WOODRUFF: All right. At the
7 moment we're kind of talking about a hypothetical
8 situation here. And it's my understanding because
9 Public Counsel -- this all started when Public
10 Counsel indicated they would prepare an exhibit,
11 which nobody has seen yet because it hasn't been
12 prepared, obviously. And that will be coming in this
13 afternoon.

14 So if there's objections to that
15 exhibit at that time, we'll deal with them at that
16 time. And I don't expect we'll be finished with
17 recross before lunchtime anyway. So while I'll defer
18 -- once again, I'll defer making a ruling on that
19 until a more appropriate time. All right.

20 So we're still questioning from
21 Commissioner Gaw.

22 COMMISSIONER GAW: Judge, that's all
23 the questions I have. Thank you.

24 THE WITNESS: Thanks.

25 JUDGE WOODRUFF: I had a couple

1 questions that have come up.

2 BY JUDGE WOODRUFF:

3 Q. You talked about how MGE's
4 consolidated capital structure might be appropriate
5 to use in this case because of management decisions
6 that the Company used in -- to invest in PEPL and in
7 the companies in New England and Pennsylvania caused
8 them to have a lot of debt.

9 A. Right.

10 Q. Or more debt than most companies. And
11 I want to relate that to your testimony in that
12 previous case of the St. Joseph Light & Power case.
13 Didn't St. Joseph Light & Power have a high equity
14 ratio because of management decisions?

15 A. Yes, it was sort of the opposite of
16 this case, because St. Joe Light & Power had an
17 equity ratio that was far out of line compared to
18 other comparable companies. And it was for that
19 reason that I felt that it was potentially
20 inappropriate to use that capital structure.

21 And I looked at those comparable
22 companies and determined what I had deemed that range
23 of reasonableness in that case. And then I bumped
24 that capital structure of the Company, actual capital
25 structure down to the high end of that range.

1 Q. Similar to what Mr. Allen did with the
2 low end on this case?

3 A. And then bump -- yeah, bumping it from
4 the consolidated to the low end.

5 Q. Okay. My question is really, does it
6 matter why the Company got into that position where
7 they're not lighter or just simply it's more fair to
8 bring them into the range of reasonableness or zone
9 of reasonableness?

10 A. Right. I think it's worth
11 consideration on the part of the Commission in terms
12 of the situation that -- that resulted in that. But
13 I think there's very sound fundamental logic for
14 moving it up to that low end of the zone and in
15 making a determination based on that.

16 But it certainly is worth
17 consideration that the actual market-derived,
18 market-tested capital structure of Southern Union is
19 that consolidated capital structure and that has 28
20 percent equity, and the Company exists with that
21 capital structure and it exists with a bond rating
22 that's generally considered investment grade.

23 And its position is not because it was
24 required to issue debt to, you know, fund existing
25 additional necessary investment in Missouri, it was

1 -- it was a more opportunistic acquisition oriented
2 decision.

3 Q. And St. Joseph Light & Power's equity
4 ratio was market tested at that time as well and it
5 had a high bond rating as well, I believe?

6 A. Correct.

7 Q. Okay. During Mr. Allen's
8 cross-examination yesterday, he indicated that he had
9 done a couple -- I believe he said three CAPM
10 analysis.

11 A. Right.

12 Q. Similar to what you just did for
13 Chairman Gaw. And he said that he -- one of them
14 came up to be within the midpoint of what his DCF
15 analysis --

16 A. Right.

17 Q. -- showed. And then he did two others
18 which showed significantly higher results --

19 A. I actually --

20 Q. -- which you didn't use.

21 A. I have that page in front of me right
22 now.

23 Q. Okay. My question is, was that
24 appropriate for him to not utilize those other
25 CAPM's?

1 A. Well, I think his three CAPM's, the
2 reason they're different is because in one, he uses
3 the three-month T bill as the risk-free rate. And
4 then in another, he uses the 10-year -- the yield on
5 the 10-year treasury as the risk-free rate. And then
6 in the final one, he uses the yield on the 30-year
7 treasury as the risk-free rate.

8 And there's pluses and minuses
9 associated. You know, the true risk-free rate sort
10 of exists in such a way that you have to find a proxy
11 for what it really is. And all three of these can be
12 considered proxies for that, but they all three have
13 disadvantages associated with them.

14 The three-month yield has a positive
15 of the fact that it's short-term and so it's not
16 exposed to changes in interest rates or things like
17 that, so it's a good measure in that regard.

18 But it's heavily influenced by what
19 current fed policy is, and it sort of makes it sort
20 of unstable. And one has to figure conceptually the
21 risk-free rate required by investors would probably
22 have a greater level of stability to it.

23 The 10-year and 30-year treasury
24 bonds, the yield on those can overstate the risk-free
25 rate because there's a component of that yield that

1 is a return that investors require because they know
2 that future inflation may turn out to be different
3 than what they expect. And so for that reason,
4 they're not the perfect surrogate either.

5 So what Mr. Allen did is he provided
6 the results of all three, I think to be fair and
7 reasonable. And of course, he used a different risk
8 premium than what I calculated just a moment ago.

9 Q. That was going to be my next question.
10 That yours was a forced result?

11 A. Yeah. Well, mine was based on the
12 forward looking estimate of what the risk premium is.
13 And what Mr. Allen used was the historic risk premium
14 as indicated by the Stocks, Bonds, Bills, and
15 Inflation by Roger Ibbotson.

16 But the three results on schedule TA9
17 of Mr. Allen's direct testimony is 9.17 with the
18 three-month T bond, 10.05 percent with the 10-year
19 treasury, and 10.27 percent with the 30-year
20 treasury.

21 I think Mr. Allen stated that he
22 thought the 9.17 was more reasonable because he
23 thought -- he believes that the three-year -- in his
24 mind, I think, after his assessment of issues related
25 to that, believes that the three-month T bill is the

1 more appropriate surrogate for the -- for the
2 risk-free rate.

3 And as I had stated earlier, if I was
4 providing direct testimony in this case and I did a
5 CAPM analysis, I would have most likely used 10-year
6 -- I would have used the 10-year treasury rate.

7 Q. Now, you talked about the beta for
8 Southern Union was, I believe you said, .9, and the
9 beta for other natural gas distribution companies was
10 somewhat lower than that.

11 A. Right.

12 Q. And I wanted to know what is the
13 relevant comparison here. Should we be comparing
14 Southern Union to the market as a whole or comparing
15 them to other gas utilities?

16 A. I think, you know, in what's been done
17 in this case is to compare Southern Union to -- to
18 gas distribution utilities. And the three witnesses
19 that filed direct testimony all made their own
20 determination of a comparable group, and they're a
21 little bit different in each case. But they all are
22 -- consist primarily of natural -- of natural gas
23 distribution utilities.

24 Q. So the upshot of that is that Southern
25 Union is somewhat more risky than other natural gas

1 distribution utilities?

2 A. Well, I think there's a couple things
3 you can look at. You know, there's financial risk
4 and there's business risk. And I think Mr. Dunn
5 talks about those in his testimony. And if you
6 isolate that financial risk and measure that as the
7 difference in the capital structures of the different
8 companies, because Southern Union has less equity and
9 more debt, on that measure of financial risk, it's
10 riskier than most of the other companies that it has
11 been compared to.

12 As far as the business risks built
13 into the operations of these MGE properties and the
14 comparable group, you know, as I had said earlier, I
15 don't think any witness has -- some witnesses have
16 brought up differences here or differences there in
17 the risk profiles of the companies, but I think it's
18 almost impossible for anyone to truly do a complete
19 and thorough final risk by risk assessment of all the
20 companies.

21 And that's where I think that drawing
22 the conclusion that if the comparable group or proxy
23 group has been -- been reasonably determined, that
24 it's fairly reasonable to assume that comparable
25 companies are indeed comparable.

1 Now, looking at the beta, which is a
2 concept that's implied in modern portfolio theory,
3 capital asset pricing model theory, the beta for
4 Southern Union is .9 versus the average for Mr.
5 Allen's comparable group of .74. The average of Mr.
6 Murray's comparable group of .68.

7 And in that realm of thought, that
8 higher beta would imply a higher level of systematic
9 risk, which is the risk under capless's pricing
10 theory that matters to investors.

11 JUDGE WOODRUFF: That's all the
12 questions I have. We'll go ahead and get started on
13 recross, then, beginning first with Staff.

14 RE CROSS-EXAMINATION BY MR. BERLIN:

15 Q. Good morning, Mr. Tuck.

16 A. Good morning.

17 Q. Mr. Tuck, is it reasonable for experts
18 in this field to disagree on methodologies?

19 A. Yes, I believe it is absolutely
20 expected because, you know, there is some science to
21 this, but there's a lot of art, too. And that
22 subjectivity, I think, is what leads to different
23 views as far as how models could be applied.

24 Q. Ultimately, would you agree that the
25 end results determine reasonableness?

1 A. I think that is true, yes.

2 Q. Earlier you had questions from a Mr.
3 Herschmann and Commissioner Clayton on the concept of
4 zone of reasonableness. Do you recall those
5 questions?

6 A. Yes.

7 Q. Does the concept of zone of
8 reasonableness also apply to a recommended return on
9 equity?

10 A. Well, again, you know, the zone of
11 reasonableness that's referred to in Mr. Allen's
12 testimony is a measure of kind of what --
13 incorporates what most utilities do in terms of the
14 way of their capital structure.

15 And I still believe that a
16 market-derived cost of equity estimation using
17 something like -- using the DCF model is -- is the
18 appropriate way to determine a cost of equity. But
19 it's reasonable, I think, to make comparisons and to
20 try to confirm that using other methods as well.

21 Q. Mr. Tuck, why would management of a
22 company, and I'll refer to the broader spectrum of
23 companies that you look at in your current position,
24 why would management choose to not pay a dividend?

25 A. It can be dependent upon a number of

1 factors, but the selection to not pay a dividend can
2 still be for the benefit of shareholders, because
3 those funds, those earnings that aren't paid out in
4 dividends, are then available for reinvestment in
5 that company.

6 And if the Company believes that it
7 has ample investment opportunities that will provide
8 a return above the Company's cost of capital, then it
9 is still a wealth accumulation decision to not pay a
10 dividend and it will still directly relate to the
11 benefit of shareholders if the Company makes wise
12 decisions.

13 Q. So a company might elect to hold on to
14 their funds to pursue other strategies; is that
15 correct?

16 A. Yes. That's correct, yes.

17 Q. Might a strategy that a company might
18 be employing be one of acquisition?

19 A. Absolutely.

20 MR. BERLIN: No further questions.

21 JUDGE WOODRUFF: Kansas City and
22 Joplin are not here. Federal agencies?

23 MR. PAULSON: No, sir.

24 JUDGE WOODRUFF: Jackson County and
25 Midwest Gas? They're not here.

1 MGE for recross, I'll give you the
2 option, do you want to wait until after lunch to
3 start or do you want to go for ten minute or so?

4 MR. HERSCHMANN: Why don't I start.

5 JUDGE WOODRUFF: All right. Go ahead.

6 MR. HERSCHMANN: Thank you.

7 RECROSS-EXAMINATION BY MR. HERSCHMANN:

8 Q. Mr. Tuck, I'm going to follow-up on
9 some questions by Commissioner Clayton and Mr.
10 Berlin. You said that Southern Union doesn't pay a
11 dividend. Do you recall that testimony?

12 A. Yes.

13 Q. Is that accurate, sir?

14 A. They do not -- they issue a stock
15 dividend, they do not pay a cash dividend.

16 Q. And by not paying a cash dividend,
17 they have retained earnings, right?

18 A. Southern Union has retained earnings,
19 yes.

20 Q. And if you maintain your earnings,
21 does that help your leverage situation?

22 A. Yes.

23 Q. And how does it help your leverage
24 situation?

25 A. It increases the book value of the

1 equity of the Company.

2 Q. And if companies are paying out cash
3 dividends or, in other words, if Southern Union had
4 been paying out a cash dividend, do you think it
5 would hurt its leverage situation?

6 A. It would -- it would not be able to
7 accrue retained earnings at the same rate if it was
8 paying out a portion of that as a cash dividend.

9 Q. You said paying out -- I'm sorry.
10 Having the retained earnings may benefit the
11 shareholders. Do you remember that?

12 A. Yes.

13 Q. And it may also benefit the rate
14 payers, right, because the money is available to
15 reinvest in the current existing properties that are
16 owned; right?

17 A. That's correct.

18 Q. So it may very well be something that
19 helps the rate payers of Missouri; right?

20 A. That is correct, yes.

21 Q. Now, when you talk about a forward
22 looking forecast, look what investors are going to
23 look towards in the future, do you know if Southern
24 Union has any current equity units outstanding?

25 A. If you are referring to the securities

1 that it issued in 2003, I believe those are referred
2 to as equity units, yes.

3 Q. And what happened -- well, how do you
4 categorize those equity units as of today, debt or
5 equity?

6 A. I believe -- I think there's -- you
7 know, different people might have different opinions,
8 but Mr. Allen, I believe, included those in his debt
9 calculation.

10 Q. What happens to those equity units in
11 2006?

12 A. At that time it's my understanding
13 that the holders of that have the option to -- to
14 convert to equity, and at that time, then, it would
15 -- it would be equity for Southern Union.

16 Q. If it turns out that it's a mandatory
17 conversion, then would you agree that those units go
18 from the debt side of the balance sheet to the equity
19 side, if it's a mandatory conversion?

20 A. Right, yeah.

21 Q. So if you knew sitting here today, if
22 there was a portion of equity units that are
23 categorized as debt, but you know within -- by 2006,
24 they're going to be automatically converted to
25 equity, would you expect that to help Southern

1 Union's balance sheet?

2 A. Yes, I would.

3 Q. If you knew sitting here today that
4 Southern Union was going to have a stock offering,
5 would that help Southern Union's balance sheet?

6 A. That would, again, put more equity on
7 the books of Southern Union, so that would tend to
8 lower the debt ratio, yes.

9 Q. So would you agree with me that --
10 presume for a moment Southern Union maintains that it
11 doesn't pay a cash dividend.

12 A. Mm-hmm.

13 Q. Southern Union's equity units are
14 going to convert to common stock and they're going to
15 issue a stock offering, would you expect Southern
16 Union's future capital structure, all things being
17 held equal right now, to get better or worse over
18 time?

19 A. With the emphasis on the caveat all
20 things else being held equal, it would be better, it
21 would seem to be better, yes.

22 Q. Now, in response to certain questions
23 by, I believe it was Commissioner Gaw or Commissioner
24 Clayton, I apologize because I don't remember, that
25 as a general financial theory, you believe that more

1 risky companies, meaning more highly leveraged
2 companies, normally shareholders expect a greater
3 return; is that correct?

4 A. Let me answer that and see if it's
5 agreeable with what -- if you'll accept that.

6 All else being held the same,
7 financial theory would indicate that more equity in a
8 capital structure as opposed to less would be
9 indicative of a higher level of financial risk.

10 Q. And according to the comparable group
11 that Mr. Allen used in their capital structure
12 compared to Southern Union's consolidated capital
13 structure, all things being held equal, what would
14 shareholders or investors expect as a return between
15 the two groups?

16 A. They would see a higher, all else
17 being held equal, they would see a higher level of
18 financial risk in the capital structure, the
19 consolidated capital structure of Southern Union
20 which would indicate a higher required rate of
21 return.

22 Q. And you mentioned a couple times
23 Panhandle -- the Panhandle acquisition. Do you
24 recall that testimony?

25 A. I mentioned it today, yes, I recall

1 that.

2 Q. And have you read the stipulation and
3 agreement that was signed by OPC and the Staff and
4 Southern Union and then approved by the Commission?

5 A. Yes.

6 Q. And does that agreement insulate the
7 MGE -- or withdrawn.

8 Do you understand that the agreement
9 was designed to insulate the MGE rate payers from any
10 adverse consequences of the Panhandle acquisition?

11 A. That was -- yes, I agreed with that.

12 Q. And do you understand that both the
13 OPC and the Staff witnesses have testified that
14 there's not even a claim that there's been a
15 violation of that provision, other than potentially a
16 question of flotation costs?

17 A. Right.

18 Q. Do you understand that?

19 A. I wasn't here for the testimony, so I
20 -- I don't know that there were statements made
21 during this hearing. But I certainly know in their
22 written testimony, there was no claim that Southern
23 Union had violated the stipulation. And again, with
24 maybe the issue of flotation costs.

25 Q. So if the rate payers of Missouri are

1 looking to be insulated from any adverse consequences
2 of Panhandle, wouldn't it be appropriate, then, to
3 try to take Panhandle out of the picture? Wasn't
4 that the whole idea of the word insulate?

5 A. But the issue is for rate payers --
6 you can't take it out of the picture in -- in terms
7 of what really happens to the Company.

8 Q. Let me ask you a question: Talking
9 about a hypothetical capital structure, right?

10 A. Okay.

11 Q. Okay. If you were able to take the
12 Panhandle acquisition, hypothetically, out of the
13 process and say, you know what, they're going to be
14 insulated on both sides, they're not going to get any
15 risk and they're not going to get any benefit because
16 the debt that was issued has nothing to do with
17 Missouri, okay?

18 Wouldn't that be the appropriate
19 process? Wouldn't fairness dictate that you try to
20 address Missouri based on Missouri rate payers and
21 Missouri capital structure?

22 A. There's only one market-tested capital
23 structure for Southern Union, and that's the
24 consolidated capital structure of the Company.

25 Q. Was there a -- only one market for the

1 St. Joe Power & Light case?

2 A. Yes.

3 Q. But you didn't go with that one
4 market, then, right?

5 A. Right.

6 Q. You thought that would be
7 inappropriate to go with the one market because it
8 was outside the zone of reasonableness; right?

9 A. Right.

10 Q. Including Panhandle, after there's an
11 insulation and using the consolidated structure, even
12 by your own admission, Southern Union's consolidated
13 capital structure is outside the zone of
14 reasonableness for the comp group; right?

15 A. That's right.

16 Q. And under that theory, your own sworn
17 testimony previously, doesn't that tell you that now
18 is the time to be using a hypothetical capital
19 structure? Isn't that what you swore to previously?

20 A. Yeah, yeah, I think it's -- a
21 reasonable result can absolutely be achieved through
22 the use of a hypothetical capital structure.

23 Q. Now let me ask you this: You're a,
24 for lack of a better term, a portfolio manager for
25 the teachers' fund?

1 A. Let's make sure that -- that we
2 clarify this a little bit. I do not make individual
3 stock selection decisions for the retirement system.
4 We -- we don't have the resources to do the type of
5 research that would be necessary to make individual
6 stock selection decisions.

7 We manage a pool of assets, and at the
8 very highest level managing that pool of assets
9 involves making asset allocation decisions. At the
10 equity level, it involves designing a strategy and
11 structure to invest those assets.

12 But when it comes to making individual
13 stock selection decisions, we go out and we closely
14 examine investment professionals, investment
15 management firms, and the types of strategies that
16 they offer. And then we enter into arrangements to
17 employ the ones that we like that we think are most
18 qualified to then make those types of actively
19 managed portfolio decisions.

20 Q. Is it safe to say that the \$26 billion
21 that you oversee is in -- is a diversified
22 investment?

23 A. Absolutely.

24 Q. Because you want to balance against
25 all potential risks that are out there in the entire

1 marketplace, right?

2 A. Absolutely, yes.

3 Q. And you're not saying that the funds
4 that you oversee are in any way a comparable company
5 or comparable risk to MGE; right?

6 A. The aggregate investments of the
7 retirement system are not comparable in risk to any
8 one single company, no.

9 Q. They're not even comparable in risk to
10 the utilities, right, because you have diversified
11 investments, some utilities, a whole bunch of other
12 things, right?

13 A. Correct.

14 Q. And you wouldn't do a DCF analysis
15 saying let me take my pension fund overseeing 26
16 billion and put it up against MGE and say, well, what
17 am I expecting globally compared to what MGE's
18 investors would expect; right?

19 A. To -- for what purpose?

20 Q. If you were going to do a comparable
21 group, would you take your entire diversified
22 portfolio up to 26 billion and say I'm going to use
23 this as a comparison to MGE?

24 A. If I was going to make a comparison of
25 our portfolio, I would compare it to other large

1 diversified pools of assets.

2 Q. That's not MGE; right?

3 A. That's correct.

4 Q. And the expectations that teachers may
5 have in the retirement funds may be completely
6 different than what investors in natural gas
7 utilities companies would consider; right?

8 A. That's correct.

9 Q. So the most important issue to
10 consider is not what the general market may do, not
11 what management funds may consider doing, but to find
12 comparable companies with comparable risks, and I
13 think you read from Bluefield, because that's the
14 group you should be looking at; right?

15 A. For determining the cost of equity in
16 this proceeding, I think that's the best thing to do,
17 yes.

18 Q. And you're not aware of any expert or
19 any textbooks that say you should go and look at the
20 general marketplace or go look at pension funds or
21 management funds and compare those to regulated
22 utilities in determining either return on equity or a
23 fair rate of return; right?

24 A. Well, where the general market, which
25 is one thing that you just mentioned, comes into play

1 is the return expectation, the risk premium that goes
2 into a CAPM analysis.

3 Q. And I apologize for that. I mean, I'm
4 talking about specifically. I agree you have to look
5 at the market generally. But you wouldn't sit there
6 and say, let's take Fidelity Investments and take,
7 you know, the Janus Fund and say let's use the Janus
8 Fund and what their history is and their comparable
9 or expectations are and compare it to MGE; right?

10 A. That's right.

11 Q. And you wouldn't do that with the
12 funds that you oversee, and -- is that correct? You
13 have to answer.

14 A. Correct.

15 Q. And you wouldn't do it generally
16 saying, well, let me just guess what the market looks
17 like in the future and I'm now going to apply it to
18 MGE in this proceeding; right?

19 A. Well, again, the --

20 Q. Besides the general --

21 A. -- CAPM --

22 Q. Besides the general CAPM. I'm talking
23 about specifically, you wouldn't say let me look at
24 the market, the market has, let's say, a three
25 percent growth this year, and therefore, not looking

1 at anything else, I'm going to say MGE should have a
2 three percent growth; right?

3 A. I think the very best way to determine
4 what's a reasonable rate of return is to use a
5 market-derived method, like the DCF, on the company
6 in question if they pay a dividend and you can use
7 that, or a group of comparable companies if that
8 specific company does not pay a dividend. And then
9 to check that using other reasonable methods.

10 Q. Have you ever heard of RRA?

11 A. I am only familiar with it because it
12 was referenced in some Company testimony.

13 Q. And did you have occasion to go on the
14 internet and look at Regulatory Research Associates?

15 A. No.

16 Q. And when you talk about comparable
17 companies and comparable risks, let me just ask you
18 this question: If Company A had an ROE of 12
19 percent, and Company B had an ROE of nine percent,
20 all things being held equal, which company would you
21 seek to invest in?

22 A. Now, is this an earned return on
23 equity that you're talking about? Or is this an
24 authorized return on equity?

25 Q. Let's start with an authorized return

1 on equity, which would you prefer to invest in, all
2 things being equal?

3 A. Well, it would be impossible to make
4 any sort of conclusion just based on one data point.
5 But I guess if every other single thing about the
6 company was the same, and if you believe that that
7 authorized return on equity was going to represent
8 what that company might actually earn on its equity
9 investment going forward, it would seem to be
10 reasonable. All else, every other complete detail
11 held the same to focus on the one that had the higher
12 authorized return on equity.

13 Q. Now, for an authorized return on
14 equity, do you think investors would want to look
15 carefully at, let's say, two comparable companies and
16 say, wow, that company has an authorized return on
17 equity of three percent higher than the other one,
18 was that something I should at least consider?

19 A. That's something that they would look
20 at, but the overriding thing that you have to look at
21 in conjunction with it is what's the stock price.
22 Because the stock price moderates and equalizes all
23 of these factors.

24 So if you look at the stock price, the
25 dividend that's being paid, the dividend yield, and

1 those types of expectations, that's what is key and
2 absolutely necessary to look at. You can't just look
3 at one thing in a vacuum.

4 Q. Well, can you try to give me --
5 assuming the stock prices are exactly the same, okay?
6 They have been historically exactly the same, and
7 you've had two authorized rates of return, one at 12
8 percent and one at nine percent, which do you believe
9 would at least be more attractive under that
10 scenario?

11 A. Again, the stock prices could be the
12 same, but the dividends could be different, and so
13 the dividend yields would be different.

14 Q. Okay. When you were talking about
15 expected stock returns or yields on stocks, were you
16 talking about including dividends in them or
17 excluding them?

18 A. Dividend yields on stocks?

19 Q. Well, you just mentioned beforehand
20 that the returns expected for stocks generally, I
21 think you said were about nine percent.

22 A. Right, that is -- that includes
23 dividends and growth, future growth.

24 Q. And how do you know which companies
25 are going to pay dividends?

1 A. There's companies that do pay
2 dividends, companies that don't currently pay
3 dividends, and companies that don't pay dividends and
4 may pay them in the future, companies that pay
5 dividends currently and may not pay them in the
6 future.

7 Q. Are you saying that the authorized
8 rate of return of comparable companies with
9 comparable risk is not something that investors are
10 ever going to care about?

11 A. No. I -- I think that when investors
12 do a full analysis of a company, they would look at
13 that in addition to other factors, yes.

14 Q. But they'd want to know what other
15 comparable companies' authorized rates of return are,
16 especially if it's a regulated industry; right?

17 A. Yes.

18 MR. HERSCHMANN: Do you want to take a
19 lunch break?

20 JUDGE WOODRUFF: Yes, we'll take a
21 break for lunch and we'll come back at one o'clock.

22 (A lunch recess was taken at this
23 time.)

24 JUDGE WOODRUFF: All right, we're back
25 live on the internet. And we're back from lunch.

1 Before we went to lunch, there was a
2 -- the witness indicated that he was going to be
3 preparing an exhibit that is now before me that has
4 been marked as No. 219 as a Public Counsel exhibit.

5 Mr. Micheel, do you want to explain
6 what this is?

7 MR. MICHEEL: Commissioner Gaw asked
8 that Mr. Tuck prepare an exhibit of the calculations
9 that he did in response to a question from
10 Commissioner Gaw. And pursuant to Commissioner Gaw's
11 request, we have prepared that exhibit.

12 JUDGE WOODRUFF: All right. Do you
13 wish to offer it at this time?

14 MR. MICHEEL: At the request of
15 Chairman Gaw, we offer Exhibit 219.

16 JUDGE WOODRUFF: 219 has been offered
17 into evidence. Are there any objections?

18 MR. HERSCHMANN: Yes. I'm sorry. Did
19 Staff have an objection?

20 MR. BERLIN: Staff has no objection,
21 Your Honor.

22 MR. HERSCHMANN: MGE objects. As I
23 stated previously, I don't know what the
24 qualifications would be for this witness. We haven't
25 had a chance to review it or determine the source of

1 the information or to verify any of it.

2 More importantly, there is at least a
3 conflict of the witness' testimony on the use of this
4 methodology between his deposition and his errata
5 sheet that we got this morning in a way that I would
6 ask that you withhold ruling on the admissibility of
7 the exhibit until such time as we can review it, and
8 if necessary, potentially depose the witness on the
9 limited factors of this.

10 And then we may have a challenge as to
11 -- either pursuant to 498.065 on the qualifications
12 or we may have no challenge whatsoever if we
13 determine that the information and methodology is
14 both done correctly and he has the expertise.

15 JUDGE WOODRUFF: Well, fortunately,
16 you are in the process right now of cross-examining
17 this witness so I'm going to allow you to
18 cross-examination the witness. I'm not going to make
19 a ruling on it until after your cross-examination is
20 finished to give you an opportunity to inquire as to
21 that.

22 At that time I'll then make a ruling
23 on whether or not this would be admitted at that time
24 or if there'll be a need for further inquiry by MGE.

25 MR. HERSCHMANN: I guess what I would

1 ask for under that circumstance is that since this is
2 a new methodology that's been put forth by this
3 witness in this proceeding, if it turns out that we
4 have a challenge to that, then we'd like the
5 opportunity to subsequently file whatever motions may
6 or may not be necessary to address it.

7 MR. MICHEEL: Your Honor, if this is
8 going to cause all of this, I'm just going to
9 withdraw the exhibit. I have this witness here for
10 one day.

11 JUDGE WOODRUFF: Mr. Micheel, please
12 don't misunderstand me, I'm not asking this witness
13 to come back anytime other than today and I have not
14 made that ruling at all.

15 I'm going to get counsel for MGE to
16 cross-examine and then I'm going to make a ruling.
17 If you have a disagreement with my ruling at that
18 time, then raise the objection at that time. Thank
19 you.

20 You may proceed with your
21 cross-examination.

22 Q. (By Mr. Herschmann) Let me get
23 Exhibit 219 out of the way. With Exhibit 219, how
24 many times have you done -- let me withdraw that.

25 Between 1992 and 1995, when you were

1 employed by the OPC, how many times did you do a CAPM
2 analysis in relationship to your testimonies?

3 A. I specifically remember doing a
4 capital asset pricing model analysis in the last case
5 that I filed testimony, which was a Missouri American
6 Water Company Case Nos. WR-95-205 and SR-95-206.

7 In addition to that, I know that in
8 United Telephone Company of Missouri Case No.
9 TR-93-181, I did a complete CAPM analysis in my
10 rebuttal testimony.

11 Q. And the majority of the times that you
12 submitted testimony before this Commission, did you
13 use a CAPM or did you use another risk model?

14 A. I did not use the CAPM in the majority
15 of the testimonies that I filed.

16 Q. So would it be accurate that if you
17 filed testimony 15 times, you did it in -- you did
18 not use it in 13 out of the 15 occasions?

19 A. I only know of two times for certain
20 that I did. I could have done it in more than that
21 and I just don't know the answer. But like I said, I
22 am sure that the majority of the instances I did not.

23 Q. Now, you have a reference in Exhibit
24 219 to the Equity Premium Consensus Forecast
25 Revisited from 2001. See that?

1 A. That's correct.

2 Q. That's approximately three years ago?

3 A. Correct.

4 Q. And are there other sources that would
5 have a different market risk premium than the one you
6 cite here?

7 A. Yes.

8 Q. What are the other sources that would
9 have a different market risk premium?

10 A. I can't name any specifically, but I'm
11 sure that there has been other studies done as to
12 what the risk premium is.

13 Q. And did you ever do any checks to see
14 whether there was any follow-up studies on this 2001
15 study or any criticisms or reviews of it by anybody?

16 A. I made some check to see if there was
17 a follow-up. I did not see one. I had not made an
18 attempt to see if there were other articles that
19 criticized that piece of work.

20 Q. And when did you make the -- when did
21 you check to see whether there was a follow-up to the
22 2001?

23 A. Sometime after I had filed surrebuttal
24 testimony.

25 Q. And you told, I believe, Commissioner

1 Gaw or Chairman Gaw in response to some of his
2 questions about the changes in the market between
3 2001 and the present; is that correct?

4 A. That's correct.

5 Q. And do you think those changes at all
6 have any impact on the market risk premium?

7 A. People who are estimating the market
8 equity risk premium today would have more information
9 available to them than what was available at that
10 time. So anyone who makes an analysis of that now
11 could reach a different conclusion.

12 Q. And if the market risk premium as of
13 today versus three years ago was higher, would the
14 cost of equity estimate be higher?

15 A. Yes.

16 Q. So if today's market risk premium was,
17 for argument's sake, seven percent, then we should
18 expect a substantial increase than what would be
19 reflected on Exhibit 219 to reflect today's number;
20 is that correct?

21 A. If that was -- let's say, for example,
22 if that study was updated and it ended in the result
23 that you just mentioned, that would be a high -- that
24 would indicate a higher cost of equity, yes.

25 Q. Didn't you tell us beforehand that the

1 most important data to review is the most recent
2 information available?

3 A. That's true, but I think studies on
4 the scope of the one performed by Mr. Welch where 500
5 people were asked for their risk premium analysis is
6 not something that's done on a weekly or a monthly
7 basis.

8 Q. If the study was published in 2001,
9 what years did it cover?

10 A. It was a -- it was an average of the
11 risk premium analyses that were estimated by 500
12 leading economists and finance professors. So that
13 would have been their expectation for what the risk
14 premium was from 2001 going forward.

15 Q. It was published in 2001; right?

16 A. Yes.

17 Q. In your understanding, when somebody
18 publishes something, they have to gather the
19 information, analyze it, check it, see if it's
20 subject to peer reviews, see if it meets statistical
21 analysis, and all of that stuff before it ever gets
22 published; right?

23 A. I'm -- I don't know that that was what
24 occurred in this instance, but it would seem
25 reasonable that some of those things would have

1 occurred, yes.

2 Q. Wouldn't you want those things to
3 occur before you'd start quoting the information, to
4 find out whether or not it was checked as being
5 somewhat reliable and who were the people submitting
6 the information?

7 A. Well, I think that the piece done by
8 Mr. Welch was a reasonable piece. It was, I think --
9 I have no reason to believe that it wasn't accurately
10 -- accurately done. I -- certainly he did not in his
11 study list the people who were participants in that
12 study.

13 Q. But if it was printed in 2001, he had
14 to gather this 500 people's opinions before that;
15 right?

16 MR. MICHEEL: Your Honor, that's been
17 asked and answered. He already said yes to that.

18 JUDGE WOODRUFF: It's been asked, but
19 I don't think it's been answered, so overruled.

20 THE WITNESS: It took him sometime to
21 compile that information, yes.

22 Q. (By Mr. Herschmann) So would you
23 agree based on your experience that at least some
24 period of time prior to its publication, he had to
25 contact people, ask them their opinions, get the

1 information and collate it, get it to a printer, all
2 of that so it could finally be printed in 2001?

3 A. That's correct.

4 Q. So the information that he was relying
5 upon had to predate September 2001; right?

6 A. That's correct.

7 Q. We're sitting here now in late June of
8 2004; right?

9 A. That's correct.

10 Q. Did you make any efforts to determine
11 what is the market risk premium today on any type of
12 similar study to see whether or not your
13 recommendations have any relevance to today's future
14 looking? Or --

15 A. Well, I can tell you that we review
16 the, in my current employment, the average risk
17 premium analysis.

18 Q. I'm sorry, what I want you to do is I
19 want you to focus on not your job you're doing, I
20 want to focus on the purpose of your providing
21 testimony in this case, okay?

22 Did you make any determinations or
23 search for what today's market risk premiums would be
24 so it would be beneficial to this Commission to look
25 from June of 2004 forward than some point from

1 September of 2001, or prior to that, forward?

2 A. Right, I didn't file any written
3 testimony about what I -- the forward looking risk
4 premium analysis. And so it was in response to the
5 Commissioner's questions, and so I had not performed
6 the type of analysis that you just suggested.

7 MR. HERSCHMANN: Can I have one
8 second?

9 JUDGE WOODRUFF: Sure.

10 Q. (By Mr. Herschmann) How would you
11 define a market risk premium?

12 A. The market risk premium is the added
13 return that's necessary to compensate equity
14 investors for investing in equities instead of
15 risk-free assets such as U.S. Treasury-backed
16 securities.

17 Q. And do you believe there's a way of
18 determining what the market risk premium is, would
19 have a more relevant time period from today than 2001
20 and before?

21 A. To do a projected risk premium
22 analysis, you have to measure investors'
23 expectations, and there's, I'm sure, a number of ways
24 to do that. Certainly the -- the approach that was
25 taken by Welch is one of those. But something --

1 there may have been some research that's been
2 published since that time that addresses the equity
3 risk premium, and I just am not aware of that
4 research.

5 Q. So let me ask you this: Since we're
6 looking from today forward, isn't it really relevant
7 what the market risk premium is as of today versus
8 the way it was three-plus years ago?

9 A. It's more relevant, yes.

10 Q. And isn't that what the Commission
11 should be looking at, the most relevant information,
12 in making a decision that effects all the
13 shareholders of Southern Union and MGE and the rate
14 payers of Missouri?

15 A. It's my testimony that the most recent
16 information that can be reasonably employed in this
17 type of proceeding is the information that should be
18 given probably a higher weight.

19 Q. Do you agree that when experts such as
20 yourself would do a DCF calculation that they may
21 need to make certain adjustments in certain of the
22 numbers to come out with their opinion?

23 A. I think there has to be a logical
24 connection to the data that they review and the
25 conclusions that they reach. But I think it's

1 reasonable to expect that experts apply some judgment
2 into this process.

3 Q. Is the entire process simply to --
4 just sort of mathematical calculation?

5 A. No, it's to make a good faith estimate
6 of the return and the growth expectations that
7 investors expect and require.

8 Q. And that requires some subjective
9 determinations as to where to make adjustments in
10 numbers; right?

11 A. I think that it's reasonable for an
12 analyst to apply some judgment to the process.

13 Q. That's actually necessary, isn't it,
14 not just reasonable?

15 A. It depends. You know, sometimes the
16 data is a little more difficult to interpret than
17 other times. You know, if you take the DCF, for
18 example, if earnings and dividends and book value all
19 grow at the same rate and the payout ratio remains
20 the same, the historic numbers, the projected
21 numbers, they're all going to be very similar and
22 there's really not a lot of judgment that's required.

23 What makes the DCF more complicated is
24 that those things usually don't hold true, and that
25 they do grow at different rates or the payout ratios

1 change or the earned returns on equity change. And
2 the more those things are different, then the more
3 likely it is that the analyst will need to apply some
4 judgment to the process.

5 Q. And the judgment to the process may
6 require some adjustments; right?

7 A. I think it has to be based on the
8 information that's being reviewed. I think there has
9 to be a logical connection between the information
10 reviewed and the determination that's made. But
11 there certainly is plenty of room for professional
12 judgment in how to interpret that data.

13 Q. Had you heard of Professor Dr. Morin
14 before this proceeding?

15 A. He was mentioned, obviously, when I
16 was deposed. He filed rebuttal testimony, and I was
17 aware of -- that he was a cost of capital expert, but
18 I knew very little bit about him.

19 Q. Did you ever read his book?

20 A. No.

21 Q. Did Mr. Micheel ever discuss his book
22 with you?

23 MR. MICHEEL: I'm going to object,
24 Your Honor, it's beyond the scope of any questions
25 from the bench. I don't believe there were any

1 questions about Dr. Morin from any of the
2 Commissioners, and now we're going far afield from
3 what the questions from the bench, and that's the
4 purpose of recross.

5 MR. HERSCHMANN: I'm more than happy
6 to respond to that. This witness quoted Dr. Morin's
7 testimony in response to the Commissioner's
8 questions, which he read out of his testimony.

9 JUDGE WOODRUFF: The objection is
10 overruled. You can answer the question.

11 MR. HERSCHMANN: Can you read back the
12 question, please.

13 THE REPORTER: Did Mr. Micheel ever
14 discuss his book with you?

15 THE WITNESS: Mr. Micheel had
16 mentioned that Dr. Morin had a textbook that
17 addresses utility finance.

18 Q. (By Mr. Herschmann) Did Mr. Micheel
19 tell you that that was going to be the primary source
20 that he was going to use to cross-examine Mr. Dunn?

21 A. He had mentioned that he had looked at
22 the textbook and that he had some questions for Mr.
23 Dunn.

24 Q. Now, in Exhibit 219, you reflect a
25 different -- well, withdrawn.

1 If a beta number is higher than
2 another company's or comparable group's beta number,
3 does that mean the higher number reflects more risk
4 or less risk?

5 A. The higher number would reflect a
6 higher level of systematic risk as measured by beta.
7 A lower number would reflect a lower level of
8 systematic risk.

9 Q. Now, you spoke about reviewing Dr.
10 Morin's testimony previously, and you actually quoted
11 from a portion of Dr. Morin's testimony dealing with
12 looking at other regulatory decisions. Do you recall
13 that generally?

14 MR. MICHEEL: Your Honor, I'm going to
15 object. That's beyond the scope of the
16 cross-examination. What Mr. Tuck quoted from was
17 from Dr. Morin's deposition, not from his testimony.
18 There were absolutely no questions with respect to
19 his testimony. I believe Mr. Tuck did quote from
20 Witness Morin's deposition, a deposition answer that
21 he gave, not from his testimony. And it's beyond the
22 scope.

23 MR. HERSCHMANN: I don't think it
24 makes any difference whether he quoted from his
25 deposition testimony. He addressed it, the witness'

1 testimony, in response to a question that the
2 Commissioner Clayton specifically to limit the claim
3 that there's a circularity argument. I have the
4 absolute right to follow-up on recross and address
5 what was in the testimony and what was addressed.

6 And for Mr. Micheel, who has been
7 arguing all along that the Commission should hear
8 everything, to all of a sudden say that this witness
9 should quote from a portion of it and I shouldn't be
10 able to follow-up, I think is inappropriate.

11 JUDGE WOODRUFF: The objection is
12 overruled.

13 Q. (By Mr. Herschmann) Do you recall
14 talking about the issue of circularity if the
15 Commission would solely or strictly rely upon what
16 other commissions do?

17 A. Yeah, I quoted from Dr. Morin's
18 deposition regarding that.

19 Q. And you had occasion to read Dr.
20 Morin's rebuttal testimony; right?

21 A. I did.

22 Q. And do you have that with you?

23 A. Yes, I do.

24 Q. Is there anywhere where Dr. Morin
25 suggests that any commission should strictly rely

1 upon what other commissions do?

2 A. Not that I'm aware of, no.

3 Q. And in fact, Dr. Morin cites to what
4 other commissions are doing to determine whether or
5 not the recommended ROE lies outside -- I'm sorry,
6 lies well outside the zone of comparable authorized
7 ROE's; right?

8 A. Could you direct me to a specific
9 portion?

10 Q. Sure. You can look at page 5, line 8,
11 where Dr. Morin says, moreover, Mr. Murray's
12 recommended ROE lies well outside the zone of his own
13 comparable companies' authorized ROE's?

14 A. Yes, his testimony says that.

15 Q. And if you turn to page 6, you see
16 point one where it says, allowed returns far out of
17 the mainstream. Mr. Murray's recommended return is
18 outside the zone of currently allowed rates of return
19 for natural gas utilities in the United States and
20 for his own sample of companies.

21 The average allowed return on equity
22 for gas utilities in the years 2002 and 2003 was 11
23 percent for the average risk gas utility, and is 11.1
24 percent for the first quarter of 2004. These
25 authorized returns exceed by a significant margin Mr.

1 Murray's anemic 8.52 percent to 9.52 percent
2 recommended return for MGE, a riskier than average
3 natural gas utility. Do you see that, sir?

4 A. I do.

5 Q. And you told us that based on the
6 beta, Southern Union as a whole is considered more
7 risky than the comparable group; right?

8 A. That's correct.

9 Q. And you told us also that investors
10 would at least consider what was the allowed return
11 on equity that was being authorized by various
12 jurisdictions; right?

13 A. That's correct.

14 Q. So there's nothing -- well, withdrawn.
15 It actually can be helpful to this
16 Commission to look at other jurisdictions just to see
17 whether or not they fall within some reasonableness
18 to other commissions' decisions; right?

19 A. I agree.

20 Q. Now, do you -- withdrawn.

21 Did you check to see whether or not
22 Dr. Morin's statement that the recommendation being
23 provided by Mr. Murray to this Commission would be
24 one of the lowest, if not the lowest, in the entire
25 country for natural gas utilities?

1 A. I did not make any examination of
2 that.

3 Q. Do you think it would be relevant for
4 this Commission to know if they were well outside the
5 reasonableness of every other commission in the
6 entire country on their recommendations?

7 MR. MICHEEL: I'm going to object,
8 that misstates what is shown in the RRA study, Your
9 Honor. Every other commission in the country is not
10 -- it's limited -- it's a limited set.

11 MR. HERSCHMANN: I don't think I said
12 -- well, let me see this. Can I have the question
13 read back, because I don't think I said anything
14 about RRA in that question.

15 THE REPORTER: Do you think it would
16 be relevant for this Commission to know if they were
17 well outside the reasonableness of every other
18 commission in the entire country on their
19 recommendations?

20 JUDGE WOODRUFF: That question does
21 not assume any facts, it just simply asks the
22 question of this witness' -- to his opinion on
23 whether or not the Commission should know the
24 reasonableness of its recommendation in relation to
25 other commissions. So I'm going to allow the

1 question. Objection is overruled. You can answer
2 the question.

3 THE WITNESS: I want to make clear
4 that I still believe that a market-derived cost of
5 equity estimation technique, like the DCF, is the
6 primary method that should be used, but I do believe
7 that it is reasonable for this Commission to look at
8 returns being authorized elsewhere in the U.S.

9 MR. HERSCHMANN: I would move to
10 strike the first part of the answer as nonresponsive
11 up until the point where he said the answer to the
12 specific question.

13 JUDGE WOODRUFF: I'm going to overrule
14 it.

15 MR. HERSCHMANN: Let me see if I can
16 get a very clear answer on the record.

17 Q. (By Mr. Herschmann) Do you think it's
18 relevant for this Commission to know -- and if you
19 can answer it as a yes or no, I would appreciate it
20 so we have a clear record, okay?

21 Do you think it's relevant for this
22 Commission to know whether the recommended ROE for
23 MGE is well outside the zone of reasonableness
24 currently being authorized by other utility
25 commissions in the United States?

1 A. Well, I think it's reasonable that
2 they do that, yes.

3 Q. Now, you mention previously that, to
4 your knowledge, no witness had done a hypothetical
5 capital structure using anything other than Mr.
6 Dunn's comparable companies; do you remember that
7 testimony?

8 A. That is correct, yes.

9 Q. And if it turned out that yesterday
10 Mr. Allen did the hypothetical capital structure for
11 his comparable groups of companies and provided the
12 calculations, would you have any reason to doubt how
13 he performed those calculations?

14 A. No, I would trust that Mr. Allen did
15 those calculations correctly.

16 Q. Let me ask you this: Have you been
17 completely truthful in expressing your opinions in
18 relationship to the cost of capital and hypothetical
19 capital structures up until now during your
20 testimony?

21 A. Yes.

22 MR. HERSCHMANN: I pass the witness.

23 JUDGE WOODRUFF: All right. At this
24 time, then, I'm going to make a ruling on No. 219.
25 And -- well, let me first ask the Company, do you

1 still object to the admission of 219?

2 MR. HERSCHMANN: Yes.

3 JUDGE WOODRUFF: All right. Your
4 objection is noted for the record. 219 will be
5 admitted into evidence.

6 MR. MICHEEL: I have no recross for
7 this witness, Your Honor. So if he can be excused.

8 JUDGE WOODRUFF: You would have no
9 redirect.

10 MR. MICHEEL: I'm sorry, I have no
11 redirect for this witness. So he can be excused.

12 JUDGE WOODRUFF: This witness is
13 excused. Thank you.

14 MR. MICHEEL: Thank you.

15 JUDGE WOODRUFF: I believe the next
16 witness, then, is Mr. Murray for the Staff.

17 MR. BERLIN: Your Honor, would we be
18 able to take about five minutes to get Mr. Murray.

19 JUDGE WOODRUFF: I think you're
20 reading my mind, because I was going to suggest
21 exactly the same thing. Let's take a five-minute
22 break and we'll come back at 1:35. Thank you.

23 (A recess was taken at this time.)

24 JUDGE WOODRUFF: Let's go ahead and
25 come to order. While we were on break, Mr. Murray

1 has come up to the stand. And if you please raise
2 your right hand.

3 (Witness sworn.)

4 JUDGE WOODRUFF: You may be seated,
5 and you may inquire.

6 DAVID MURRAY, testified as follows:

7 DIRECT EXAMINATION BY MR. BERLIN:

8 Q. Mr. Murray, would you please state
9 your full name for the record?

10 A. My name is David Murray.

11 Q. When did you begin employment with the
12 Commission?

13 A. Approximately June of 2000.

14 Q. And what is the nature of your duties
15 with the Commission?

16 MR. HERSCHMANN: Objection. I don't
17 know if we're going to get -- I don't know exactly
18 what portions we're going into, I thought it was
19 going to be limited to prepared testimony. And I'm
20 going to renew my objection based on the filings that
21 we did previously pursuant to 498.065.

22 JUDGE WOODRUFF: In terms of his
23 qualifications as a witness.

24 MR. HERSCHMANN: Yeah, and the
25 methodologies.

1 JUDGE WOODRUFF: As previously
2 indicated, the Commission will defer making a ruling
3 on those -- well, actually it made a ruling on that
4 motion, to deny it. There is still an application
5 for rehearing pending which will be ruled upon at a
6 subsequent date.

7 MR. HERSCHMANN: I understand that
8 someone just spoke to Mr. Micheel, and he says he is
9 not going to cross-examine Mr. Murray, he's going to
10 pass the witness.

11 JUDGE WOODRUFF: Okay. We're not
12 quite to that.

13 MR. HERSCHMANN: Well -- who are you,
14 sir?

15 MR. NOACK: I'm Mike Noack with
16 Missouri Gas Energy.

17 JUDGE WOODRUFF: And you just spoke
18 with Mr. Micheel?

19 MR. NOACK: I just spoke with Mr.
20 Micheel, yes.

21 JUDGE WOODRUFF: All right. You can
22 continue with your direct examination.

23 Q. (By Mr. Berlin) Mr. Murray, please
24 state for the record what is the nature of your
25 duties with this Commission?

1 A. I was hired as a public utility
2 financial analyst to review finance applications
3 filed by utility companies, to review merger and
4 acquisition applications filed by companies, to
5 review the financial -- the financial soundness of
6 telephone companies applying for certificate to
7 operate as a competitive local exchange company.

8 I was also hired to look at small
9 water and sewer companies' rate cases and certificate
10 cases, to look at their capital structure and
11 determine what a reasonable rate of return would be
12 for those companies.

13 And then as I was with the Commission
14 for a little while longer, I'd say about six months,
15 I was allowed to take on some of the more responsible
16 and meaningful duties within financial analysis
17 department of submitting rate of return testimony,
18 first of all, with some small telephone cases, and
19 then my first major rate case was MGE.

20 But the primary and the most important
21 and the biggest priority of the financial analysis
22 department is to participate in rate cases and
23 recommend adjusting a reasonable rate of return.

24 Q. Did you cause to be prepared in a
25 question and answer format direct testimony, rebuttal

1 testimony, and surrebuttal testimony?

2 A. Yes, I did.

3 Q. And that testimony is respectively
4 listed as Exhibit 825 for direct, 826 for rebuttal,
5 and 827 for surrebuttal testimony?

6 A. Yes.

7 Q. Do you have any corrections to make to
8 any of your testimony at this time?

9 A. Yes, I do.

10 Q. What are they?

11 A. Let me first clarify that many of the
12 corrections have already been made on the record in
13 my written testimony with my rebuttal testimony on
14 page -- starting on page 1 and going through page 2,
15 which affects a good part of my direct testimony.
16 I'll just focus on the areas where there's
17 corrections that were not addressed to my rebuttal
18 testimony.

19 On page 24, line 17, it indicates the
20 continuous growth form of the DCF model was used in
21 this analysis. That's actually the annual constant
22 growth form of the DCF model.

23 JUDGE WOODRUFF: Annual constant
24 growth?

25 THE WITNESS: Yes.

1 MR. FRANSON: I'm sorry, was that in
2 direct?

3 THE WITNESS: That was in direct, page
4 24, line 17.

5 And I believe other than the changes
6 that I made in my rebuttal testimony already, those
7 were the only changes that I would need to make today
8 with the direct testimony.

9 As far as the rebuttal testimony, on
10 page 10, line 25, it should read Aquila's corporate
11 structure was similar to Southern Union's now. So
12 basically eliminate the "is" at the end of the
13 sentence there right before the word now.

14 And on page 11, on line 4, it
15 indicates Southern Union's capital structures.
16 That's actually Southern Union's corporate structure.
17 Those are all the changes that I am aware of in the
18 rebuttal.

19 As far as surrebuttal is concerned, on
20 page 4, line 19, it indicates Dr. Morin's use of
21 allowed ROE's without the order does not provide full
22 context. It should indicate Dr. Morin's use of
23 allowed ROE's without the order date does not provide
24 full context.

25 On page 7, line 8, it indicates --

1 this is towards the middle of the sentence, it
2 indicates this is important to note this because. I
3 just took out "this." This is important to note
4 because I criticize Mr. Dunn's, so eliminate "this."

5 And those are all the changes I am
6 aware of at this time.

7 Q. (By Mr. Berlin) Mr. Murray, would
8 your answers be the same today as the answers that
9 you gave in your prepared testimony?

10 A. Yes, they would.

11 Q. And do you swear that the information
12 contained in your direct, your rebuttal, and
13 surrebuttal testimony is true and correct to the best
14 of your knowledge?

15 A. Yes.

16 MR. BERLIN: Your Honor, before I move
17 to admit Mr. Murray's testimony into the record, I
18 would request the Commission allow me an opportunity
19 to lay a foundation to the qualifications of Staff
20 Expert Witness David Murray.

21 This Commission is no doubt aware that
22 a great attention of substantial resources that have
23 been expended by MGE to challenge Mr. Murray's
24 qualifications. On David Murray's qualifications
25 alone, MGE filed its initial motion to strike and

1 supporting memorandum on May 7th. They filed on May
2 28 a reply memorandum.

3 They filed a memorandum on June 7th in
4 response to the June 3rd hearing that included the
5 oral argument on their motion to strike. And most
6 recently, they filed a motion for reconsideration
7 after 5 p.m. last Friday.

8 And indeed, while Mr. Murray is known
9 to this Commission from his appearances in several
10 previous cases, Mr. Murray has not been heard from in
11 this case. There has been no evidentiary hearing.

12 And at this point I believe this
13 Commission needs to hear from Mr. Murray. And with
14 your permission, Judge Woodruff, I would ask Mr.
15 Murray questions and he will provide answers that lay
16 a foundation for his qualifications as a rate of
17 return and capital structure witness.

18 Additionally, through these
19 foundational questions, we will present the concepts
20 and the terms underlying capital structure and rate
21 of return that may be of some assistance to the
22 Commission in their understanding of these concepts.

23 I also believe that given the zeal of
24 MGE expressed by Mr. Herschmann attacking opposing
25 witness on this subject that such additional

1 foundation might be welcomed.

2 JUDGE WOODRUFF: Is there any
3 objection to the Staff's proposal?

4 MR. HACK: Yes, there is, Your Honor.
5 The time for direct testimony, the time to lay the
6 foundation has long since past. The direct testimony
7 date was April 15th. That was the time for the Staff
8 to include its case in chief. Its case in chief
9 would include the foundation necessary to be laid for
10 the qualifications of an expert.

11 To the extent that MGE would
12 cross-examine Mr. Murray on his qualifications at
13 this point or voir dire Mr. Murray on his
14 qualifications at this point, perhaps then it would
15 be appropriate for, on recross or on rebuttal or voir
16 dire, for this to take place. At this point it's
17 procedurally improper and should not occur. It's
18 inconsistent with the Commission rules.

19 JUDGE WOODRUFF: It is inconsistent
20 with Commission rules. The Staff certainly had an
21 opportunity to establish this witness' credentials
22 through its direct filed testimony. Your request is
23 denied.

24 Are you going to offer the exhibits at
25 this time?

1 MR. BERLIN: Yes. Your Honor, I would
2 like to offer into evidence Exhibits numbered --

3 JUDGE WOODRUFF: I believe it would be
4 825, 826, and 827.

5 MR. BERLIN: Yes. I have these.

6 JUDGE WOODRUFF: Exhibits 825, 826,
7 and 827 have been offered into evidence. Are there
8 any objections to their receipt?

9 MR. HERSCHMANN: Judge, the objections
10 are the same as previously noted.

11 JUDGE WOODRUFF: All right. Subject
12 to those previously noted objections, 825, 826, and
13 827 will be received into evidence.

14 MR. BERLIN: And Your Honor, I also
15 have for admission into evidence an errata sheet by
16 Mr. David Murray concerning corrections made to his
17 deposition. His deposition is entered into evidence
18 on the -- on, I believe, Mr. Dunn's testimony as an
19 exhibit, his surrebuttal testimony, and so this
20 errata sheet serves to make some corrections to that
21 deposition.

22 JUDGE WOODRUFF: It's not marked at
23 this time, is it?

24 MR. BERLIN: No, it is not.

25 JUDGE WOODRUFF: Do you wish to mark

1 it?

2 MR. BERLIN: Yes, I do.

3 JUDGE WOODRUFF: It will be No. 847.

4 (An off-the-record discussion was
5 held.)

6 MR. BERLIN: Do you need more copies?

7 JUDGE WOODRUFF: We will need five
8 more copies, yes. If you don't have them right now,
9 you can give them to us later.

10 MR. FRANSON: We'll have them for you
11 shortly.

12 JUDGE WOODRUFF: And do you wish to
13 offer these at this time?

14 MR. BERLIN: Yes, I do.

15 JUDGE WOODRUFF: No. 847 has been
16 offered into evidence. Are there any objections to
17 its receipt?

18 MR. HERSCHMANN: Same objection.
19 Obviously, if the testimony comes in, I don't have
20 any objection to the errata sheet; but if the
21 testimony doesn't come in, then I --

22 JUDGE WOODRUFF: This is actually an
23 errata sheet to the deposition which is already in
24 evidence.

25 MR. HERSCHMANN: I'm sorry, I

1 apologize. I have no objections.

2 JUDGE WOODRUFF: All right. 847 will
3 be received into evidence.

4 MR. BERLIN: I pass the witness.

5 JUDGE WOODRUFF: Thank you. For Staff
6 witness, first up is Public Counsel. Mr. Coffman, do
7 you have any questions?

8 MR. COFFMAN: No questions.

9 JUDGE WOODRUFF: All right. City of
10 Kansas City and Joplin are not here. Federal
11 agencies?

12 MR. PAULSON: No questions, sir.

13 JUDGE WOODRUFF: Jackson County and
14 Midwest Gas are not here. We'll go to MGE.

15 MR. HERSCHMANN: No questions.

16 JUDGE WOODRUFF: All right. Then
17 we'll come up for questions from the bench.

18 Commissioner Clayton, it's up to you.

19 COMMISSIONER CLAYTON: If I could have
20 a moment, Judge.

21 JUDGE WOODRUFF: You certainly may.

22 BY COMMISSIONER CLAYTON:

23 Q. Okay. Good afternoon, Mr. Murray.

24 A. Good afternoon.

25 Q. I want to start off with -- with the

1 capital structure that you have used in your
2 testimony.

3 A. Yes.

4 Q. And there's been a lot of discussion
5 on capital structure, and for some reason I've been
6 focusing on that. But over the last three days with
7 a lot of witnesses providing their opinions on what
8 is the appropriate capital structure to use in this
9 instance. To start off, what I'd like to do is ask
10 you to basically summarize your opinion on which
11 capital structure we should use.

12 A. My capital structure is the
13 appropriate capital structure to use for rate-making
14 purposes in this case. And the reason why that is is
15 that's the actual capital structure as of the update
16 period within this proceeding.

17 This capital structure is a -- it
18 represents the true measurable, identifiable capital
19 structure of Southern Union, and therefore, MGE. I
20 think there's been some discussion that this company,
21 it has entirely different operations. However, they
22 didn't argue that that was the case when they were
23 asking for approval to acquire Panhandle.

24 And I have seen actually updated
25 Standard & Poor reports as early as June of this year

1 that indicate that the business profile of Southern
2 Union and Panhandle are both at three. And when they
3 assign a business risk profile, they are looking at
4 the general business risk of the Company.

5 And financial theory would dictate
6 that if the risk of all of these operations of
7 Panhandle and distribution operations are one and the
8 same, then it's entirely appropriate to use the
9 consolidated capital structure.

10 I think there was discussion on --

11 Q. You're beyond where I wanted to go
12 with my question.

13 A. Oh, I'm sorry. I'm sorry.

14 Q. And I don't want to be rude, but
15 everybody --

16 A. That's okay. I'm sorry.

17 Q. -- everybody's got time invested here,
18 and just to move through this.

19 So your position is to use the actual
20 -- you started off saying the actual capital
21 structure of the Company, but actually your position
22 is that it's the actual consolidated capital
23 structure; is that correct?

24 A. Well, yes. MGE is not a company, it's
25 a division. When people refer to MGE as a company,

1 that may be convenient for discussion purposes, but
2 it's not a separate legal corporation.

3 Q. Is Panhandle Eastern a separate legal
4 entity?

5 A. Yes, it is.

6 Q. Okay. Well, that's what we're talking
7 about. We're not talking about consolidating MGE and
8 Southern Union, we're talking about the consolidated
9 structure with Panhandle Eastern; isn't that correct?

10 A. That's correct.

11 Q. So your position is to use the
12 consolidated capital structure, including the
13 components of Panhandle Eastern; is that correct?

14 A. That's correct.

15 Q. All right. And that includes -- how
16 much is it in debt?

17 A. About 1.2 billion, that's the
18 Panhandle. As far as the Southern Union debt, let me
19 refer so I can give you the specific number. Refer
20 to one of my schedules.

21 As far as the Southern Union debt that
22 existed before it acquired Panhandle, it was about 1
23 billion, because there's 2.2 billion in long-term
24 debt -- that's excluding short-term debt. It gets
25 all the way up to 2 point -- close to 2.5 billion if

1 you include the short-term debt.

2 Q. In your analysis, did you look at the
3 actual capital structure of Southern Union prior to
4 the Panhandle Eastern acquisition?

5 A. I looked at the capital structure of
6 Southern Union prior to the sale of Texas -- of their
7 Texas natural gas distribution operations. I really
8 didn't want to look at the capital structure prior to
9 the Panhandle, because that cash that they received
10 from the sale of the Texas distribution --

11 Q. Is that a no or a yes?

12 A. I'm sorry, can you repeat the
13 question?

14 Q. The question was, did you look at the
15 capital structure of Southern Union prior to the
16 acquisition of Panhandle Eastern?

17 A. Yes.

18 Q. You did?

19 A. Yes.

20 Q. Okay. What was the capital structure
21 of the Company prior to the acquisition?

22 A. At the end of December 31st, 2002, the
23 common equity ratio was about 32, 33 percent, which
24 is consistent with how Southern Union has
25 historically capitalized its company. Usually in

1 about the low 30 percent equity ratio level.

2 Q. So 32, 33 percent equity, a common
3 equity, how about -- do you recall in generalities
4 the other components of the capital structure?

5 A. I didn't calculate that. I have that
6 information available. I could easily calculate that
7 for you.

8 Q. But -- so you haven't calculated it?

9 A. No, I was just looking at the equity
10 ratio to get an idea.

11 Q. Well, don't you have to determine --
12 don't you use the other pieces to determine that
13 common equity ratio?

14 A. You just subtract -- I just subtracted
15 all the other pieces. I added up all the capital,
16 which I didn't pay attention to how much of it was
17 preferred, how much of it was short-term debt, how
18 much of it was long-term debt, to come up with a
19 total capitalization level. And I just took the
20 common equity balance and divided that by the total
21 capitalization level to determine a ratio.

22 Q. And what was the end date that you
23 used -- or the date on which you picked all the
24 numbers to -- for this consolidated post acquisition
25 capital structure, what date did you use?

1 A. That was based on Southern Union's
2 form 10Q as of 12/31/2002.

3 Q. 12/31 -- '02?

4 A. Yes.

5 Q. Now, that's -- that's post Panhandle
6 Eastern acquisition?

7 A. Post -- it's prior to Panhandle.

8 Q. It's prior, okay. I want to go back
9 towards what your position is in this case after the
10 acquisition. What is the date that you use for your
11 capital structure, your end date?

12 A. December 31st, 2003.

13 Q. Okay. And how did you choose that
14 date?

15 A. That's the update period for purpose
16 of this hearing.

17 Q. Okay. Isn't -- what is -- isn't there
18 a true update for the end of April of this year?

19 A. Yes, but I believe there's a true-up
20 hearing that addresses that. To be quite honest with
21 you, I still haven't received my DR responses to look
22 at that information and thought it would be
23 appropriate to address it at true-up.

24 Q. Have you reviewed the testimony of
25 John Gillen for Company?

1 A. Yes, I have.

2 Q. Do you have that with you?

3 A. Yes, I do. I have it.

4 Q. I'd like to direct your attention to

5 schedule JJG-2. You find it?

6 A. Yes, I have.

7 Q. There's a column that's marked

8 subtotal consolidating?

9 A. Yes.

10 Q. Do you see that column?

11 A. Yes, I do.

12 Q. And you notice that this schedule is

13 dated March 31, 2004?

14 A. Yes.

15 Q. So there's going to be a three-year --

16 or three-month difference in time, so the numbers are

17 going to be different from the calculations that you

18 used?

19 A. Yes.

20 Q. Okay. My question is, the figures

21 that you used to come up with your capital structure

22 to use in this case, how do they compare to this?

23 Because the -- if you -- if you total up the debt and

24 the preferred stock and the common equity, it's

25 significantly different than the structure that you

1 have put together.

2 My question, I guess, is, is that --
3 have there been changes that have occurred to the
4 Company in that three-month period or did you use a
5 different mechanism or are these numbers not relevant
6 because they're accounting and not financial numbers?
7 I'm offering suggestions, so you tell me what the
8 answer is.

9 A. I understand. I can speak to you
10 about what I did in direct testimony. Mr. Mark
11 Oligschlaeger, who is a CPA with Staff, specifically
12 addressed Mr. John Gillen's testimony in his
13 surrebuttal, and I believe he'll probably give you a
14 better answer than I would be able to give you.

15 Q. That's all right, you give me an
16 answer. Do the best you can. If you don't know the
17 answer, then just tell me you don't know.

18 I don't expect you to use a calculator
19 and come out -- I mean, I can give you the
20 percentages from preferred debt and the debt of the
21 -- the debt and the preferred stock.

22 A. What I can tell you is it looks like
23 he, and I believe Mr. Oligschlaeger confirmed this,
24 that he follows the GAAP principles. But what I was
25 doing in my direct testimony was looking at it from a

1 financial analyst's perspective.

2 Q. How would a financial analysis differ
3 from an accounting analysis?

4 A. Accounting has very specific rules
5 that they have to abide by in coming up with various
6 book numbers.

7 Q. Do you have any rules that you abide
8 by?

9 A. I look at it from a financial analyst
10 perspective which, say, for instance, the earnings of
11 Panhandle has been -- it's been indicated that's
12 about equivalent, about the same as the earnings from
13 natural gas distribution operations.

14 So if I was purchasing a share of
15 Southern Union's stock, I would -- I would believe
16 that half the value of that stock is from Panhandle
17 and half the value of that stock is from the
18 distribution operations.

19 Q. In your opinion, does this -- is this
20 schedule even relevant, this financial analysis? Is
21 this the wrong type of schedule to be using?

22 A. I think this schedule proves to me why
23 Staff has never tried to separate out a operating
24 company when it has a subsidiary.

25 Q. I understand, but I'm only looking at

1 the consolidated column, I'm not going into the
2 pulling of a part section.

3 A. I don't believe this is appropriate.

4 Q. You don't believe?

5 A. No.

6 Q. Okay. Can you tell me what the
7 average of the -- the average common equity ratio
8 that your comparable companies' study shows?

9 A. We use about 49 percent, but let me
10 tell you to be exact. The 2002 common equity to
11 total capital ratio is 49.68 percent. And that
12 compares to my recommended common equity ratio for
13 Southern Union, as a result MGE, of 25.91 percent.

14 Q. I was reading through some of the
15 textbooks we got in the office, I'm not sure if
16 that's right or not. Some of them have been
17 referenced here in this hearing. But there is some
18 authority to use a hypothetical capital structure in
19 -- in setting rates, would you agree with that
20 statement?

21 A. I believe that's been done in some
22 other jurisdictions. I believe it's been done in
23 Missouri. If you give me a chance to explain my --
24 my feeling and my opinion on that, I would.

25 Q. I'm not asking you what think about

1 it, I'm asking -- my question is, there is some
2 authority -- there are authorities out there that
3 suggests that a hypothetical capital structure should
4 be used in the event that an actual capital structure
5 is outside a zone of reasonableness or is for some
6 reason inappropriate. You're familiar with that,
7 what I'm talking about?

8 A. There are analysts that will recommend
9 that, yes.

10 Q. Is there -- is that a dispute in the
11 field of financial theory?

12 A. Yes, and I think it's a specific
13 dispute in the field of regulatory financial theory.

14 Q. How about non regulatory financial
15 theory?

16 A. In non regulatory financial theory --
17 and I know hypotheticals have been talked about a bit
18 in this proceeding. If you are going to use a
19 hypothetical, usually it's to determine whether or
20 not you are going to accept a project for investment.

21 And what you use that hypothetical
22 capital structure for is to look at the specific risk
23 of that project, especially if that project is
24 completely different from the business that -- that
25 they are normally investing in, such as, let's say,

1 General Electric, a very diversified company.

2 So you would want to look at some --
3 at a hypothetical capital structure and you could
4 base that on the industry. But the key thing, and
5 this is not done in regulatory rate-making
6 proceedings, is that the hypothetical capital
7 structure really should have a hypothetical cost of
8 debt associated with it, not an embedded cost of
9 debt.

10 And that would be a lower cost of debt
11 than what's recommended, especially considering the
12 low interest rate environment. And that's why it's
13 very important to distinguish that. Because we
14 recommend in regulatory proceedings the embedded cost
15 of debt is -- is what is recommended in pretty well
16 almost every jurisdiction that I know. And that
17 embedded cost of debt is based on the consolidated
18 capital structure of a company.

19 So if a company has more leverage in
20 its capital structure and tends to have more leverage
21 in its capital structure, its debt costs are going to
22 reflect that. And if you don't adjust those debt
23 costs down to consider the fact that this is a more
24 favorable capital structure, then you're passing
25 costs through to rate payers that should not be

1 passed through.

2 Q. That was an interesting point that you
3 started off with there. You suggested that if you're
4 going to use a hypothetical capital structure that
5 you should then use a hypothetical cost of debt; is
6 that what you said?

7 A. Yes.

8 Q. Cost of common equity, is that what
9 you said?

10 A. Yes.

11 Q. In your analysis, you used an actual
12 consolidated capital structure; correct?

13 A. Yes.

14 Q. And then did you use an actual cost of
15 common equity?

16 A. I used a -- I used an estimated cost
17 of common equity.

18 Q. What's the difference between an
19 estimated and an hypothetical?

20 A. On a cost of common equity?

21 Q. Mm-hmm.

22 A. I believe -- that's an interesting
23 question because it's -- that is more of an art.

24 Q. About \$100 an hour?

25 A. More than that, for some. But that is

1 -- that is exactly why this is such a contentious
2 issue. You can't say an actual cost to common
3 equity. We are recommending what we think is the
4 actual cost of common equity based on the capital and
5 economic environment.

6 But to -- to know exactly what
7 investors are thinking is -- it can be a moving
8 target. But there are certain tests of
9 reasonableness out there that you can look at to see
10 if you're, you know, within the ballpark on what
11 investors are requiring.

12 Q. Well, speaking of reasonableness, you
13 -- you have to look at a comparable set of companies
14 to evaluate whether your -- the capital structure you
15 are going to use is reasonable, that's -- you have to
16 do a comparison; is that a fair statement?

17 A. I think you have to do a comparison
18 and look at other factors as well, though.

19 Q. Okay. But that's one of the factors
20 that you look at, is a comparable group of companies
21 to see what their equity ratio would be?

22 A. Along with the credit ratings of the
23 company, yes.

24 Q. Well, according to the -- what you
25 just said, the average comparable common equity ratio

1 for your -- what do you call them, proxy companies or

2 --

3 A. Yes.

4 Q. -- your sample was over 49 and a half
5 percent, almost 50 percent, and yet the actual ratio
6 for common equity that you are recommending is 26
7 percent. Now, that's a difference of 24 percent
8 which seems significant to me being a non financial
9 analyst.

10 Is it not a significant difference
11 that should call into question your analysis?

12 A. I don't think it should call into
13 question my analysis. It is significant, and if I --
14 if I could explain why I think --

15 Q. Go ahead and explain.

16 A. Okay, thank you. I looked at my
17 comparable companies, and if you look on schedule --
18 schedule 22 attached to my direct testimony, in the
19 last column --

20 Q. Which schedule was that, I'm sorry?

21 A. Schedule 22.

22 Q. 20-2 or --

23 A. 22.

24 Q. Well, you have a 20-2 and a 22.

25 A. I'm sorry, 22. Okay. And then in

1 column six --

2 Q. Yes?

3 A. -- do you see the bond ratings of all
4 the comparable companies?

5 Q. Yes.

6 A. And if you see -- if you look at the
7 average at the bottom of that list of comparable
8 companies, there's a average credit rating of an A.
9 And then if you go one row down further, you'll see
10 that Southern Union Company has a credit rating of a
11 triple B.

12 And credit rating agencies, when they
13 evaluate the creditworthiness of a company, they look
14 at both business and financial risk. And that's very
15 important, because not -- you can't just set
16 financial risk and put it -- set it aside and say
17 this is the only thing you should be looking at as
18 far as the overall risk level of the company.

19 When a credit rating agency looks at
20 the risk of the company, they're looking at their
21 business risk and their financial risk. And so I --
22 I rely on third party sources. They do a very
23 comprehensive analysis, more so than I can explain to
24 you. I have talked to credit rating agency analysts
25 and they have explained some of these processes to

1 me.

2 But they look at the overall risk, and
3 that's why I think it's appropriate to just look at
4 the overall risk, determine what the spreads are
5 between a triple B bond and an A rated bond, and
6 that's how you can come up with appropriate risk
7 adjustment to the capital structure, because that
8 takes into consideration the financial risk and the
9 business risk.

10 So my point is, you cannot look at one
11 in a vacuum, you have to look at both, because that's
12 what investors do. And that's why I think that that
13 -- I did take that into consideration. I took the
14 fact that probably the reason why Southern Union is a
15 triple B versus these other companies is because of
16 their capital structure. I think most of them have
17 the same business profile of Southern Union, most of
18 them have a business profile of a three, which means
19 their business risk is about equivalent.

20 So the triple B credit rating for
21 Southern Union -- and it's really no secret, Southern
22 Union is an aggressively leveraged company, always
23 has been an aggressively leveraged company, and as
24 far as I know, will continue to be an aggressively
25 leveraged company. And that right there explains the

1 risk difference in what type of adjustment should be
2 made.

3 Q. Well, if there's greater risks,
4 though, wouldn't that -- wouldn't that in turn
5 require a higher cost of equity?

6 A. And I made an adjustment for that of
7 32 basis points to my recommended cost to common
8 equity.

9 Q. Okay. Are there no other triple B --
10 well, first of all, this Company is rated -- bond
11 rating is triple B; is that right?

12 A. Currently, yes.

13 Q. What do you call that, big B, big B,
14 bib B, is that what --

15 A. Triple B's good.

16 Q. Triple B. Are these the only natural
17 gas distribution companies that are rated triple B?

18 A. Oh, I'm sure there's others that are
19 rated triple B. There's two in my comparable group
20 that are rated triple B. There may be others out
21 there that are more diversified, and I didn't feel
22 like it was appropriate to include them.

23 Q. None of these go down to 26 percent
24 common equity ratio.

25 A. That's correct.

1 Q. Doesn't that cry out for some sort of
2 adjustment in the capital structure?

3 A. Sir, I did, I made -- well, not for
4 the capital structure. I don't feel that that's the
5 proper way to make this adjustment. I made an
6 adjustment to the cost to common equity.

7 If you make an adjustment to the
8 capital structure, then you need to make an
9 adjustment to the cost of debt, because that's what
10 the debt investors are looking at when they're making
11 a decision to loan money to this Company.

12 And you also need to make an
13 adjustment to the cost to common equity. Say, for
14 instance, if this was an A rated -- if they had an A
15 rating and their capital structure was stronger, then
16 I wouldn't have made an adjustment.

17 Q. Okay. Your position with regard to
18 both capital structure and the cost of equity for
19 each of them are less favorable to the Company than
20 even the Office of Public Counsel; is that correct?

21 A. Can you repeat the question? I'm
22 sorry.

23 Q. Well, I'll break it into two parts.
24 For capital structure, you are almost, I suppose,
25 identical to one of their proposals for a capital

1 structure, and then they also suggest a hypothetical
2 structure.

3 A. Yes.

4 Q. Do you agree with that? Your ratio of
5 common equity is the lowest of all the witnesses in
6 this case.

7 A. Yes, I think it's fairly similar to
8 the first capital structure that Public Counsel
9 recommended, but yes.

10 Q. Okay. And you have also listed the
11 lowest cost of common equity of any other party -- of
12 any other witness in this case.

13 A. I don't agree.

14 Q. Okay.

15 A. I had a range of 8.5 to 9 point --
16 8.52 to 9.52, so the higher end of my range is above
17 the Office of Public Counsel.

18 Q. What was their range?

19 A. 9 point -- low 9's to 9.37, I believe.
20 I could check to verify.

21 Q. Let me see here. 9.01 to 9.34. Okay.
22 They overlap, but they are fairly similar, you have a
23 lower end to your range; correct?

24 A. Yes.

25 Q. Okay. What is the charge of the Staff

1 in a rate case?

2 A. To balance the investor and the
3 public's interest.

4 Q. And how did you balance those
5 interests when your recommendations are less
6 favorable to the Company and to the shareholders than
7 the Office of Public Counsel, whose sole
8 responsibility it is to watch out for the rate
9 payers?

10 A. I performed an objective analysis and
11 looked at what I felt was a reasonable return on
12 equity, adjusted for the capital structure. I also
13 looked at the -- what I thought was reasonable
14 considering Southern Union's corporate structure as
15 far as how to calculate the recommended cost of debt.

16 These are all based on principles and
17 -- and knowledge and theories and what have you that
18 I have adopted in prior cases. This is what I truly
19 feel the cost of capital is.

20 Q. If you were a witness for the Office
21 of Public Counsel, do you think your calculations
22 would be any different?

23 A. No.

24 Q. Shouldn't there be a difference in
25 approaching a case from the perspective of either the

1 Office of Public Counsel or the Staff?

2 A. No, I think the mission of both the
3 Public Counsel and the Staff is to try to estimate
4 the cost of capital to the Company, and this is what
5 I estimate the cost of capital is to the Company.

6 Q. Well, then is it duplication? Do we
7 need two parties?

8 A. It provides the Commission with more
9 information to look at.

10 Q. Well, it's a legitimate question.
11 Because if you have a position of a party in this
12 case, theoretically you're the hired gun for that
13 particular position.

14 My question is, why -- how someone who
15 is supposed to balance comes up with a lower end,
16 then decides it's advocating on behalf of the rate
17 payers?

18 A. That can change from case to case.
19 We're not always going to agree as far as the cost to
20 common equity. We're not going to agree on the
21 capital structure. Sometimes Staff may be higher,
22 sometimes Staff may be lower.

23 But when I perform an analysis, if I
24 was -- had some preconceived notion in my mind that I
25 needed to get to a number that was above Public

1 Counsel, I don't think I would be performing within
2 the ethical boundaries that I think are appropriate.

3 Q. Okay. Well, what things do you think
4 about on behalf of the shareholders when you're doing
5 your calculations?

6 A. I think --

7 Q. That would not be in the mind of
8 Office of Public Counsel?

9 A. I think that the shareholders --
10 obviously, they have a required rate of return. And
11 the whole idea of regulation is to make sure that you
12 recommend at least that required rate of return,
13 because that's what ultimately decides the -- the
14 shareholders' incentive to invest in a company.

15 They're not going to invest in a
16 company if the cost of capital is -- if a company is
17 not earning the cost of capital, or else they may get
18 out fairly soon, because that's driving the share
19 price down.

20 But the ultimate goal of competition
21 is to get all companies down to a level where they're
22 earning their cost of capital. And there may be more
23 efficiencies in some company that allow them to earn
24 higher than their cost of capital, and therefore,
25 boost their shareholder value.

1 Q. Let me go back and ask one more
2 question on capital structure, and then I'll let
3 other members of the bench interrogate you.

4 In the merger case of Panhandle
5 Eastern a few years back, you're familiar with that
6 report and order in that case?

7 A. Yes, and I actually wrote testimony in
8 that case.

9 Q. Okay. Is it relevant that Staff
10 required as part of that agreement and then the
11 Commission ordered as part of that agreement the --
12 the line between cash flowing between Panhandle
13 Eastern and Southern Union? Is that a relevant point
14 to bring up in this discussion regarding capital
15 structure?

16 A. I believe that was a safeguard that
17 was -- that was put into place within the context of
18 that agreement in their -- in their acquisition of
19 Panhandle and their application for approval to
20 acquire Panhandle.

21 But another condition in there was
22 that usually this is standard condition in merger
23 cases, there's no rate-making principles within the
24 approval of a merger case or an acquisition case.
25 Nothing that occurs within those cases is necessarily

1 going to tie somebody's hands when it comes to a rate
2 case. We reserve the right to look at rate-making
3 principles in the future when rate cases occur or a
4 complaint case occurs.

5 But one other thing in there is -- is,
6 I don't agree that there is true insulation for MGE,
7 and I believe that there was --

8 Q. Well, before you go into that, and I
9 apologize for this, but do you think it's relevant,
10 was my question? Do you think it's relevant that
11 there was that provision in that report and order in
12 determining the capital structure in this case? Is
13 there a relevant consideration?

14 A. Oh, it's relevant to consider.

15 Q. Okay. It is relevant, and that would
16 indicate by implication, would it not, that Panhandle
17 Eastern should be excluded from the capital
18 structure?

19 A. I don't agree.

20 Q. Okay. Now tell me why.

21 A. Well, one of the conditions within
22 that agreement was -- there were -- there were some
23 language about cash flow down to Panhandle and
24 guarantees and pledging of assets and what have you.
25 There was also, and I believe Travis Allen read this

1 into the record when he was -- when he was on the
2 stand, there's also a provision at the end of that
3 condition that indicates that Southern Union will
4 make its best efforts in attempting to insulate MGE
5 and provide quarterly reports to the Commission
6 advising and updating the Staff as to their progress
7 with insulating MGE.

8 So I think based on that -- just that
9 very last sentence, there was recognition on all
10 parties that this was not full insulation of MGE, and
11 we felt that there could be, you know, better ways to
12 insulate MGE.

13 And actually, as it's been indicated
14 before, because of the way Southern Union's corporate
15 structure is set up, when you look at Southern
16 Union's credit rating, it involves all the operations
17 of Southern Union. It includes Panhandle, it
18 includes subsidiaries of Panhandle. And these are
19 all things that effect the credit rating of Southern
20 Union.

21 And when Southern Union issues debt
22 for any type of investment in the future, that cost
23 of debt is going to be influenced by Panhandle being
24 in that consolidated credit rating.

25 So I do not agree that we have gotten

1 to that point, and I don't know that any reports have
2 been submitted to show us that they are at that
3 point. COMMISSIONER CLAYTON: Thank you very
4 much.

5 COMMISSIONER CLAYTON: Thank you very
6 much.

7 THE WITNESS: Thank you.

8 JUDGE WOODRUFF: I have no questions,
9 so we'll go to recross beginning with Public Counsel.

10 MR. MICHEEL: No questions.

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

13 MR. PAULSON: No questions.

14 JUDGE WOODRUFF: Jackson County and
15 Midwest Gas are not here. MGE?

16 CROSS-EXAMINATION BY MR. HERSCHMANN:

17 Q. I'm going to follow-up briefly with
18 some questions that Commissioner Clayton asked you.
19 The first deals with rating agencies rating bonds.
20 And when someone mentions -- or as you mentioned a
21 triple B rating, is that the rating of bonds to the
22 company?

23 A. Yes, it's a rating of the debt of the
24 company, that's the bonds. You can also have -- let
25 me clarify, you could have a corporate credit rating

1 as well.

2 Q. And is Southern Union's equity rated?

3 A. No.

4 Q. And the adjustments that you spoke
5 about, this 32 basis points, that was the adjustment
6 between the bond ratings of your comparable group
7 companies and the bond ratings of Southern Union as a
8 whole; is that correct?

9 A. That's correct.

10 Q. You told Commissioner Clayton that you
11 submitted sworn testimony in relationship to the
12 Panhandle acquisition; do you remember that?

13 A. Yes, I do.

14 Q. And when you submitted that testimony,
15 were you truthful?

16 A. Yes, I was.

17 Q. And when you were deposed in this
18 matter in May of this year, were you truthful?

19 A. Yes.

20 Q. Now, you have had a chance to read the
21 stipulation and agreement and the order in
22 relationship to the acquisition of Panhandle; right?

23 A. Yes.

24 Q. And you know that there are certain
25 conditions that you just mentioned about not having

1 cash flow from Southern Union down to the Panhandle;
2 right?

3 A. Yes.

4 Q. And yet, in your testimony, you say
5 that there's -- you read something in S and P about
6 cash, I think the words were, would flow freely
7 between Southern Union and Panhandle; right?

8 A. Yes, that's what S and P said.

9 Q. And you have no reason to believe that
10 that S and P report is correct; right?

11 A. I rely on S and P for their analysis.
12 They talk to management of the Company.

13 Q. How do you know that S and P spoke to
14 management at the Company dealing with the free flow
15 of cash?

16 A. Because S and P regularly talks to
17 company representatives. That's part of how they
18 find out what the expectations are going to be for
19 the company.

20 Q. Have you been into Southern Union's
21 headquarters anytime lately?

22 A. No, I haven't.

23 Q. They haven't discussed with you free
24 flow of cash in violating any orders that they have
25 signed before this Commission, have they?

1 A. No.

2 Q. So you don't have any evidence to
3 believe that Southern Union's going to go ahead and
4 let free flowing cash go from Southern Union down to
5 the Panhandle in direct violation of the stipulation
6 agreement that they signed in this -- before this
7 Commission; right?

8 A. Currently I don't have any evidence of
9 that.

10 Q. Did you have any at any point, when
11 you say currently?

12 A. I say currently, not right now. I
13 have not had any evidence up to this point.

14 Q. Do you have any reason to believe
15 whatsoever that Southern Union has or will violate
16 the stipulation and agreement dealing with the
17 insulation of MGE rate payers from the Panhandle
18 acquisition?

19 A. Yes.

20 Q. Let me ask you -- I'm going to read a
21 question to you from your deposition of May 4th,
22 2004, page 68, line 16: Question: And you have no
23 reason to believe sitting here today that Southern
24 Union has or will violate that agreement; right?

25 I don't have any evidence that they

1 violated.

2 I want you to focus now between May
3 4th and June 23rd, today. Tell us what evidence do
4 you have that Southern Union's going to let cash flow
5 freely between Southern Union and Panhandle?

6 A. First your question was whether or not
7 they violated anything in the agreement, but not the
8 cash flow issue.

9 Q. I want you to answer my questions. We
10 had some issues in the depositions where --

11 A. I did not indicate that they violated
12 the cash flow issue.

13 Q. Let's start with that, sir. Do you
14 have any reason to believe that Southern Union is
15 going to violate the cash flow issue?

16 A. I have no evidence of that.

17 Q. Do you have any reason to believe it,
18 if you don't have any evidence?

19 A. I can tell you what I know right now.
20 Currently I don't have any evidence of that.

21 Q. So the fact that you read some
22 statement from S and P, that also gave you a belief
23 that it's going to happen?

24 A. Yes.

25 Q. Who deals more -- well, withdrawn.

1 Does S and P have any oversight of
2 Southern Union? Do they regulate Southern Union?

3 A. They don't regulate Southern Union,
4 no.

5 Q. Does the Missouri Commission regulate
6 Southern Union?

7 A. Yes, we do.

8 Q. Could you ask a data request at any
9 point and say to Southern Union, by the way, is it
10 your intention to violate the stipulation and
11 agreement and disregard the order of this Commission?
12 Did you ever do that, sir?

13 A. I don't think a data request would be
14 the way to look into that. I would think we'd almost
15 have to do an audit.

16 Q. Did you ask that an audit be done?

17 A. No, I have not asked for an audit to
18 be done.

19 Q. Did you informally inquire of anyone,
20 say by the way, you're all here for the rate case, I
21 believe you're going to start violating the
22 agreements and you're going to let cash flow freely,
23 why are you going to do that?

24 A. I haven't talked to anybody
25 specifically about performing an audit in the future.

1 Q. Have you questioned any of the MGE or
2 Southern Union representatives that have been here or
3 suggested that any one of the Staff question them of
4 your belief that all of a sudden Southern Union is
5 going to disregard the orders of this Commission?

6 A. I don't think anybody in Southern
7 Union has filed, as far as the Treasurer or the CFO,
8 has filed testimony in this case, so I don't know
9 what informal conversation's going to achieve.

10 Q. Get you some information that may be
11 relevant to blanket accusations that you know nothing
12 about?

13 A. I don't believe it's a blanket
14 accusation. I relied on a third party source which I
15 frequently rely on.

16 Q. A third party source doesn't have any
17 direct information when it comes to the Panhandle
18 agreement. You're the one that negotiated it and put
19 in testimony; right?

20 A. I put a different condition in my
21 testimony, that's correct.

22 Q. Did S and P join in -- in relationship
23 to the stipulation agreement, were they a party to
24 that agreement?

25 A. No, they weren't.

1 Q. Did you submit testimony on behalf of
2 the Staff?

3 A. Yes, I did.

4 Q. You submitted sworn testimony, right?

5 A. Yes, I did.

6 Q. And the idea was to insulate the MGE
7 rate payers from the acquisition; right?

8 A. That was the attempt, yes.

9 Q. And tell me if you agree with this
10 statement: Without insulation, MGE will not truly be
11 autonomous as it relates to Southern Union's other
12 operations, and consequently, will not enjoy the full
13 benefit of a lower risk profile. Do you agree with
14 that statement?

15 A. I believe that was in my testimony,
16 that's correct.

17 Q. And you agreed with it; right?

18 A. Well, let me look specifically at
19 that.

20 Q. Page 4, line 4 through 6.

21 MR. BERLIN: Is this direct or
22 surrebuttal?

23 MR. HERSCHMANN: This is the rebuttal
24 in the GM-2003-0238.

25 THE WITNESS: That's exactly what I

1 said in my testimony.

2 Q. (By Mr. Herschmann) And that's
3 accurate and truthful testimony; right?

4 A. Yes.

5 Q. And there was a provision in the
6 stipulation agreement that specifically dealt with
7 this insulation issue; right?

8 A. There was, I think it's paragraph two
9 in the stipulation and agreement.

10 Q. Now, this S and P thing that you read,
11 did you read that before your deposition?

12 A. I'll have to check the date on that.
13 I usually read them as soon as they come out.

14 Q. Well, you put it in your testimony;
15 right? In your prepared testimony? Did you put the
16 S and P --

17 A. Can you refer me specifically to it,
18 and then I'll tell you, confirm.

19 Q. Why don't you look at your direct
20 testimony and tell us if you ever referenced to the S
21 and P work. And if it helps you, if you look at, I
22 believe it's page 66 of your deposition, you'll see
23 you talk about the S and P cash flowing freely
24 statement.

25 A. In my direct testimony on page 17,

1 line 16 through page 18, line 31, I cite from some
2 specific -- I think it's the entire research report
3 from Panhandle.

4 Q. And is that the flowing of cash freely
5 quote?

6 A. Yes, that's in there. It's in that
7 report.

8 Q. And you read that before your
9 deposition; right?

10 A. Yes, I did.

11 Q. And you cited it in your prepared
12 testimony before your deposition; right?

13 A. Yes.

14 Q. And this was a question that you got
15 asked at your deposition, sir, page 70, line 2: I'm
16 asking you, sitting here today, do you have any
17 evidence that Southern Union intends to violate any
18 provision of the agreement?

19 No, I don't have evidence that
20 Southern Union intends to violate that provision.

21 You had that opinion after you already
22 read the S and P article; right?

23 A. As far as the free cash flow issue,
24 yes, that's correct.

25 Q. And it's now your opinion that since

1 you have read this article and you're here testifying
2 today, that Southern Union's going to violate this
3 free cash flow issue?

4 A. I don't -- I don't know what Southern
5 Union is going to do in the future. I can tell you
6 right now currently we don't have evidence that
7 Southern Union has violated its condition.

8 Q. Do you recall talking in your --
9 during your testimony, both in your prepared
10 testimony, direct, and in your deposition, about how
11 you went about trying to back out Panhandle from
12 Southern Union's --

13 JUDGE WOODRUFF: I'm going to
14 interrupt because we need to take a break. We'll
15 come back at three o'clock. Thank you.

16 MR. FRANSON: Your Honor?

17 JUDGE WOODRUFF: Yes, sir.

18 MR. FRANSON: Before we go off the
19 record, may Mr. Hack and I make an announcement about
20 an issue that, believe it or not, is actually
21 settled?

22 JUDGE WOODRUFF: All right.

23 MR. HERSCHMANN: I object.

24 MR. FRANSON: Well, who speaks here,
25 Mr. Hack or Mr. Herschmann?

1 MR. HERSCHMANN: He definitely speaks
2 on this one.

3 MR. FRANSON: Why don't you go ahead.

4 MR. HACK: We've had continuing
5 discussions on the issue called alternative minimum
6 tax credit. It is scheduled to be heard tomorrow
7 afternoon. And the Staff and MGE have -- have
8 reached an agreement in principle to use as the rate
9 base amount related to alternative minimum tax or AMT
10 of \$12,782,852.

11 That is the amount currently reflected
12 in rate base for that item in MGE's current revenue
13 requirement. As a further provision of the agreement
14 reached in principle between the Staff and MGE, the
15 AMT rate base item will not be subject to true-up.
16 So that will be the number, assuming everybody is
17 okay with it, to be used in revenue requirement in
18 this case.

19 Is that --

20 MR. FRANSON: Could you state that
21 number again, please?

22 MR. HACK: \$12,782,852.

23 MR. FRANSON: That's correct, Your
24 Honor.

25 JUDGE WOODRUFF: Go right ahead.

1 COMMISSIONER CLAYTON: I just want to
2 -- on Exhibit 842, which is the reconciliation
3 prepared by Staff, which line is that?

4 MR. FRANSON: I'm not sure I've got
5 that in front of me.

6 MR. HACK: If I may approach, I can
7 help you.

8 COMMISSIONER CLAYTON: I didn't see
9 AMT on this, so I just wondered if it was in dispute
10 when we started or if it just -- it came in dispute.

11 MR. FRANSON: That's a very good
12 question. Your Honor, Mr. Oligschlaeger pointed to
13 me, and I think it would be consistent with what Mr.
14 Hack reviewed with Commissioner Clayton, that issue
15 is not specifically on Exhibit 842, which was the
16 Staff's reconciliation.

17 JUDGE WOODRUFF: Is that just an
18 oversight or?

19 MR. OLIGSCHLAEGER: May I speak?

20 MR. HACK: If the Judge is willing, I
21 think --

22 JUDGE WOODRUFF: Certainly, explain it
23 to us, Mr. Oligschlaeger.

24 MR. OLIGSCHLAEGER: It would be hard
25 to explain it coherently, but I will try.

1 MR. HERSCHMANN: Consistent with
2 everything else here.

3 MR. OLIGSCHLAEGER: By the time that
4 reconciliation was prepared, the Staff and the
5 Company had informally agreed upon the number.
6 Actually, I believe the number that Mr. Hack and Mr.
7 Franson just gave you.

8 However, there was a question of
9 whether that should be further updated, and that was
10 the subject of continuing discussions. As per this
11 resolution of the issue, a decision was made it did
12 not need to be updated and all parties could live
13 with that value. So that --

14 JUDGE WOODRUFF: Okay. Fair enough.

15 COMMISSIONER CLAYTON: So we're still
16 45 million apart.

17 MR. OLIGSCHLAEGER: Yes.

18 JUDGE WOODRUFF: Okay. Will you be
19 filing something -- this is on for Monday at 3:30, I
20 believe? Is that right?

21 MR. FRANSON: Actually, I believe it's
22 tomorrow. That's actually why we wanted to do it,
23 because I think MGE has a witness that they want to
24 try and avoid bringing here. Is that correct, Mr.
25 Hack?

1 JUDGE WOODRUFF: I see it on Staff's
2 proposed revised statement of order of issue as being
3 alternative minimum tax credit for 3:30 p.m. on
4 Monday, 6/28.

5 MR. HACK: Judge, I apologize, we
6 probably should have filed the second revised
7 schedule, but this was one of the issues that I had
8 raised at the opening of the hearing. We were
9 actually swapping AMT --

10 JUDGE WOODRUFF: Okay, I remember you
11 did state that.

12 MR. HACK: -- with bad debts. And as
13 a further request, Mr. Warren, who is MGE's AMT
14 witness, is currently scheduled to fly out of
15 Portland, Maine, to St. Louis this afternoon at 4:30.
16 And if we can avoid requiring him to fly in, we would
17 prefer to do so.

18 And we just wanted to let the parties
19 know that we had reached this agreement in principle.
20 The Commission to know. I don't -- I'm not -- it's
21 probably not an issue of great interest to everybody,
22 but everybody ought to have the opportunity to know.

23 JUDGE WOODRUFF: Okay. And I
24 appreciate that. I assume you'll be filing -- will
25 you be filing a stipulation or something on this, or

1 just will we just have a witness explain it when it
2 comes up.

3 MR. FRANSON: Actually, Your Honor,
4 that's something Mr. Hack and I have to discuss. I
5 can't go into any detail, but there may be some other
6 issues we will need to discuss and possibly ask you
7 how you need that, because there may be some other
8 issues that will have a similar situation.

9 We have some witnesses who have filed
10 testimony, and we may need to ask how you want to
11 handle that sometime in the near future. But on
12 this, I think our announcement, at least for now,
13 will probably have to suffice and we can memorialize
14 that and a few other things if you would prefer.

15 JUDGE WOODRUFF: Okay. We just need
16 to have -- somehow get it into the record how it's
17 revolved, and however want to do that is fine with
18 me. As far as your witness coming from Portland, I'd
19 say he can stay there.

20 MR. HACK: I had been hoping that
21 discussing it on the record would suffice.

22 JUDGE WOODRUFF: Okay.

23 MR. FRANSON: I guess our question
24 would be, if it does, Your Honor, that's fine. If
25 you need something else, we can certainly provide

1 that.

2 JUDGE WOODRUFF: Staff witness, I
3 assume, can come on the stand at some point and
4 explain exactly what's up. I just want to have it
5 clear on the record exactly what's happening.

6 MR. HACK: And that's not a problem.

7 MR. FRANSON: Okay. I think we can do
8 that. That would either be Mr. Hyneman or Mr.
9 Oligschlaeger at some point.

10 JUDGE WOODRUFF: With that then, we'll
11 take a break until three o'clock.

12 (A recess was taken at this time.)

13 JUDGE WOODRUFF: Okay. We're back
14 live on the internet. And when we left off, MGE was
15 doing its recross of Mr. Murray, so let's take up
16 from there.

17 MR. HERSCHMANN: Thank you, Your
18 Honor.

19 Q. (By Mr. Herschmann) Mr. Murray, I
20 want to follow-up on a couple things you said
21 beforehand. It is your opinion that MGE should not
22 ask for a flotation cost in this matter; is that
23 correct?

24 A. Yes, it is.

25 Q. And do you believe that that one

1 request is somehow vie -- I'm sorry, violates the
2 Panhandle stipulation agreement?

3 A. Yes, I do.

4 Q. Okay. Other than that issue, is there
5 anything else that you think violates the stipulation
6 agreement related to the Panhandle acquisition?

7 A. I have checked with other Staff
8 personnel and attorneys as to whether or not Southern
9 Union has been filing quarterly reports indicating
10 what steps are being taken to further insulate MGE,
11 and I have not seen or -- and have found from other
12 Staff personnel that they have not seen these reports
13 being submitted. And so that was a -- that was
14 something that was agreed to in that stipulation
15 agreement.

16 Q. Okay. So you don't know whether or
17 not those reports are going to reflect whether
18 there's been any financial, you know, flowing of cash
19 or anything else it violated.

20 So I just want to make sure that I
21 understand this. Your two issues are the request for
22 flotation costs and whether or not there have been
23 these quarterly reports filed; is that right?

24 A. Yes, I haven't seen those reports.
25 And another -- those reports filed and another -- I

1 think you're wanting for me to discuss all of the
2 things that may be considered a violation.

3 Q. That's not my question.

4 A. You're not? Okay.

5 Q. I want you to identify for us the
6 things that you think are a violation of the
7 agreement, not maybe, but are a violation.

8 Let me make sure I'm clear. I don't
9 want to know if you read something in S and P that
10 says this may happen, so therefore, there may be an
11 agreement -- may be a violation. I want to know what
12 specific things do you believe and have some evidence
13 to support are a violation of the stipulation
14 agreement.

15 A. With the capital structure that was
16 submitted and recommended by Mr. John Dunn, we
17 obviously do not agree that that is a proper capital
18 structure, that it was even done properly. And that
19 capital structure -- the use of that capital
20 structure allows for a higher rate of return, and
21 obviously, we feel that that is an inappropriate rate
22 of return and an inappropriate capital structure.

23 And the condition specifically
24 indicates that MGE will not ask for an increase cost
25 of capital. And the capital structure that's been

1 submitted is a result of some backing out of
2 Panhandle debt without any -- without any Southern
3 Union -- or any equity associated with Panhandle.

4 Q. In the surrebuttal testimony of Mr.
5 Dunn, does it back out the Panhandle debt and the
6 equity associated with it consistent with GAAP?

7 A. You'll have to ask Mr. Mark
8 Oligschlaeger if that's consistent with GAAP, but I
9 do know that later on in rebuttal and surrebuttal,
10 Mr. Dunn started to change his position and pull out
11 some equity.

12 Q. And you know the way that you tried to
13 pull out the equity is wrong; right?

14 A. I don't agree that it's wrong.

15 Q. Well, did Mr. Oligschlaeger agree with
16 how you did it?

17 A. That's an error, and Mr. Oligschlaeger
18 will take care of that when he gets up on the stand.

19 Q. Well, I don't want to know what Mr.
20 Oligschlaeger is going to say. I want to know what
21 you have to say while you're here. Okay?

22 So let me ask you a question. Did Mr.
23 Oligschlaeger say the way you did the backing out of
24 Panhandle was correct or incorrect?

25 A. In his current testimony, that's what

1 he said.

2 Q. He said it was incorrect; right?

3 A. And that was an error. That's in his
4 current testimony. He's going to change that.

5 Q. He's going to say the way you backed
6 out Panhandle is consistent with GAAP?

7 A. No, he's going to say it's correct. I
8 don't know if he's going to say it's consistent with
9 GAAP. You can ask him about that when he gets on the
10 stand.

11 Q. Are you now telling us that Mr.
12 Oligschlaeger, having just filed his testimony on
13 June 10th of this year, is now going to get up here
14 and change the answer to the question as to whether
15 or not you backed out Panhandle from Southern Union's
16 consolidated capital structure in a proper manner?

17 A. I guess you -- once Mark Oligschlaeger
18 is on the stand, he'll clarify that for you.

19 Q. No, I'm asking you the question.
20 Would you please answer my question?

21 MR. HERSCHMANN: Would you read it
22 back, please?

23 THE REPORTER: Are you now telling us
24 that Mr. Oligschlaeger, having just filed his
25 testimony on June 10th of this year, is now going to

1 get up here and change the answer to the question as
2 to whether or not you backed out Panhandle from
3 Southern Union's consolidated capital structure in a
4 proper manner?

5 THE WITNESS: Based on my discussions
6 with Mr. Oligschlaeger, yes, that's correct.

7 Q. (By Mr. Herschmann) Let's make sure
8 we run through this. You submitted your prepared
9 direct testimony on what date?

10 A. April 15, 2004.

11 Q. Were you deposed on May 4th of 2004?

12 A. Yes, I was.

13 Q. And in your errata sheet -- withdrawn.

14 Between May 4th, 2004 and June 10th of
15 2004, did you have occasion to speak to Mr.
16 Oligschlaeger?

17 A. Many times.

18 Q. And did you speak to Mr. Oligschlaeger
19 in relationship to how you backed out Panhandle?

20 A. Yes, he actually reviewed my testimony
21 and all these -- all rounds of testimony, so he's
22 obviously aware of what I did in my testimony.

23 Q. And did you try to convince him before
24 he submitted his testimony on June 10th of 2004, that
25 the way you backed out Panhandle was correct?

1 A. No.

2 Q. Did he tell you he thought you were
3 correct in the way you backed out Panhandle between
4 May 4th and June 10th?

5 A. Yes. It was a mistake, he made a
6 mistake in his testimony, and he'll take care of that
7 when he's on the stand.

8 Q. Were you truthful in your deposition?

9 A. Yes.

10 Q. In every step of the deposition?

11 A. Yes.

12 Q. Were you aware of the request for
13 flotation costs in time for your deposition?

14 A. I was aware that Mr. John Dunn had
15 that in his direct testimony at that time, yes.

16 Q. Were you aware of the proposal dealing
17 with the capital structure at the time of your
18 deposition?

19 A. I was aware of the issue of capital
20 structure, yes.

21 Q. Were you aware that there was a motion
22 to exclude your testimony in this proceeding?

23 A. Yes.

24 Q. And was there an opportunity for Staff
25 to oppose that motion?

1 A. That's -- I mean, I believe the legal
2 process allows for an opportunity to oppose, but I'm
3 not a lawyer and I don't know the legal process.

4 Q. Were you here when there was an
5 argument as to whether or not you satisfied the
6 standards that were necessary?

7 A. I was here.

8 Q. And you didn't submit any revised
9 errata sheets to your deposition that said I do
10 believe there's a violation of the stipulation and
11 agreement based on the request for flotation costs or
12 the capital structure being proposed, did you, sir?

13 A. No, I did not.

14 Q. And you had the opportunity in your
15 deposition to answer the question when I asked you,
16 and you have no reason to believe sitting here today
17 that Southern Union has or will violate that
18 agreement, right? And your answer was, I don't have
19 any evidence that they violated. Right?

20 A. The key words were sitting here today.

21 Q. Oh, so --

22 A. And that was my understanding when I
23 was sitting there today. Once I started working on
24 rebuttal and surrebuttal testimony and really dug
25 into some of the financing arrangements that were

1 occurring within Southern Union and realizing that
2 the equity that was issued was in direct relation to
3 the Panhandle acquisition and actually the 150
4 million that's going to be issued in the future is to
5 pay down debt because of the Panhandle acquisition, I
6 decided this is something that constitutes a
7 violation. I -- once I uncover more evidence, I feel
8 like I have the right to change my mind.

9 Q. This all evidence that you just
10 mentioned was all known to you before your
11 deposition, right, sir?

12 A. I didn't know all the details of that
13 evidence.

14 Q. Sir, isn't it true you're making the
15 allegations because you're offended that MGE has
16 moved to strike your testimony in this proceeding?

17 A. Not at all.

18 Q. It just happened to hit you somewhere
19 between the denial or the -- the holding in abeyance
20 of the decision in your testimony today; right?

21 A. There's nothing personal here. I gave
22 my objective opinion in my direct testimony. I
23 looked at the facts of the case. I indicated I think
24 that the inclusion of flotation costs, which is a
25 cost that's associated with the issuing equity and

1 issuing equity in the future, and from everything I
2 read, S and P reports, Moody's reports, indications
3 by the Company itself in its deposition, Mr. John
4 Dunn, and indications by Dr. Morin that if equity had
5 to be issued because Panhandle's capital structure is
6 leveraged -- or excuse me, Southern Union's capital
7 structure is leveraged because of this acquisition,
8 that this is a direct violation of that condition.

9 Q. Sir, was the idea to segregate
10 Panhandle from MGE, is that the idea of your
11 testimony in the proceedings?

12 A. The idea was to try to provide some
13 insulation.

14 Q. And that's why you submitted sworn
15 testimony; right?

16 A. The idea was to provide insulation,
17 that's why I provided sworn testimony, that's
18 correct.

19 Q. And you wanted to achieve insulation
20 of the regulated utility business and financial risk
21 of Southern Union's operations and protect Missouri
22 rate payers; right?

23 A. That was the objective, yes.

24 Q. And then you gave testimony to support
25 that objective; right?

1 A. I had testimony with a condition in
2 there that was different than what was ultimately
3 agreed to.

4 Q. And agreed to by whom, your
5 supervisors on behalf of the Staff?

6 A. Agreed by Staff, that's correct.

7 Q. And your supervisors agreed and had
8 provisions in the stipulation that spoke about
9 insulation of Southern Union's MGE operating division
10 from Panhandle business; to insulate MGE from the
11 transaction, Southern Union agrees that, and then
12 there's a list of things; right?

13 A. Yes.

14 Q. So you made your opinions and then
15 someone who was a supervisor to you made a
16 determination to sign a stipulation agreement that
17 would protect Missouri rate payers; right?

18 A. And that condition also said to submit
19 reports until the Missouri Commission determined that
20 MGE is truly insulated.

21 MR. HERSCHMANN: Move to strike the
22 last part of the answer as nonresponsive.

23 JUDGE WOODRUFF: Nonresponsive, it is
24 stricken.

25 Q. (By Mr. Herschmann) Now, you spoke

1 about best efforts, do you recall that?

2 A. Yes.

3 Q. Do you recall that the actual language
4 of the stipulation says that Southern Union will
5 exercise its best efforts to insulate MGE from any
6 adverse consequences from its other operations or the
7 activities of any of its affiliates?

8 A. Yes.

9 Q. Now, did Southern Union file an
10 application in relationship to authority to purchase
11 the Panhandle properties?

12 A. Yes, it did.

13 Q. And did Southern Union address in that
14 application whether or not the business of Panhandle
15 Eastern was similar to the natural gas distribution
16 business of MGE?

17 A. I don't recall.

18 Q. I'll read to you from page 6 of the
19 application, Section 393.190.2 of the Revised
20 Missouri Statutes in pertinent part states, this is a
21 quote, "that no gas corporation shall directly or
22 indirectly acquire the stocks or bonds of any other
23 corporation engaged in the same or a similar business
24 unless authorized to do so by the Commission," close
25 quote.

1 MR. BERLIN: I have to object, Your
2 Honor, he's reading from a document that's not in
3 evidence in this proceeding.

4 JUDGE WOODRUFF: Overruled.

5 Q. (By Mr. Herschmann) There is no
6 statutory or judicial case law guidance on the scope
7 of this language because Panhandle Eastern is not
8 directly or indirectly engaged in the natural gas
9 distribution business and is not regulated by the
10 Commission as a public utility, Panhandle Eastern may
11 reasonably be considered not to be engaged in the
12 same or similar business as Southern Union, and
13 consequently, the Commission may reasonably be
14 considered not to have jurisdiction over the
15 transaction.

16 However, in an abundance of caution
17 and also in an effort to keep the Commission fully
18 informed, Southern Union has filed this application
19 with the Commission. The application should not,
20 however, be construed as an admission on the part of
21 Southern Union that the Commission's authority is
22 required for Southern Union to perform in accordance
23 with the terms of the purchase and sale agreement.

24 Having read that to you, does that now
25 refresh your recollection as to Southern Union's

1 position regarding Panhandle's business?

2 A. That sounds pretty similar to what I
3 recall.

4 Q. And you testified previously in
5 response to Commissioner Clayton that Southern Union
6 had said in its application that the businesses were
7 the same; right?

8 A. I believe that was the discussion as
9 to why -- whether or not there was -- if I said it in
10 the application, that was incorrect. On discussion
11 with settlement and discussing the testimony and what
12 have you and the issues of this case, it was
13 emphasized quite a few times by Southern Union that
14 this is a regulated entity, it's a natural gas
15 transmission, pipeline, that there's not a lot of
16 difference here, we don't understand why you're
17 concerned about bankruptcy or what have you.

18 That was discussed between Staff and
19 OPC and the Company. So if I indicated so in the
20 application, that was an error on my part and I
21 apologize.

22 Q. And Southern Union has taken the
23 position that an interstate pipeline company is
24 different in operating risks compared to an LDC
25 business; right?

1 A. I don't know, you'd have to show me
2 where they have taken that position. Are you
3 referring to the application?

4 Q. Application.

5 A. For purposes of that application, I
6 think they have taken that position, yes.

7 Q. Do you regulate any interstate
8 pipelines?

9 A. No, I do not.

10 Q. Are there any pipelines that go
11 through the State of Missouri?

12 A. Yes.

13 Q. Have you tried to take regulation over
14 those pipelines saying they pass through here and
15 it's just like an LDC business, and therefore, we
16 should oversee it?

17 A. Other than filing for intervention
18 with FERC cases, I don't believe so.

19 Q. And are there business risks that are
20 different for interstate pipeline than there are for
21 an LDC business?

22 A. I believe there are.

23 Q. There are different operating risks?

24 A. I believe pipelines are generally
25 considered to be more risky than transmission --

1 excuse me, than distribution.

2 Q. If the idea was to insulate MGE rate
3 payers from the Panhandle acquisition and the
4 Panhandle operations, isn't it appropriate to
5 insulate it for rate-making purposes, also?

6 A. Yes.

7 Q. Now, you mentioned also in the
8 stipulation and agreement that there was no reference
9 to matters for rate-making purposes. And let me just
10 ask you this: If the agreement talks about the
11 amount of any asserted acquisition premium shall be
12 treated below the line for rate-making purposes in
13 Missouri and not recovered in retail distribution
14 rates, would that help you change your testimony that
15 there was reference to the application or the
16 stipulation agreement being applicable to this
17 rate-making proceeding?

18 A. It may be specifically as it refers to
19 that, but it's pretty standard in any approval for an
20 acquisition or a merger that none of the positions
21 taken in that acquisition or merger are going to have
22 any rate making -- they will not have rate-making
23 type of -- I'm sorry, I'm searching for a word here.
24 It will not set any precedence for rate-making
25 purposes in future rate cases. That's a standard

1 condition.

2 Q. And that was a condition in this
3 application and stipulation agreement as well; right?

4 A. It should have been.

5 Q. So when you made the comment to
6 Commissioner Murray that it has no relevance or
7 application to the rate-making proceeding here, is
8 that accurate or inaccurate, sir?

9 A. I don't believe Commissioner Murray
10 asked me a question.

11 Q. I'm sorry, Commissioner Clayton. I
12 apologize.

13 A. Could you repeat the question?

14 Q. Sure. When you told Commissioner
15 Clayton that the Panhandle acquisition had no
16 relevance to this current application, do you believe
17 that's accurate in light of the provision dealing
18 with acquisition premium?

19 A. I'm not an expert on acquisition
20 premium, that's not an issue I dealt with in that
21 case. So I --

22 Q. How about the provision that talks
23 about total joint in common causes allocated to
24 Missouri for purposes of setting retail distribution
25 rates will not increase as a result of the

1 transaction?

2 A. Once again, I'm not an expert in that
3 area.

4 Q. Well, do you think that this Panhandle
5 stipulation agreement is something that's relevant
6 since it has specific provisions that would preclude
7 MGE for asking for rates associated with the
8 transaction?

9 A. Oh, I think it's relevant.

10 Q. Now, let's talk about how you think --
11 well, withdrawn.

12 You read Mr. Gillen's testimony; is
13 that right?

14 A. Yes, I did.

15 Q. Does MGE or Southern Union have to
16 comply with GAAP?

17 MR. BERLIN: Objection, that's beyond
18 his scope. He is not a certified public accountant,
19 and that's beyond his scope and knowledge in this
20 proceeding.

21 JUDGE WOODRUFF: I believe the
22 question was, asked whether he's read testimony and
23 what that testimony said. I'm going to overrule the
24 objection.

25 THE WITNESS: Well, actually, was the

1 question whether or not --

2 Q. (By Mr. Herschmann) You had read Mr.
3 Gillen's --

4 A. Yeah, I have read Mr. Gillen's
5 testimony.

6 Q. And you recall that Commissioner
7 Clayton asked you some questions about Mr. Gillen's
8 testimony?

9 A. Yes, I do.

10 Q. And what is GAAP?

11 A. Generally accepted accounting
12 principles.

13 Q. And what do you understand GAAP to be
14 applicable to?

15 A. The accounting field.

16 Q. And to your knowledge, are publicly
17 traded companies required to be in compliance with
18 GAAP?

19 A. Publicly traded companies, yes.

20 Q. And does this Commission oversee some
21 publicly traded companies?

22 A. A portion of that publicly traded
23 company.

24 Q. That's right, this Commission only has
25 jurisdiction over one part of Southern Union; is that

1 right?

2 A. That's correct.

3 Q. Which part is that?

4 A. It's the division which is not a
5 company, MGE.

6 Q. When did you figure out that divisions
7 and subsidiaries are different? Because back in 2001
8 when you started, you didn't know that distinction.
9 So what point between 2001 and now did you learn that
10 there's a difference between divisions and
11 subsidiaries?

12 A. I got a better -- I received a better
13 grasp on that during that case.

14 Q. So somewhere between 2001 and 2004,
15 you figured out that actually a division is part of a
16 company and a subsidiary is a separate legal entity;
17 right?

18 A. I'd say between the time I had my
19 deposition then and probably a month or two after
20 that, not between that and 2004.

21 Q. So this Commission only has
22 jurisdiction over Southern Union's Missouri
23 operations; is that right?

24 A. Yes.

25 Q. And the Missouri operations here that

1 we're talking about is MGE; right?

2 A. Yes.

3 Q. Now, you're setting -- you try to set
4 rates as it relates to delivery of service that is
5 used and useful for Missouri rate payers; right?

6 A. Yes.

7 Q. Interstate pipeline doesn't service
8 Missouri rate payers; right?

9 A. Indirectly it does, yes.

10 Q. How does it indirectly provide
11 services to the Missouri rate payers?

12 A. It delivers gas to the distribution
13 companies, and also there may be some commercial
14 wholesalers that have storage in the State of
15 Missouri. So that's why we intervene in FERC cases,
16 because there are concerns.

17 Q. Are there any rates associated with
18 the maintenance of the interstate pipeline that get
19 passed on to the Missouri rate payers?

20 A. Repeat the question, please.

21 Q. Sure. Are there any operating costs
22 associated with the interstate pipeline that get
23 passed on to the Missouri rate payers?

24 A. I don't know.

25 Q. Do you have any reason to believe

1 there aren't?

2 A. No, I would presume so, but I don't
3 know. I haven't looked into that to verify that
4 specifically.

5 Q. Now, do you understand that the
6 benefit of GAAP is it sets a standard, keep you in
7 compliance with GAAP and everyone else is in
8 compliance with GAAP, it's under the same standard?

9 MR. BERLIN: Objection, this is beyond
10 his scope and knowledge and his testimony. He's not
11 an accountant and he doesn't represent himself to be
12 an accountant.

13 JUDGE WOODRUFF: Overruled.

14 THE WITNESS: Yes, actually, as a
15 financial analyst, we -- we like to see standards out
16 there that allow us an opportunity to try to compare
17 companies. And to be able to do so, there has to be
18 some standards in place; otherwise, it would be like
19 comparing apples to oranges.

20 Q. (By Mr. Herschmann) And the advantage
21 of using GAAP is you have some standards; right?

22 A. Exactly.

23 Q. Now, when you went about backing out
24 Panhandle, you just thought that that was your
25 layperson's reasonable approach; right?

1 A. It seemed reasonable being the fact
2 that the common equity balance that was shown on
3 SEC's 10-K -- Form 10-K for Panhandle was right about
4 the purchase price, and a good portion of that
5 purchase price, at least from my reading of Southern
6 Union's 2003 annual report, was -- was financed with
7 equity.

8 Q. Was \$646,818,000 financed with equity?

9 A. Not the entire amount. They're --
10 unfortunately, the 2003 annual report was a little
11 vague as to the amount of the equity units and the
12 common equity that was issued. It indicated an
13 amount that was issued, but it just indicated that
14 the common equity and the equity units were issued in
15 concurrence to fund the majority of the portion of
16 the price for Panhandle. It was not broken out
17 specifically. And also, there was the \$437 in cash.

18 Q. You mean 437 million.

19 A. Oh, excuse me. Yeah --

20 Q. Big difference.

21 A. Four hundred --

22 Q. It wouldn't be a big deal at 437.

23 A. Yeah, well. The \$437 million in cash
24 from the Texas distribution operations to fund the
25 acquisition.

1 MR. HERSCHMANN: I apologize, I don't
2 know what exhibit number it is, but it's the Form
3 10-K that we had offered into evidence previously
4 dated December 31st, 2003.

5 JUDGE WOODRUFF: It's 31.

6 MR. HERSCHMANN: Do we have the
7 exhibits here? If I can approach?

8 JUDGE WOODRUFF: You may.

9 MR. HERSCHMANN: May I approach the
10 witness?

11 JUDGE WOODRUFF: You may.

12 Q. (By Mr. Herschmann) Do you have
13 Exhibit 31? Read yourself the paragraph on June 11,
14 2003.

15 A. For the record, this is Form 10-K
16 dated December 31st, 2003, for Panhandle Eastern
17 Pipeline Company, LLC. That paragraph indicates on
18 June 11, 2003 --

19 Q. I just asked you to read it to
20 yourself first.

21 A. Okay.

22 Q. Actually, you can read it.

23 A. On June 11th, 2003, Southern Union
24 acquired Panhandle (Panhandle acquisition) from CMS
25 for approximately 581,729,000 in cash and three

1 million shares of Southern Union common stock
2 beginning (before adjustment for subsequent stock
3 dividend distribution) valued at approximately
4 48,900,000 based on market prices at closing of the
5 Panhandle acquisition, and in connection therewith
6 incurred transaction costs of approximately
7 30,448,000.

8 Southern Union also incurred
9 additional deferred state income tax liabilities
10 estimated at 18,388,000 as a result of the
11 transaction. At the time of the acquisition,
12 Panhandle had approximately 1,157,228,000 of debt
13 principal outstanding that it retained.

14 Southern Union funded the cash portion
15 of the acquisition with approximately 437 million in
16 cash proceeds it received from the January 1st, 2003
17 sale of its Texas operations, approximately
18 121,250,000 of net proceeds it received from
19 concurrent common stock and equity units offerings
20 and with working capital available to Southern Union.

21 Southern Union structured the
22 Panhandle acquisition and the sale of its Texas
23 operations to qualify as a like kind exchange of
24 property under section 1031 of the Internal Revenue
25 Code of 1986 as amended.

1 Panhandle and five of its subsidiaries
2 as well as a Southern Union subsidiary that became
3 Panhandle's direct parent upon the acquisition
4 converted from Delaware corporations to Delaware
5 limited liability companies in June 2003.

6 Q. Thank you. Now, let's talk about how
7 Southern Union acquired Panhandle. Okay?

8 A. Yes.

9 Q. The first is it was approximately
10 581,729 -- I'm sorry, \$581,729,000 in cash; is that
11 correct?

12 A. Yes.

13 Q. And a portion of that cash came from
14 \$437 million in cash that Southern Union had in the
15 bank; right?

16 A. I assume it was in the bank. It was
17 cash, yes.

18 Q. And the remainder of it came from
19 these equity units and the offerings that Southern
20 Union did; right?

21 A. No. It says approximately 121,250,000
22 of the net proceeds it received from concurrent,
23 which is -- which is at the same time, common stock
24 and equity units.

25 Q. So that's what I'm saying.

1 A. You said equity units.

2 Q. I apologize.

3 A. It's both.

4 Q. I'm sorry, I apologize. Southern
5 Union raised a certain amount of money between common
6 stock offering and equity units offering; right?

7 A. That's correct.

8 Q. And they used some of those proceeds
9 to buy CMS; right?

10 A. I believe -- it indicated in the 2003
11 annual report that a majority of the proceeds were
12 used to acquire Panhandle.

13 Q. Well, how much money did Southern
14 Union raise between its equity offering and its
15 equity units offerings?

16 A. I believe it was somewhere around 290
17 million.

18 Q. Okay. And how much money did they
19 give out of the 290 million to acquire Panhandle? Do
20 you see the \$121,250,000 number?

21 A. I understand. I was just quoting from
22 Southern Union's annual report that's given to
23 investors.

24 Q. Is this filed with the SEC, this 10-K?

25 A. So is the 2003 annual report.

1 Q. Are you saying that you think this
2 10-K is false?

3 A. No, I'm not saying I think it's false.

4 Q. Did you read somewhere in S and P that
5 said wow, I think the 10-K is false?

6 A. I was looking at another publication
7 made by Southern Union that was given to investors
8 that indicated something different than what's
9 indicated in here.

10 Q. Are you saying that there is a
11 conflict that -- let me take a step back.

12 Are you making an allegation that the
13 10-K that's filed that's in your hands as Exhibit 31
14 is false in any way?

15 A. No, I'm not.

16 Q. Did you contact the SEC and tell them
17 you think something's improper with the filing?

18 A. No, I do not.

19 Q. Do you have any reason to believe --
20 are you publicly making an allegation of securities
21 fraud against Southern Union at this time?

22 A. No, I am not.

23 Q. Let's focus on the exhibit you have in
24 front of you which deals with the acquisition; is
25 that okay, sir?

1 A. That's fine.

2 Q. See the number 121,250,000?

3 A. Yes I do.

4 Q. And that's part of the offerings of
5 the equity units in the common stock; right?

6 A. Yes, that's part of both of the common
7 stock offering and the equity units offering.

8 Q. And that's, between the cash and the
9 common stock offering and equity units offering,
10 that's how they got to the total of \$581,729,000;
11 right?

12 A. That's approximately correct, yes.

13 Q. In your testimony, sir, you took out
14 \$646,818,000 from Southern Union's common equity when
15 you backed out Panhandle; right?

16 A. Let me refer to my direct testimony,
17 please.

18 Q. Sure. Look at page 84 of your
19 deposition.

20 A. Is that attached to Mr. Dunn's
21 surrebuttal?

22 Q. I believe so.

23 A. What page was it again? I'm sorry.

24 Q. Page 84.

25 A. Yes, I'm looking at that right now.

1 Q. Is it correct that you backed out
2 \$646,818,000 from Southern Union's total common
3 equity?

4 A. Yes, that was based on Panhandle's
5 Form 10-K, yes.

6 Q. Now, the \$437 million that Southern
7 Union had on the books in cash, all right, what did
8 you decide to do with that? Or did we just lose that
9 in your calculations?

10 A. That amount's available to
11 shareholders, whether to invest -- are you talking
12 about the 437 million in cash?

13 Q. Southern Union had \$946 million of
14 stockholder equity on December 31st. You took away
15 646 million, and then what do we do, we just lose the
16 \$437 million in cash from our balance sheet?

17 MR. BERLIN: Objection, Your Honor,
18 this goes well beyond the scope of Commissioner
19 Clayton's questions.

20 JUDGE WOODRUFF: Overruled.

21 THE WITNESS: The 437 million in cash
22 basically just went from cash available to
23 shareholders to cash available to -- for investments
24 in other remaining distribution operations and was
25 made as a shareholder investment into the Panhandle

1 operations.

2 Q. (By Mr. Herschmann) Are you saying
3 that it's your opinion that the \$437 million in cash
4 is part of the \$946 million in shareholder equity or
5 is it separate?

6 A. That's part of the assets.

7 Q. Is it -- now, answer the question,
8 please, sir. Is it part of the shareholder equity of
9 \$946 million or is it separate?

10 A. Cash that's outstanding on the books
11 is not supported by debt. This is cash above and
12 beyond what was sold, that they received without any
13 outstanding debt to lay claim to that 437 million.
14 That -- those assets, that increased the asset base,
15 so it has to increase either the liabilities or the
16 owner's equity. The 437 million in cash, it's no
17 different than Microsoft having a billion dollars in
18 cash idle, the shareholders still have an interest in
19 that.

20 MR. BERLIN: Your Honor, I'd just like
21 to interject that I think that these accounting
22 questions go well beyond the scope of Mr. Murray.
23 Mr. Oligschlaeger is a CPA and he will be testifying
24 in this proceeding. And I think those questions are
25 better directed towards Mr. Oligschlaeger.

1 JUDGE WOODRUFF: They may be directed
2 at Mr. Oligschlaeger as well, but certainly Mr.
3 Murray made these calculations within his testimony.
4 So I'm going to overrule the objection.

5 Q. (By Mr. Herschmann) I really want to
6 make sure I understand what you're saying. Because
7 if \$437 million vanished from Southern Union, I would
8 like to know where it went according to you.

9 A. It went into Panhandle.

10 Q. You think \$437 million went into
11 Panhandle in cash, and then another \$640 million of
12 shareholder equity also went into Panhandle?

13 A. No, that's part of the shareholder
14 equity.

15 Q. That's what I want to get to. So it's
16 your understanding that the \$437 million in cash that
17 was sitting on Southern Union's books is part of the
18 946 million shareholder equity; right?

19 A. My position is --

20 Q. That's a yes or no, sir.

21 MR. HERSCHMANN: Could you read it
22 back, please?

23 THE REPORTER: So it's your
24 understanding that the \$437 million in cash that was
25 sitting on Southern Union's books is part of the 946

1 million shareholder equity; right?

2 THE WITNESS: Yes.

3 Q. (By Mr. Herschmann) Just so I
4 understand this more perfectly clear, you took -- in
5 relationship to the Panhandle acquisition now,
6 Southern Union, you deduct \$646,818,000 from its
7 shareholder equity; right? You did that; right?

8 A. Yes.

9 Q. And then the \$437 million that was in
10 the bank, we lose that also; right? That went over
11 to the CMS owners to buy the property; right?

12 A. Yes, that's investment into Panhandle
13 to buy Panhandle.

14 Q. And I'll ask you the question that I
15 asked you at your deposition. You're as sure of the
16 answers dealing with the calculations of Panhandle as
17 everything else that you have testified to in this
18 case; right, sir?

19 A. Yes.

20 MR. HERSCHMANN: Can I have a moment,
21 please? Actually, a two-minute recess and I may be
22 done.

23 JUDGE WOODRUFF: All right, two-minute
24 recess, come back at a quarter-till.

25 MR. HERSCHMANN: Thank you.

1 (A recess was taken at this time.)

2 JUDGE WOODRUFF: We're back live. And
3 Mr. Herschmann, you can continue your
4 cross-examination -- or recross.

5 MR. HERSCHMANN: Thank you.

6 Q. (By Mr. Herschmann) Just make sure,
7 let me close the loop on this. Is your belief --
8 well, withdrawn.

9 Did you talk to Mr. Oligschlaeger
10 during the break?

11 A. Yes, I did.

12 Q. And did he try to correct some of the
13 things that you were saying up here?

14 A. No.

15 Q. Did he tell you that you were correct
16 in your analysis?

17 A. He just indicated that some of the
18 things I have said may make his life a little harder,
19 but that's it, we didn't talk about the details.

20 Q. My guess is it is going to make it a
21 lot harder.

22 A. I don't think I agree, but that's
23 okay.

24 Q. All right. Did -- I just want to make
25 sure I'm clear on one point. In Mr. Oligschlaeger's

1 testimony on page 5 of the surrebuttal, the question
2 was asked: Do you agree with Staff Witness Murray's
3 approach of subtracting the stand-alone amount of
4 Panhandle equity from Panhandle's Form 10-K from the
5 total Company SU equity or SU's Form 10-K to
6 determine the appropriate amount of equity in an MGE
7 capital structure excluding Panhandle? He answered
8 no.

9 Was that the question that he's going
10 to change the answer to, or are there other things
11 that he told you that will change?

12 A. That's my understanding, that's the
13 only question.

14 Q. Do you recall testifying previously
15 that one of the violations that you believe that
16 occurred based on the Panhandle agreement was
17 Southern Union's failure to comply with the
18 provisions dealing with quarterly certifications?

19 A. Yes.

20 Q. Who did you talk to that told you that
21 there was no compliance?

22 A. I don't believe anybody said -- and
23 maybe I should rephrase that. I have not talked to
24 anybody that has said they received those reports. I
25 have checked with the individuals that were also on

1 that case, the attorneys involved with that case, my
2 Division Director which is Bob Shalemburg [phonetic].
3 I talked with two other individuals that were on the
4 case, Mark Oligschlaeger and Chuck Hyneman. And we
5 -- they had not seen those reports.

6 Q. You've not seen any certifications
7 from anybody about compliance?

8 A. No.

9 MR. HERSCHMANN: Can I mark some
10 exhibits, please? What number are we up to?

11 JUDGE WOODRUFF: We're up to 33.

12 (Exhibits 33 through 36 marked for
13 identification.) 33 through 36).

14 MR. HERSCHMANN: For the record, I
15 know they're being handed out now, I'll also provide
16 additional copies to the Commissioners.

17 33 is entitled a Certificate of
18 Compliance, which is an affidavit submitted by
19 Richard N. Marshall, the Vice President and Treasurer
20 for Southern Union Company, and sworn to on August
21 1st of 2003.

22 Exhibit 34 is also a Certificate of
23 Compliance, again, an affidavit by Richard N.
24 Marshall, which is sworn to November 10th, 2003.

25 Exhibit 35 is another Certificate of

1 Compliance, an affidavit by Richard Marshall, sworn
2 to on February 4th -- I'm sorry, February 3rd, 2004.

3 And Exhibit 36 is a Certificate of
4 Compliance, again, an affidavit signed by Richard N.
5 Marshall, the Vice President and Treasurer for
6 Southern Union Company dated May 4th of this year.

7 Q. (By Mr. Herschmann) Now, Mr. Murray,
8 at the time of your deposition, you told us you
9 didn't have any reason to believe there were any
10 violations of the stipulation agreement; is that
11 right?

12 A. That's correct.

13 Q. One of the things you just raised
14 today was your understanding or belief that Southern
15 Union had not filed the certifications of compliance;
16 is that correct?

17 A. I had not seen those, yes.

18 Q. And now do you have before you each of
19 the certifications of compliance for the relevant
20 time periods that shows that Southern Union was, in
21 fact, in compliance with the terms of the Panhandle
22 agreement, stipulation, and order?

23 A. I don't know if the determination has
24 been made that this is the best efforts, that's kind
25 of a vague term, but best efforts to insulate MGE.

1 You have -- there's the same things written each time
2 in these certificates of compliance, but as far as
3 what best efforts means and whether or not that means
4 taking any additional type of steps to further
5 insulate MGE, I don't know that that's clear.

6 Q. So your first objection was that there
7 were no reports; right? There were no
8 certifications; right?

9 A. None that I was aware of, I don't --

10 Q. And now that you have the
11 certifications in front of you that you weren't even
12 aware of, you are not going to modify your answer and
13 say, well, you're not sure whether these
14 certifications comply with the stipulation order; is
15 that it?

16 A. This is the first time I have had a
17 chance to look at them.

18 Q. Do you understand that Mr. Marshall is
19 the Vice President and Treasurer for Southern Union
20 Company?

21 A. I understand that.

22 Q. Do you understand it's a publicly
23 traded company?

24 A. Yes, I do.

25 Q. Do you understand that he swore to

1 something under penalties of perjury?

2 A. Yes, I do.

3 Q. Do you think as the Vice President and
4 Treasurer of a publicly traded company, he would file
5 a false affidavit before this Commission?

6 A. No.

7 Q. Is it your belief that if Southern
8 Union is in compliance with the stipulation and
9 agreement and has insulated MGE, that's not the best
10 efforts? I'm just trying to figure out --

11 A. I understand. I understand. I
12 understand. But one of the issues here is I have not
13 -- this is the first time I have seen these -- these
14 certificates of compliance. And I have not discussed
15 this with any of the individuals that were assigned
16 to that case.

17 And as far as the language that was
18 used in that stipulation agreement, whether or not
19 this would meet the best efforts and as far as saying
20 the -- you know, maintaining everything in each one
21 of these certificate of compliance that they are not
22 doing such-and-such in the paragraph 2 does not
23 really show any additional steps that are being taken
24 to -- to help to properly insulate MGE. And that's
25 probably a problem with the vagary of the language in

1 that condition.

2 But I have not had time to discuss
3 this with other Staff personnel. This is the first
4 time I have seen these documents.

5 Q. Okay. Have you ever heard of a term a
6 good faith obligation in a contract?

7 MR. BERLIN: Objection, Your Honor.
8 Mr. Murray is not a legal expert. We're getting into
9 contracts, we're getting into contract law. He's not
10 a lawyer, he's not representing himself as an
11 attorney, and this is well far afield of what should
12 be allowed.

13 JUDGE WOODRUFF: The question was
14 simply whether or not he's heard of the term. That's
15 a proper question. Your objection is overruled.

16 THE WITNESS: I believe I've heard the
17 term before, I'm not real familiar with the specific
18 definition.

19 Q. (By Mr. Herschmann) Do you understand
20 that in almost every single contract, there's an
21 implicit duty of good faith? Have you ever heard of
22 that?

23 MR. BERLIN: Objection, Your Honor.
24 Again, we're talking about contract law here, and Mr.
25 -- Mr. Murray is not an attorney. And Mr. Herschmann

1 obviously would like to discuss contract law with
2 him, but -- by his questions, and it's improper.

3 JUDGE WOODRUFF: Overruled.

4 THE WITNESS: Could you repeat the
5 question, please?

6 MR. HERSCHMANN: Could you read it
7 back, please?

8 THE REPORTER: Do you understand that
9 in almost every single contract, there's an implicit
10 duty of good faith? Have you ever heard of that?

11 THE WITNESS: Anytime there's a
12 contract, I would think that there's an obligation,
13 if not a legal obligation, to abide by that contract.

14 Q. (By Mr. Herschmann) And what is the
15 requirement in the contract as it relates to the
16 certifications that you said previously you didn't
17 know were filed?

18 A. Repeat the question, please.

19 Q. What are the obligations pursuant to
20 the stipulation agreement and order that are required
21 to be filed quarterly?

22 A. Let me refer to that specific edition.

23 Q. Let me make it easier, I'll read it to
24 you from page 6.

25 A. I'll pull out the stipulation

1 agreement, please.

2 Q. You can pull it out and if you can
3 listen at the same time, it may make it easier.

4 Southern Union will submit reports
5 certifying its compliance with this paragraph 2 on a
6 quarterly basis to Staff, Public Counsel, and other
7 interested parties that are subject to a Commission
8 protective order until the Commission determines that
9 MGE is insulated from Southern Union's other
10 operations and activities of any of its affiliates or
11 that the requirement is no longer needed.

12 A. Yes, I understand that to be correct.

13 Q. And you testified beforehand and
14 alleged that Southern Union had breached the
15 agreement because it hadn't filed the certifications
16 of the quarterly reports; right?

17 A. I indicated that I had not received
18 those reports, and had contacted others in our Staff
19 and they had indicated they had not received any
20 reports. So I don't know who ended up receiving
21 these, to be quite honest with you, and I don't know
22 -- do you know who these ended up being --

23 Q. I'm not testifying, but I'm going to
24 help you out.

25 A. I appreciate that.

1 Q. You did allege that there was a breach
2 of the agreement because we didn't file the quarterly
3 reports; right?

4 A. I indicated I had not seen the
5 reports, so that was my assumption that we had not
6 received those reports.

7 Q. And that was a breach, right, that's
8 what you said?

9 A. That would have been a violation of
10 the agreement if we had not received those reports.

11 Q. Who is Cliff, is it Snodgrass?

12 A. He's an attorney with the General
13 Counsel's Office.

14 Q. And General Counsel's Office of which
15 entity?

16 A. Missouri Public Service Commission.

17 Q. And what is his title there?

18 A. He's part of the General Counsel's
19 Office, I don't know what his specific title is.

20 Q. And do you know Mr. Micheel?

21 A. Yes, I do.

22 Q. And who is Mr. Micheel?

23 A. He's sitting right to my right here.
24 He's an attorney with the Office of the Public
25 Counsel.

1 Q. Did you ever ask Mr. Micheel, by the
2 way, did Southern Union ever file those
3 certifications pursuant to the stipulation agreement?

4 A. No, I asked within my own agency. I
5 didn't ask Mr. Micheel.

6 MR. HERSCHMANN: I'm going to be
7 starting with Exhibit 37, and I apologize that I
8 don't have multiple copies. But for the record,
9 these are letters dated August 14th, 2003, November
10 13th, 2003, February 13th, 2003, and May 14th, 2004.

11 And it has the -- well, the second
12 page of the exhibits are the cover pages that state
13 Missouri Gas Energy, a division of Southern Union
14 Company. It has a listing of cases and then lists
15 the reporting period that is being covered. And I'd
16 ask that we mark each one of these separately.

17 JUDGE WOODRUFF: All right.

18 MR. HERSCHMANN: At this time I'd
19 offer Exhibits 33, 34, 35, 36, 37, 38, 39, and 40
20 into evidence.

21 JUDGE WOODRUFF: Can you describe for
22 me what 37 through 40 are? Because I haven't seen
23 any of them.

24 MR. HERSCHMANN: Sure. I apologize.
25 37 is a letter dated August 14th, 2003. I believe

1 these will correspond with the same month exhibited
2 -- exhibits. So 37 I believe had the certifications,
3 the cover letter from -- to Mr. Micheel, is it Mr.
4 Snodgrass?

5 THE WITNESS: Snodgrass.

6 MR. HERSCHMANN: Snodgrass, from Mr.
7 Hack in dealing with the compliance with the
8 stipulation and agreement with the Panhandle
9 acquisition.

10 So Exhibit 37, pages 1 and 2, would go
11 with Exhibit 33.

Exhibit 38 is a November 13th, 2003 letter, again, dealing with the same issues to the same individuals. And again, Exhibit 38 goes with Exhibit 34, which was part of the letter.

16 Exhibit 39 is dated February 13th,
17 2004, and that one is addressed to Mr. Micheel, Mr.
18 Snodgrass, and Mr. Franson, and that goes with
19 Exhibit 35.

20 And then Exhibit 40 is, again, the
21 same cover letter addressed to Mr. Micheel and Mr.
22 Snodgrass, and that would go with Exhibit 36.

23 And I'd offer those exhibits into
24 evidence at this time.

25 JUDGE WOODRUFF: What was the date on

1 No. 40?

2 MR. HERSCHMANN: May 14th, 2004.

3 MR. FRANSON: What was the date on 39?

4 MR. HERSCHMANN: That's February 13th,
5 2004.

6 JUDGE WOODRUFF: All right, Exhibits
7 33, 34, 35, 36, 37, 38, 39, and 40 have been offered
8 into evidence. Are there any objections to their
9 receipt? Hearing none, they will be received into
10 evidence.

11 MR. HERSCHMANN: If I could just have
12 somebody make copies of these for everybody.

13 JUDGE WOODRUFF: I would appreciate
14 that.

15 Q. (By Mr. Herschmann) Mr. Murray, do
16 you recall being asked certain questions by
17 Commissioner Clayton dealing with the recommendations
18 that the Staff has made in comparison to the OPC and
19 the different roles of the Staff and the OPC?

20 A. Yes, I do.

21 Q. And if you could look at the chart
22 that's on the board, I believe it's JCD-7 attached to
23 Mr. Dunn's testimony, do you see that this is an
24 analysis of the recommendations of the Staff, the
25 OPC, compared to the RRA for the time periods

1 September 1993 through September of '03?

2 A. Yes, I see that.

3 Q. Do you see where Staff is on the graph
4 beginning in 1998?

5 A. Yes, I do.

6 Q. And do you see the box of Staff is
7 almost consistently below the recommendation of the
8 OPC starting in 1998; is that correct?

9 A. Yes.

10 Q. What changes, if any, occurred in the
11 Staff that caused them to begin to recommend below
12 the OPC during that time period?

13 A. Actually -- I addressed this in some
14 detail in my rebuttal testimony in Missouri American
15 Water Company, WR-2003-0500. Usually I do not,
16 because Public Counsel is usually not far off of what
17 we're recommending. We were coming under some
18 criticism for coming in lower than Public Counsel, so
19 I addressed extensively in rebuttal testimony in
20 Missouri American WR-2003-0500 as to the reasons why
21 I thought Staff was lower than OPC.

22 MR. HERSCHMANN: Can I ask that the
23 question be read back, and can you give us your
24 answer today, please?

25 THE WITNESS: Well, if you want me to

1 be able to give you an answer today, I need to look
2 at my testimony from WR-2003-0500 that explained some
3 of the changes in the methodologies that occurred at
4 OPC that resulted in their recommendations being
5 higher than Staff's recommendations.

6 MR. HERSCHMANN: Could you read back
7 the question, please? And just tell me if you can
8 answer any portion of it today without reviewing some
9 testimony that, obviously, I don't know what you're
10 talking about.

11 THE WITNESS: Well, it was pretty
12 lengthy, so.

13 MR. HERSCHMANN: Let's see what you
14 recall from it, then.

15 THE WITNESS: Okay. This is what I
16 recall --

17 MR. HERSCHMANN: I think we have to
18 read back the question now.

19 THE REPORTER: What changes, if any,
20 occurred in the Staff that caused them to begin to
21 recommend below the OPC during that time period?

22 THE WITNESS: Okay. One thing I
23 mentioned in my testimony and in the Missouri
24 American case was that there were times that the OPC
25 witness would include negative growth rates in his

1 calculations to evaluate what he thought was an
2 appropriate growth rate. There were also times when
3 he decided to exclude negative growth rates.

4 It was not consistent from case to
5 case. At one time he excluded the negative growth
6 rates, and then for a while there for about two or
7 three cases he included the negative growth --
8 included the negative growth rates. And in the last
9 couple cases, he decided to exclude them.

10 There were things going on where
11 methodologies were being changed that I thought
12 resulted in an upward recommended cost to equity.
13 There were -- it was also some changes to his capital
14 asset pricing model analysis. Typically he would
15 look at the -- the returns on large companies' stocks
16 and subtract that from the returns on long-term
17 treasuries over the period of 1926 to whenever the
18 ending period was from the Ibbotson & Associates
19 book.

20 He changed his market return to an
21 average of the small and large companies' stocks,
22 which obviously when you put the small stocks into
23 the mix, the market return was much higher, resulting
24 in a higher risk premium. And this also acted to
25 have an upward adjusted cost to common equity.

1 And all these things were occurring,
2 and I -- I can't get in the mind of the Public
3 Counsel witness at the time, but I will, you know,
4 tell you that the Staff, the financial analysis
5 department felt a bit of pressure because of this --
6 this trend that was occurring. And we were not
7 changing our analysis, we were consistent with our
8 analysis.

9 And I had a very good relationship
10 with the Public Counsel witness at the time and still
11 do, and -- but it was just a matter of professional
12 credibility. I felt like this is something that had
13 to be addressed. This is -- we're all here to do a
14 job, and I needed to defend my professional
15 credibility and as to why Staff was coming in a bit
16 lower.

17 We've always been consistent with --
18 with our methodologies. We do not change because
19 we're not comfortable with the lower number or a
20 higher number. We are just -- we are just following
21 what's going on within the capital and economic
22 environment.

23 The interest rates are at their lowest
24 level since 1966. I think anybody that has received
25 a mortgage since 1998 recognizes that this is about

1 the cheapest money that you have been able to receive
2 on a mortgage on your house. That's why people are
3 refinancing and that's why money is being pumped into
4 the economy.

5 And that's why -- that's why people
6 make investments if -- once the economy starts to
7 pick up, because money is cheap right now. And I
8 know you see the articles indicate that money --
9 money -- that cheap money is about to end, and who
10 knows if that will happen. Who knows if that will
11 happen. I've tried to make bets on interest rates
12 before, and I've lost.

13 Q. (By Mr. Herschmann) Does Alan
14 Greenspan, do you think, know?

15 A. Excuse me?

16 Q. Do you think Alan Greenspan knows?

17 A. I think Alan Greenspan does his best.
18 He's just like anybody else, doing his best. He's
19 very well respected, just like many other people are
20 well respected. But we know what the interest rates
21 are now and we know that they're very low levels.
22 And these low levels were not even understood by
23 Roger Morin. Dr. Morin, that is.

24 Q. Let me ask you a question. Southern
25 Union has some outstanding debt now; right?

1 A. Yes, they do.

2 Q. And can Southern Union, like a home
3 mortgage, refinance that debt right now?

4 A. They have indicated they can't because
5 of -- because the call premium is too high. I have
6 not seen any net present value calculations of that.
7 I do know that there's been refinancing going on at
8 the Panhandle level that occurred quite quickly after
9 -- after it was acquired by Southern Union.

10 Q. You mentioned the mortgage as an
11 analogy. If you want to refinance a mortgage on your
12 house, normally there are not restrictions that would
13 preclude you from doing so; right?

14 A. You have to pay closing costs which
15 could be anywhere from a thousand dollars to \$2,000,
16 so you have to weigh that up-front cost associated
17 with whether or not the savings in interest is going
18 to be worth it. You have to look at your situation,
19 look at how long you're going to be in the house, and
20 look at whether or not this is going to result in a
21 long-term savings. Hence, the use of net present
22 value calculations in corporate finance.

23 Q. The bonds in this case, Southern Union
24 just can't call up the bond holders and say, oh, by
25 the way, just give us back the bonds and we'll just

1 issue you some new bonds at lower rates; right? You
2 guys don't mind; right? That's not going to actually
3 work --

4 A. I believe the tender offer's been made
5 at the Panhandle level where they called up the bond
6 holders and said, hey, would you mind if we bought
7 the bonds back from you and we want to refinance and
8 take advantage of lower cost debt.

9 Q. Are there any restrictive confidence
10 in the Southern Union debt levels that you're aware
11 of?

12 A. I have not had a chance to look at the
13 indentured agreements in the covenants.

14 Q. So if there were covenants that had
15 certain premiums recalled, payments -- or the
16 requirements of the payment of all the interest, do
17 you think that would be prohibitive for Southern
18 Union to do?

19 A. I have not seen any detail analysis
20 from Southern Union on their -- on how they determine
21 that they thought this was cost prohibitive.

22 Q. Now, I just want to go back for a
23 moment to the Panhandle issue that you raised. You
24 said you read Mr. Dunn's surrebuttal; is that
25 correct?

1 A. Yes, I did.

2 Q. Will you turn to page 9 of his
3 surrebuttal, please.

4 A. I'm there.

5 MR. MICHEEL: Your Honor, I think at
6 this point I'm going to object. I don't recall any
7 questions at all about Mr. Dunn's surrebuttal
8 testimony, and I'm not really certain how this is
9 even remotely close to a question that Commissioner
10 Clayton asked at this point.

11 MR. BERLIN: Staff agrees, Your Honor.
12 This doesn't even relate to Commissioner Clayton's
13 questions.

14 JUDGE WOODRUFF: Let's ask. How does
15 this relate to Commissioner Clayton --

16 MR. HERSCHMANN: This witness
17 testified that Mr. Dunn improperly backed out the
18 Panhandle acquisition from the Southern Union
19 consolidated GAAP structure in response to
20 Commissioner Clayton's questions. He further said
21 that it has no relevance whatsoever. And I think
22 this directly will go to his credibility in light of
23 the fact he said there is no way to do it and the way
24 he did it is the correct way. And I'd like to walk
25 him through what I believe is total maybe of a page

1 with a chart.

2 JUDGE WOODRUFF: You may address the
3 issue quickly. The objection is overruled.

4 Q. (By Mr. Herschmann) Now, Mr. Murray,
5 do you see that the first thing that Mr. Dunn did in
6 the elimination of Panhandle from Southern Union's
7 consolidated capital structure is that he removed
8 \$48.9 million of common equity. Do you see that?

9 A. This is page 9 in the surrebuttal
10 testimony?

11 Q. That's correct.

12 A. Line 25?

13 Q. You got it.

14 A. 48.9 -- yes, I see it.

15 Q. And you have Exhibit 31 in front of
16 you still?

17 A. Yes, I do.

18 Q. And do you see on Exhibit 31 that
19 there were three million shares of Southern Union's
20 common stock valued at approximately \$48.9 million
21 that were issued and given to the prior owners of
22 Panhandle?

23 A. CMS Energy, that's correct.

24 Q. So \$48.9 million had clearly come off
25 of Southern Union's consolidated balance sheet

1 because they gave away \$48.9 million of its common
2 equity; right?

3 A. That's one way of doing it, yes.

4 Q. You see the second adjustment that Mr.
5 Dunn made was to eliminate \$91 million in equity
6 related to retained earnings of Panhandle Eastern
7 since the acquisition.

8 A. I see that.

9 Q. You see the last adjustment that he
10 made is to eliminate actually \$145 million compared
11 to the \$121 million that's listed on the 10-K with a
12 combination of common equity and equity units, do you
13 see that?

14 A. I see that.

15 Q. Now, do you know that Southern Union
16 issued \$300 million worth of common equity and equity
17 units?

18 A. Combined, that's correct.

19 Q. And if \$175 million was common stock
20 and \$125 million was equity units, can you give us a
21 approximation of what the percentages are from the
22 total offering? And just tell me if these sound
23 right.

24 A. For the common equity versus the
25 total?

1 Q. Right. Well, the common equity and
2 equity units. Does it sound correct if it's \$175
3 million worth of common stock out of 300 million,
4 that it's 58.33 percent of common stock; and if it's
5 125 million, then the balance would be 41.67 percent.
6 Does that sound correct to you?

7 A. Why don't you let me pull my
8 calculator out and I'll verify that.

9 Q. Sure.

10 A. What was your total amount again,
11 please?

12 Q. 300 million.

13 A. And how did you arrive at the 300
14 million?

15 Q. Based on Southern Union's actual
16 equity offerings, the equity units in the stock
17 offering.

18 A. I thought it was 290. Can you tell me
19 the specific numbers you used to get to 300?

20 Q. I don't have that in front of me.
21 It's a June 2003 offering. I think we're looking at
22 the gross amounts versus the net amounts. The gross
23 offering.

24 A. I'd like to be able to get this right
25 as far as the numbers.

1 Q. Let's just do it at 300 million, and
2 tell me if 175 million of common stock would
3 translate into approximately 58 percent of the 300 --

4 A. I would still like to --

5 MR. MICHEEL: Your Honor, I'm going to
6 object at this point. He's asking him to assume
7 facts not in evidence about this \$300 million, maybe
8 they did it, maybe they didn't. And to that extent,
9 those facts aren't in evidence and this line of
10 questioning is improper.

11 JUDGE WOODRUFF: Overruled.

12 MR. BERLIN: I join in --

13 JUDGE WOODRUFF: Pardon me?

14 MR. BERLIN: I'll join in on that
15 objection. It's not in the record.

16 JUDGE WOODRUFF: Again, it's
17 overruled.

18 THE WITNESS: Can I ask for the
19 specific numbers that he's referring to, because he's
20 evidently gotten to 300 somehow or another.

21 Q. (By Mr. Herschmann) You said it's
22 290. It was a \$300 million offering and the net
23 proceeds were 290 million; is that right?

24 A. I believe 290 is the number that I
25 recall.

1 Q. And were there costs associated with
2 an offering?

3 A. There usually is, yes.

4 Q. What are those things called?

5 A. Usually you'll have some just issuance
6 expenses.

7 Q. Flotation costs?

8 A. Flotation costs, that's more or less a
9 -- it's not something that's tangible. The flotation
10 costs are cost of -- for the depression of the stock
11 price. That's not something that is necessarily a
12 cash outflow for the Company.

13 Q. Let's just make round numbers so it
14 will be easier. Can we go with 300 million?

15 A. No, I would like to go with the
16 specific numbers.

17 Q. Well, I'm going to ask you to do it
18 anyway, if you don't mind. Is 175 million
19 approximately 58 percent of 300 million? That's the
20 question. Can you do that calculation?

21 A. It's 58.3 percent.

22 Q. And so the balance of the equity units
23 would be the balance between 58 percent and 100
24 percent, which is approximately 41 percent and
25 change; right?

1 A. Yes.

2 Q. So we now know that Southern Union
3 gave \$581 million in cash; right? Go back to the
4 10-K. \$581 million --

5 A. Okay.

6 Q. -- 729,000 in cash; right?

7 A. Yes.

8 Q. And three million shares of Southern
9 Union's stock; right?

10 A. Yes.

11 Q. And they raised additional funds
12 through this equity offering and equity units
13 offerings; right?

14 A. Yes.

15 Q. And if you take a percentage of the
16 equity offering of 58 percent, since that's part of
17 the entire offering of common stock, and you take the
18 41 percent of equity units, you come -- you can come
19 out with another \$121 million in additional cash that
20 was raised; right?

21 A. According to those calculations, yes.

22 Q. And those were actually the number
23 that's used in the 10-K, which is Exhibit 31 in front
24 of you; right?

25 A. Those are based on those numbers,

1 that's correct.

2 Q. And the \$121 million number is the
3 same number Mr. Oligschlaeger used; right?

4 A. I don't recall. I haven't looked in
5 his testimony for a while.

6 Q. We'll agree with whatever number it
7 says in his testimony is what he used; right?

8 A. Let me take a look.

9 JUDGE WOODRUFF: One moment, please,
10 while the court reporter changes her tape.

11 THE WITNESS: Yes.

12 Q. (By Mr. Herschmann) Do you see the
13 number now?

14 A. Yes, I do.

15 Q. So that's how Southern Union came up
16 with the \$581,729,000; right?

17 A. Based on percentages and allocations,
18 yes, that's based on what you're alleging, yes,
19 that's correct.

20 Q. And do you still believe that, since
21 you now have an understanding based on the 10-K how
22 they raised the money to give to CMS for the
23 acquisition of Panhandle, they should take another
24 \$437 million or 640 -- I'm sorry, another \$646
25 million off of Southern Union's total shareholder

1 equity?

2 A. Like I said, I think that's something
3 Mr. Oligschlaeger is going to address. He addressed
4 all these issues very specifically in his rebuttal
5 testimony.

6 Q. I'm looking for you to answer my
7 question. Do you still think --

8 A. Yes.

9 Q. Let me ask it so it's on the record.

10 A. Yes.

11 Q. Do you still think it's appropriate,
12 after going through these calculations just now,
13 looking at the 10-K, to still take off \$646 million
14 from Southern Union's consolidated capital structure
15 in relationship to the rate proceedings in this case?

16 A. Yes, it's one way to look at it.

17 MR. HERSCHMANN: I have no further
18 questions at this time.

19 JUDGE WOODRUFF: Thank you. Move to
20 redirect.

21 REDIRECT EXAMINATION BY MR. BERLIN:

22 Q. Good afternoon, Mr. Murray.

23 A. Good afternoon.

24 MR. BERLIN: Your Honor, I would like
25 to offer into evidence Exhibit 843.

1 JUDGE WOODRUFF: That's the cost of
2 capital chart?

3 MR. BERLIN: Yes.

4 JUDGE WOODRUFF: That was actually
5 offered earlier and I deferred ruling on it. I
6 believe it was used during your opening statements.

7 MR. BERLIN: Yes, it was.

8 JUDGE WOODRUFF: 843 at this time is
9 being offered. Does anybody have any objection to
10 it?

11 MR. HACK: Objection based on the same
12 standing objection related to Mr. Murray's
13 qualifications and expertise.

14 JUDGE WOODRUFF: All right. Subject
15 to that objection, the 843 will be admitted into
16 evidence. You can proceed.

17 Q. (By Mr. Berlin) Mr. Murray, I'm
18 holding a copy of a -- or some copies of a book --

19 MR. BERLIN: Your Honor, may I
20 approach the witness?

21 JUDGE WOODRUFF: You may.

22 Q. (By Mr. Berlin) Mr. Murray, could you
23 please identify what copies I have presented to you?

24 A. Yes, this is a copy of the front cover
25 of the book by Aswath Damodaran, Investment

1 Valuation: Tools and Techniques for Determining the
2 Value of Any Asset, which is a book that's used in
3 the curriculum for the CFA program.

4 Q. And is this a book that you relied
5 upon in your testimony?

6 A. Yes, it is.

7 MR. BERLIN: Your Honor, I would like
8 to offer into evidence what was premarked Exhibit
9 846.

10 JUDGE WOODRUFF: I believe that was
11 marked earlier under somebody else's testimony, was
12 it not? As 846?

13 MR. BERLIN: Yes.

14 JUDGE WOODRUFF: Do you remember which
15 person that was -- it was marked and then withdrawn,
16 as I recall.

17 MR. BERLIN: Yes.

18 JUDGE WOODRUFF: Do you remember who
19 was testifying at that time? Was that Mr. Dunn?

20 MR. BERLIN: I believe Mr. Dunn was
21 testifying at that time.

22 JUDGE WOODRUFF: All right. Well --

23 MR. HACK: Objection.

24 JUDGE WOODRUFF: What is your
25 objection?

1 MR. HACK: Objection, same basis as
2 the earlier objection, that we don't believe and we
3 have alleged that Mr. Murray doesn't qualify as an
4 expert, and therefore, this material is hearsay and
5 there's a lack of foundation for its admission. Not
6 entitled to rely on it as not being an expert.

7 JUDGE WOODRUFF: Okay. You are
8 objecting to Mr. Murray's qualifications as an
9 expert? Mr. Herschmann.

10 MR. HERSCHMANN: There's an objection
11 on lack of -- I'm sorry.

12 JUDGE WOODRUFF: Just a minute, Mr. --
13 let him speak his peace first, and then I'll come
14 over to you. Mr. Herschmann.

15 MR. HERSCHMANN: The objection is it's
16 hearsay, and again, specifically as relates to this
17 exhibit, the copyright page of the book specifically
18 says it is sold with the understanding that the
19 publisher is not engaged in rendering legal
20 accounting or other professional services. If legal
21 advice or other expert assistance is required, the
22 services of a competent professional person should be
23 sought.

24 In light of the specific caveat and --
25 I've only seen these three pages or four pages of

1 this book, I would object, but specifically on
2 hearsay grounds.

3 JUDGE WOODRUFF: All right. Mr.
4 Micheel?

5 MR. MICHEEL: I just don't think they
6 should be tag teaming. I mean, either Mr. Herschmann
7 is making the objections or Mr. Hack is making the
8 objections, and the witness, and from here on out,
9 could we just have one lawyer doing the talking for
10 the Company?

11 MR. HERSCHMANN: I'm more than happy
12 to accept that responsibility, and I don't even
13 object to both Bobs doing it on behalf of the Staff.

14 MR. FRANSON: Actually, until this
15 moment in time, this Bob, who prefers to be called
16 Robert, hasn't said a word. But with that
17 understanding, let's make it clear, Mr. Berlin is
18 Staff's attorney in this matter.

19 JUDGE WOODRUFF: Mr. Micheel's
20 objection is well taken. We do need to avoid tag
21 teaming the witness. And so, Mr. Herschmann, we'll
22 expect you to be the counsel making objections.

23 MR. HERSCHMANN: Yes, Your Honor.

24 JUDGE WOODRUFF: Thank you. All
25 right. As to the objection, can you -- Mr. Berlin,

1 can you explain the relevance of this document?

2 MR. BERLIN: Yes. The Company is
3 stating that and claiming that Staff Expert Witness
4 Murray is not a qualified expert witness. Mr. Murray
5 just said that he used this resource in the
6 preparation of his testimony. Throughout --

7 JUDGE WOODRUFF: I don't know if he
8 said that yet, or you were about to ask him that. So
9 why don't you ask him that.

10 THE WITNESS: Actually, I used it in
11 rebuttal testimony to question some of the -- some of
12 the models or some of the application of the models
13 of the CAPM of other witnesses in this case, which I
14 believe gets into some other knowledge as well.

15 JUDGE WOODRUFF: All right.

16 MR. HERSCHMANN: I'm going to renew my
17 objection.

18 JUDGE WOODRUFF: All right.

19 MR. HERSCHMANN: On hearsay grounds.
20 And also it's clearly beyond the scope of the
21 recross, since I didn't address this issue and I
22 don't think Commissioner Clayton addressed this issue
23 at all.

24 JUDGE WOODRUFF: Certainly nobody
25 talked about this book, but what issue is this book

1 excerpt relevant to?

2 MR. BERLIN: This goes, Your Honor, to
3 the CAPM model and the analysis that Mr. Murray had
4 performed in his rebuttal testimony, which Mr.
5 Herschmann, you know, is objecting to being allowed
6 into evidence in this case.

7 And this is a source, much like the
8 other sources that have been relied upon by expert
9 witnesses in this proceeding, that Mr. Murray has
10 relied on. And it is an important tool and resource
11 that was used in the preparation of his testimony.

12 JUDGE WOODRUFF: You indicated you
13 referred to -- it's talking about the CAPM model?

14 MR. BERLIN: Yes.

15 JUDGE WOODRUFF: What -- were there
16 any questions from the bench about the CAPM model of
17 this witness?

18 MR. BERLIN: Well, Your Honor, I think
19 this just goes to Mr. Murray's analysis of -- of the
20 testimony and the preparation of his testimony.

21 JUDGE WOODRUFF: Is -- is -- what I'm
22 trying to get at, is there any basis for saying that
23 this is in response to the questions from the bench?
24 Because that was the only -- well, there was another
25 cross, too.

1 Just tell me how this is related to
2 what has gone before on this -- regarding this
3 witness. I mean, I haven't read the excerpt, so I
4 haven't -- I don't have any idea at this point what
5 -- what relevance this might have, and I just need to
6 have you explain that to me.

7 MR. BERLIN: If I could take a
8 two-minute recess.

9 JUDGE WOODRUFF: All right. We'll
10 stay on the record, and counsel can converse if they
11 wish to.

12 MR. FRANSON: Thank you, Your Honor.

13 JUDGE WOODRUFF: This is already going
14 longer than I thought it would. We'll take a
15 three-minute recess. We'll come back at 20 minutes
16 to 5.

17 (A recess was taken at this time.)

18 JUDGE WOODRUFF: All right. Let's go
19 back on the record then, and everybody's had a short
20 break and, Mr. Berlin, if you would like to proceed.

21 MR. BERLIN: Thank you, Your Honor.

22 Q. (By Mr. Berlin) Mr. Murray, would you
23 please identify this particular document. What is
24 this?

25 A. This is a textbook that's used for a

1 chartered financial analyst program which is a --

2 MR. HERSCHMANN: I'm going to object.

3 The question is to identify the exhibit, the question
4 is not related to what it's used for. It's four
5 pages, what are the four pages? Not to give
6 testimony of the usage of the book. It has to first
7 be identified, and then if they offer it, we'll deal
8 with things.

9 MR. BERLIN: Your Honor, I am going
10 trying to have this identified.

11 JUDGE WOODRUFF: It's a nonresponsive
12 response. Okay. You can ask your next question.

13 Q. (By Mr. Berlin) Mr. Murray, is
14 Investment Valuation a resource book that you have
15 consulted with?

16 A. Yes, it is.

17 Q. Is it written by a Mr. Damodaran?

18 A. Yes, it is.

19 Q. Who is Mr. Damodaran?

20 A. He's actually a professor, a Ph.D., at
21 NYU, the Stern School of Business. And he's actually
22 -- well, obviously, a recognized individual in the
23 area of finance. I think even Mr. Dunn himself
24 quoted from his website in his surrebuttal testimony.

25 MR. HERSCHMANN: Your Honor, I'm going

1 to object to this line. This is clearly beyond any
2 of the recross.

3 MR. BERLIN: No --

4 JUDGE WOODRUFF: It's foundational,
5 you're overruled.

6 Q. (By Mr. Berlin) All right. Mr.
7 Murray, this is a textbook, is it?

8 A. Yes, it is.

9 Q. And Mr. Damodaran is connected with
10 New York University?

11 A. Yes, he is.

12 Q. And this is a resource that you
13 consulted with; correct?

14 A. Specifically for the CAPM model, yes,
15 that's correct.

16 Q. And the CAPM model was one of the cost
17 of capital models that you looked at; is that
18 correct?

19 A. Yes, it's one of the cost of capital
20 models used to determine a required return in this
21 proceeding.

22 MR. BERLIN: And Your Honor, I'd like
23 to offer this into evidence. Commissioner Clayton
24 did indeed talk about cost of capital models in his
25 questioning, he referred to cost of capital models.

1 Mr. Herschmann had extensive questions for Mr. Murray
2 regarding Mr. Dunn's testimony, and this is a key
3 resource that Mr. Murray used in the analysis of Mr.
4 Dunn's testimony.

5 MR. HERSCHMANN: May I respond?

6 JUDGE WOODRUFF: You may.

7 MR. HERSCHMANN: I looked at the
8 pages, this directly relates to CAPM. And I am
9 certain if you looked at the transcript, I don't
10 believe it was mentioned once in either the questions
11 from Mr. Clayton, clearly not in any questions from
12 me. The only portion of Mr. Dunn's testimony that I
13 addressed was the relationship to backing out
14 Panhandle, which is on page 9 of the surrebuttal.

15 Moreover, besides being improper
16 redirect, this is an attempt to bolster this witness'
17 methodologies that he used on recross. And he could
18 say, and he has said, he read the book and it's in
19 his testimony and he says he relied upon it. That
20 all he can do. He can't offer pages on it, it's
21 clearly going to be hearsay under any circumstances.
22 And it's well beyond the scope and it's clearly
23 designed just to bolster this witness' testimony.

24 JUDGE WOODRUFF: I'm going to rule in
25 favor of MGE. I don't see the relevance of this. It

1 does appear to be hearsay. I'm not going to admit it
2 at this time. If you can provide further foundation
3 for it, you can try again.

4 Q. (By Mr. Berlin) Mr. Murray, are you
5 Staff's expert financial witness and are you
6 providing opinions in this proceeding as Staff's
7 financial witness on the subject of capital structure
8 and rate of return?

9 A. Yes, I am.

10 Q. Are the accounting questions that were
11 asked you previously, particularly related to the
12 Panhandle Eastern 10-K, many of the technical
13 questions of the accounting questions, do you recall
14 those questions?

15 A. Yes, I do.

16 Q. Are those questions better addressed
17 by Staff Witness Mark Oligschlaeger?

18 A. Yes, they are.

19 Q. Mr. Murray, this goes to one of Mr.
20 Herschmann's questions and it goes to some of the
21 finance and better understanding. If, in this
22 hypothetical situation, a very easy hypothetical, if
23 you had a house that you sold -- that you are asking
24 for \$500,000 for and you sold it for 400, and then
25 you went and turned around and bought a \$600,000

1 house, what is the equity, if you put the \$400,000
2 into the \$600,000 house, what is the equity?

3 MR. HERSCHMANN: Objection, Your
4 Honor.

5 THE WITNESS: I think --

6 MR. HERSCHMANN: If this is a
7 follow-up on the hypothetical that I used, the
8 question dealt with the witness' example of mortgage
9 and refinancing a mortgage. And all I asked was when
10 you refinance a mortgage, is there a restriction
11 competent compared to debt instruments in this
12 proceeding.

13 Not equity investments, not purchasing
14 a house the first time. The only issue that was
15 addressed in the hypothetical that was raised by this
16 witness was whether there was a difference in
17 refinancing a mortgage and the ability to refinance
18 long-term debt.

19 Now they're trying to imply or work
20 into this proceeding now equity investments and what
21 they are. That has nothing to do with what was
22 raised. And if he wants to try to follow-up as to
23 whether or not, you know, Southern Union has the
24 ability to just call in this long-term debt and
25 reissue new debt, then he can ask that. But it's

1 clearly designed to try to get in in a roundabout way
2 things that are improper in redirect.

3 JUDGE WOODRUFF: What is it you're
4 trying to get at here?

5 MR. BERLIN: I'm trying to get a
6 little clarification from Mr. Murray on some basic
7 financing principles that were brought up by Mr.
8 Herschmann in his line of questioning.

9 JUDGE WOODRUFF: All right. The
10 objection is overruled, you can proceed.

11 THE WITNESS: Can you repeat the
12 question?

13 Q. (By Mr. Berlin) Can you answer the
14 question?

15 A. I was actually confused by your
16 question. I think you said something about a house
17 sold for -- the mortgage was 400,000. Explain it
18 again, please.

19 Q. Mr. Murray, you have a \$500,000 house
20 and you try to sell that house and you get \$400,000
21 for it, and then you take that and go and buy the
22 house across the street for \$600,000. What is the
23 equity?

24 A. There was -- was there any mortgage on
25 that \$400,000 house, or is it \$400,000 in cash you

1 received?

2 Q. You received \$400,000 in cash.

3 A. If I took that \$400,000 and bought a
4 \$600,000 house, that \$400,000 would be equity in that
5 new house.

6 Q. All right. Mr. Murray, with regard to
7 your job here at the Commission, is it your job to
8 make recommendations on cost of equity, rate of
9 return that are above Public Counsel?

10 A. That's not my job.

11 Q. Is it your job to be below the
12 Company?

13 A. No, that's not my job.

14 Q. Is Standard & Poor's an authoritative
15 source that most analysts rely on?

16 A. Yes, a lot of analysts rely on S and P
17 for their comments regarding creditworthiness of
18 companies.

19 Q. Can you tell me what is the RRA?

20 A. It's the Regulatory Research
21 Associates.

22 Q. And what do they compile?

23 A. They compile just allowed ROE's, and I
24 don't know if there's a lot of detail given when they
25 indicate the allowed ROE's or allowed rate of returns

1 for various jurisdictions. It's just a publication
2 that some may subscribe to to keep track of what's
3 going on in various jurisdictions.

4 Q. Mr. Herschmann had asked you about Mr.
5 Dunn's attempt at backing out of Panhandle equity
6 from the Southern Union capital structure in his
7 surrebuttal testimony. Do you recall those
8 questions?

9 A. Yes, I do.

10 Q. Did Mr. Dunn back out any portion of
11 the \$437 million payment in cash related to the Texas
12 sales proceeds from equity?

13 A. No, he did not.

14 Q. Did all of the June 11, 2003, common
15 stock issuance proceeds go directly to purchasing
16 Panhandle equity?

17 A. Actually, I think there's some dispute
18 on that. I think that was one of the questions that
19 Mr. Herschmann had as far as the -- the breakdown of
20 the common equity and the equity units offering as
21 far as what percentage goes to -- went to the actual
22 acquisition.

23 They're indicating there was 290
24 million, and so that full 290 million between the two
25 didn't all go to that -- all go to that -- the

1 acquisition of Panhandle. It was about 120 some odd
2 million. And whatever that mix was is something I
3 think the -- that more or less we'd have to rely on,
4 I guess, the Company as to what the mix was.

5 Q. For what other purposes was the cash
6 from the common stock issuance used for?

7 A. I believe there's some general
8 indication -- I'd have to look at their 2003 annual
9 report and some of the other annual reports, but
10 sometimes I know that with their leverage capital
11 structure, some of the common equity issuances, even
12 the next 150 million that they issue, is being used
13 to improve their balance sheet.

14 Q. So does Southern Union's payment down
15 on debt on the June 11th, 2003, issuance have any
16 relationship to the Panhandle acquisition?

17 A. Yes, the debt was paid down in June
18 11, 2003, along -- because of the fact they're
19 assuming \$1.2 billion in debt, then that is directly
20 related to that transaction.

21 Q. Commissioner Clayton asked you about
22 comparable companies. Do you recall the question?

23 A. You'd have to refresh my memory. I
24 don't recall.

25 Q. He was asking, I believe, about your

1 use of comparable companies and that you did use
2 comparable companies?

3 A. Of course I used comparable companies,
4 but I don't recall the specific line of questioning.

5 Q. What -- or how -- let me rephrase the
6 question.

7 How did you select your comparable
8 companies?

9 A. I started with the Edward Jones report
10 that -- that follows natural gas distribution
11 companies, and they have a criteria within their
12 publication that indicates whether or not they would
13 classify a company as a natural gas distribution
14 company, a natural gas diversified company, or a
15 combination electric, natural gas utility company.

16 And they have a 90 percent requirement
17 for total revenues in order to be classified as a
18 natural gas distribution company. However, as we all
19 know, the revenues from various business segments can
20 fluctuate, so they use some judgment in whether or
21 not they would still have or still classify a company
22 as a natural gas distribution company.

23 Actually, I talked to an individual at
24 Edward Jones, and they indicated that one of the
25 things that they --

1 MR. HERSCHMANN: I'm going to object
2 to this much. He's about to report -- it has to be
3 hearsay, he said he spoke to an individual from
4 Edward Jones. Moreover, this is way outside any
5 recross. It was asked as a general question, did he
6 ask you anything about comparable companies, and for
7 the witness to go into this detail is way beyond.

8 JUDGE WOODRUFF: It's all those things
9 as well as nonresponsive. The objection is
10 sustained. You can ask your next question.

11 Q. (By Mr. Berlin) Yes. Mr. Murray, on
12 capital structure, what capital structure did you
13 use?

14 A. The Southern Union's consolidated
15 capital structure as of the update period, which is
16 December 31st, 2003.

17 Q. And it's fair to say you used a
18 consolidated capital structure; is that right?

19 A. Yes, I used the consolidated capital
20 structure of Southern Union.

21 Q. There were some adjustments that you
22 made to the cost of equity. How did you make those
23 adjustments?

24 A. I looked at the average credit rating
25 for my comparable group, which was an A; and then I

1 looked at Southern Union's credit rating, which is a
2 triple B, which that directly affects the cost of
3 debt for MGE.

4 So I felt like it was appropriate to,
5 because of the fact that there's a risk differential
6 between a company that has a triple B credit rating
7 as far as the totality of the risk, which includes
8 business and financial risk, it was appropriate to
9 look at the spreads between a triple B and an A rated
10 bond.

11 And that's entirely appropriate
12 because of the fact that quite often, and as far as I
13 know, in the investment community, utility stocks are
14 -- have very similar characteristics to bonds.

15 MR. HERSCHMANN: I'm going to object
16 to that answer and move to strike as nonresponsive.

17 JUDGE WOODRUFF: Overruled.

18 Q. (By Mr. Berlin) Mr. Murray, are you
19 -- are you recommending that flotation costs be
20 included?

21 A. No.

22 MR. BERLIN: I have no further
23 questions, Your Honor.

24 JUDGE WOODRUFF: Thank you. Mr.
25 Murray, you may step down.

1 THE WITNESS: Thank you.

2 JUDGE WOODRUFF: And it is now five
3 o'clock, so we're at the end of our day.

4 MR. FRANSON: Judge -- actually, Your
5 Honor, I was going to ask, maybe Mr. Hack is about to
6 schedule for in the morning.

7 MR. HACK: If we might just plead with
8 the indulgence of the Judge, we would -- Mr.
9 Herschmann has to leave very early in the morning.
10 It is Mr. Herschmann's belief that he can finish with
11 Mr. Oligschlaeger very quickly this afternoon, and we
12 would ask respectfully if we might be able to take
13 Mr. Oligschlaeger this afternoon. I think Mr.
14 Micheel has no cross for Mr. Oligschlaeger.

15 MR. MICHEEL: Your Honor, I believe
16 you had announced an intent to depart and I believe
17 various parties, myself included, had planned on
18 that. So at this point I'm going to object.

19 JUDGE WOODRUFF: I only made that
20 statement about 30 seconds ago.

21 MR. FRANSON: I would ask Mr.
22 Herschmann to define what he means -- or Mr. Hack,
23 who's speaking here, define what he means by very
24 quickly.

25 MR. HERSCHMANN: I do not expect it's

1 going to take me more than 15 minutes at max for the
2 cross-examination.

3 JUDGE WOODRUFF: And we don't have any
4 Commissioners here, so there won't be anything from
5 the bench. We'll go ahead and take Mr.
6 Oligschlaeger. I'm sorry, if you need to make some
7 phone calls or something, is this a child care issue
8 or something?

9 MR. FRANSON: I need maybe ten
10 minutes, Your Honor.

11 JUDGE WOODRUFF: Let's take ten
12 minutes and we'll come back at 5:10.

13 (A recess was taken at this time.)

14 (Witness sworn.)

15 MARK OLIGSCHLAEGER, testified as follows:

16 DIRECT EXAMINATION BY MR. FRANSON:

17 Q. Mr. Oligschlaeger, you filed
18 surrebuttal testimony only or rebuttal and
19 surrebuttal?

20 A. I filed direct, rebuttal, and
21 surrebuttal.

22 MR. FRANSON: All right. Thank you.
23 Your Honor, at this time I would ask if you can help
24 me out on the exhibit numbers.

25 JUDGE WOODRUFF: Direct was 828,

1 rebuttal was 829, and surrebuttal is 830.

2 MR. FRANSON: Thank you. Your Honor,
3 at this time I will hand --

4 Q. (By Mr. Franson) Sir, please state
5 your name.

6 A. Mark L. Oligschlaeger.

7 Q. Mr. Oligschlaeger, how are you
8 employed?

9 A. I am employed as a regulatory auditor
10 with the Missouri Public Service Commission.

11 Q. How long have you been so employed?

12 A. Since September 1981.

13 Q. Are you a certified public accountant?

14 A. Yes, I am.

15 Q. Licensed as such in the State of
16 Missouri?

17 A. Yes, I am.

18 Q. Have you prepared testimony in this
19 case?

20 A. Yes, I have.

21 Q. Specifically would that have been
22 direct testimony?

23 A. Yes.

24 Q. Rebuttal testimony?

25 A. Yes.

1 Q. And surrebuttal testimony?

2 A. Yes.

3 Q. Let's start with what's been premarked
4 as Exhibit 828, your direct testimony of Mark
5 Oligschlaeger. Do you have any additions, deletions,
6 or corrections to your direct testimony?

7 A. No, I do not.

8 Q. Okay. And that was prefiled on April
9 15, 2004.

10 A. Yes, it was.

11 Q. Okay. Let's turn to your rebuttal
12 testimony, Exhibit 829. Do you have any additions --
13 corrections or additions to your rebuttal testimony?

14 A. Yes, I do.

15 Q. Okay. Could you give us the first
16 one, please?

17 A. Yes, on page 4, line 22.

18 Q. Okay.

19 A. Where the numbers 1998 dash 2003 -- or
20 the years 1998 dash 2003 are shown, it should be 1998
21 dash 2002.

22 MR. FRANSON: Your Honor, at this time
23 I'd like to approach the witness so he may make that
24 change on the copy that will be offered into
25 evidence.

1 JUDGE WOODRUFF: That's fine.

2 MR. MICHEEL: Could you do that again?

3 I'm sorry, Mr. Oligschlaeger.

4 THE WITNESS: Sure. It's page 4, line
5 22, after the first word on that line the years 1998
6 dash 2003 appear. That should be 1998 dash 2002.

7 MR. MICHEEL: Thank you.

8 Q. (By Mr. Franson) And are you
9 currently making that change on Exhibit 829, Mr.
10 Oligschlaeger?

11 A. Yes, I am.

12 Q. Okay. Mr. Oligschlaeger, while you
13 still have Exhibit 829, do you have any other changes
14 to Exhibit 829?

15 A. No, I do not.

16 Q. Okay. Exhibit 830, did you -- I
17 believe is your surrebuttal testimony. Did you also
18 file surrebuttal testimony in this case?

19 A. Yes, I did.

20 Q. And that was on June 14, 2004?

21 A. That's correct.

22 Q. Did you have any additions, deletions,
23 or corrections to your surrebuttal testimony, Exhibit
24 830?

25 A. Yes, I do. On page 6, line 1, the

1 first word in that answer appears as no. That was in
2 error, it should be yes.

3 Q. And that's on page 6, line 1?

4 A. That is correct.

5 MR. FRANSON: Okay. Actually, Your
6 Honor, if I may approach the witness, I need him to
7 mark that in the copy that will be offered into
8 evidence.

9 JUDGE WOODRUFF: Very well.

10 Q. (By Mr. Franson) Mr. Oligschlaeger,
11 you, I believe, were going to make that change in
12 Exhibit 830, your surrebuttal testimony. Do you have
13 any other changes, additions, or deletions to your
14 surrebuttal testimony, Exhibit 830?

15 A. No, I do not.

16 MR. FRANSON: Your Honor, at this time
17 Staff would offer into evidence Exhibits 828 --

18 Q. (By Mr. Franson) Or, well, actually,
19 Mr. Oligschlaeger, other than the changes you have
20 made to Exhibits 828, 829, and 830, do you have any
21 other changes to your testimony?

22 A. No, I do not.

23 Q. And if you were asked those questions
24 again today, would your answers be the same?

25 A. Yes.

1 MR. FRANSON: Your Honor, at this time
2 Staff will offer into evidence Exhibits 828, 829, and
3 830.

4 JUDGE WOODRUFF: All right. Now, I'm
5 looking at Exhibits 828 and 829. They indicate that
6 they're talking about other issues, is that --

7 MR. FRANSON: They are. And, well,
8 Your Honor, Mr. Oligschlaeger is like several other
9 witnesses, he will be --

10 JUDGE WOODRUFF: Yes.

11 MR. FRANSON: -- coming in -- he will
12 be bringing in testimony on other issues.

13 JUDGE WOODRUFF: The surrebuttal,
14 however, indicates it's on capital structure.

15 MR. FRANSON: I believe that is
16 correct with one exception. On the table of
17 contents, it indicates corporate cost allocation
18 study, and I'm not sure that has to do with the
19 revenue requirement -- well, actually -- no, I'm
20 looking at his direct. I'm sorry, I don't have that.

21 Mr. Oligschlaeger, is your surrebuttal
22 strictly dealing with capital structure?

23 THE WITNESS: Yes.

24 MR. FRANSON: Your Honor, at this time
25 I'll offer them all, but if you reserve ruling on 828

1 and 829, I understand.

2 JUDGE WOODRUFF: That's precisely what
3 I'll do. I will go ahead and ask for objections on
4 830. Any objection to its receipt?

5 MR. HERSCHMANN: No objection.

6 JUDGE WOODRUFF: All right. 830 will
7 be received into evidence at this point. And this
8 will this --

9 MR. FRANSON: Your Honor, if I may
10 approach the court reporter and the witness.

11 JUDGE WOODRUFF: Yes.

12 MR. FRANSON: Your Honor, with those
13 offerings and those rulings, I tender the witness for
14 cross-examination.

15 JUDGE WOODRUFF: All right. And for
16 cross-examination, then, we begin with Public
17 Counsel.

18 MR. MICHEEL: No questions, Your
19 Honor.

20 JUDGE WOODRUFF: All right, Kansas
21 City and Joplin are no longer here. Federal
22 agencies?

23 MR. PAULSON: None, sir.

24 JUDGE WOODRUFF: Jackson County and
25 Midwest Gas are not here. MGE?

1 MR. HERSCHMANN: Thank you, Your
2 Honor.

3 MR. FRANSON: Your Honor, I will note
4 that this will be a test for Mr. Herschmann's
5 definition of brief.

6 MR. HERSCHMANN: Something I've
7 probably never passed before in my life. There are
8 some areas that are definitely not mine of expertise,
9 and timing is one of them.

10 With all due respect to the court
11 reporter, I may speak in my normal pace now, which
12 may be somewhat scary.

13 CROSS-EXAMINATION BY MR. HERSCHMANN:

14 Q. Mr. Oligschlaeger, you just made an
15 adjustment to your testimony that was the
16 surrebuttal; is that correct?

17 A. That is correct.

18 Q. Let me ask you this question: Do you
19 agree that it would be appropriate to remove, as Mr.
20 Murray did in his testimony, \$646 million from
21 Southern Union's shareholder equity in relationship
22 to the acquisition of Panhandle?

23 A. It is the Staff's position it is
24 inappropriate to remove any amount as specifically
25 associated with Panhandle because we are advocating

1 use of a consolidated capital structure.

2 Q. I'm going to ask you this. I really
3 don't want to get into consolidated capital structure
4 issue.

5 A. Sure.

6 Q. We've heard a lot of times that you're
7 going to deal with the accounting side.

8 A. I was just trying to answer your
9 question accurately, sir.

10 Q. I want you to talk about it from an
11 accounting standpoint and I don't want to get back
12 into the cost of capital world, if you don't mind.

13 MR. FRANSON: Your Honor, there needs
14 to be a little bit of clarity. The witness will
15 certainly answer the questions put to him, but they
16 may not necessarily be answered in a way that pleases
17 Mr. Herschmann. So I think the general rule is he
18 needs to ask his questions and he'll get the answers
19 he gets.

20 MR. HERSCHMANN: Well, if I could just
21 address that for a moment. I'll try to ask specific
22 questions, but this witness has been proffered for an
23 area of expertise on one subject, and that's the
24 calculations, as to whether or not they were done
25 correctly, at least in the surrebuttal.

1 That's the only area I want to discuss
2 with you, the matters in which you have been
3 designated an expert, okay?

4 THE WITNESS: All right.

5 Q. (By Mr. Herschmann) Now, I want to
6 focus on shareholder equity, see if you can answer
7 this question: Do you believe it was appropriate
8 under accounting standards the way Mr. Murray removed
9 the \$646 million from Southern Union's shareholder
10 equity?

11 A. Let me --

12 Q. Yes or no, if you can.

13 A. If I'm restricted to a yes or no
14 answer, I would answer yes.

15 Q. Which financial accounting principal
16 justified the removal of the \$646 million from the
17 shareholder's equity on the consolidated balance
18 sheet? Just cite whatever rule you are aware of that
19 justified that.

20 A. Mr. Murray was not attempting to
21 assert an accounting rule or principle.

22 Q. That wasn't my question.

23 A. He was making a rate making --

24 JUDGE WOODRUFF: I'm stumbling over
25 your name, I'm sorry. If you would just answer the

1 question as asked to you.

2 Q. (By Mr. Herschmann) Which accounting
3 principle or rule are you aware of that you can cite
4 to us that would say that Mr. Murray's backing out of
5 \$646 million from Southern Union's shareholder equity
6 was appropriate?

7 A. As a rate-making recommendation, which
8 is what Mr. Murray intended, I am not aware of an
9 accounting or financial accounting rule that would
10 apply or be relevant.

11 MR. HERSCHMANN: I'd ask to move to
12 strike the first portion of the answer up until the
13 point I'm not aware of.

14 MR. FRANSON: Your Honor, I would pose
15 that for the simple reason that life is not always as
16 simple as yes or no. The matter was responsive, and
17 the mere fact that Mr. Herschmann doesn't like part
18 of the answer does not make it nonresponsive.
19 There's more to this than what Mr. Herschmann would
20 like to believe at this point or like to portray.

21 I believe the answer was responsive
22 and the witness is entitled to provide an answer. So
23 I would oppose the motion to strike because it was
24 appropriately responsive.

25 JUDGE WOODRUFF: I'm going to grant

1 the motion.

2 MR. HERSCHMANN: Thank you, Your
3 Honor.

4 JUDGE WOODRUFF: Again, please just
5 answer the question. If you want to provide further
6 explanations, your counsel is going to have a chance
7 to explain it to you -- or to bring -- elicit that
8 from you on redirect.

9 MR. HERSCHMANN: Mr. Oligschlaeger, I
10 promise it will be much briefer. I will choose my
11 words carefully in my questions, and if you can
12 specifically answer those questions, I hopefully will
13 be done very briefly. Okay?

14 Q. (By Mr. Herschmann) Now, you have
15 indicated in your testimony that Mr. Gillen did
16 accurately prepare schedules JJG-1 and JJG-2 in
17 compliance with GAAP. Do you still hold that belief,
18 sir?

19 A. Yes, I did. But the further comment I
20 believe they were irrelevant to the issue.

21 MR. HERSCHMANN: Move to strike the
22 last part as nonresponsive.

23 JUDGE WOODRUFF: Granted.

24 Q. (By Mr. Herschmann) Now, there is a
25 mechanism under GAAP that's called purchase

1 accounting; is that right?

2 A. That is correct.

3 Q. And in purchase accounting -- do you
4 have JJG-2 in front of you?

5 MR. FRANSON: Your Honor, I am going
6 to object at this point. I'm not sure where we're
7 going. I thought these were about adjustments made
8 by Mr. Murray and the propriety thereof. I am not
9 sure what JJG-1 and JJG-2 have to do with specific
10 areas raised in this witness' testimony.

11 JUDGE WOODRUFF: Objection's
12 overruled.

13 THE WITNESS: The answer to your
14 question is, yes, I do have it in front of me.

15 Q. (By Mr. Herschmann) And do you see on
16 JJG-2 that there are certain eliminations that occur?

17 A. Yes, I do.

18 Q. And what do those eliminations
19 reflect?

20 A. Those eliminations for -- in the
21 context of the schedule reflect the elimination of
22 amounts that are found in the consolidating Panhandle
23 stand-alone column that are also found within the
24 Southern Union stand-alone consolidating column.

25 Q. So according to GAAP, this is a

1 correct calculation of what's reflected in JJG-2;
2 right?

3 A. Yes.

4 Q. Now, you have made certain proposals
5 to the Commission; is that correct?

6 A. If you could be more specific.

7 Q. Sure. Did you make certain proposed
8 adjustments for the Commission in your surrebuttal
9 testimony?

10 A. What I suggest are some alternative
11 approaches to backing out the Panhandle equity,
12 alternatives to Mr. Murray's approach if the
13 Commission were interested in such alternatives.
14 Other than that, I'm not sure what you would be
15 referring to.

16 Q. Is your alternative proposals
17 consistent with GAAP?

18 A. I believe they are.

19 Q. Are they consistent with purchase
20 accounting GAAP?

21 A. I don't know any reason why they would
22 be inconsistent with purchase accounting.

23 Q. Well, do you believe they are
24 consistent with purchase accounting?

25 MR. FRANSON: Your Honor, objection,

1 asked and answered.

2 JUDGE WOODRUFF: Overruled.

3 THE WITNESS: I have reviewed FAS-141,
4 and I do not believe my suggested rate-making
5 alternatives are inconsistent with the accounting
6 pronouncements within FAS-141.

7 Q. (By Mr. Herschmann) I don't want to
8 talk about your rate-making proposals or
9 alternatives.

10 A. That's why we're here.

11 Q. You are here for a limited purpose;
12 right, sir?

13 A. Yes.

14 Q. But for Mr. Murray saying the things
15 in his deposition about how to back it out, you
16 weren't even going to address this issue; right?

17 A. But for Mr. Gillen's rebuttal
18 testimony, I doubt I would have addressed this issue.

19 Q. Mr. Gillen's rebuttal testimony was
20 spurned by comments Mr. Murray made in his
21 deposition; right?

22 MR. FRANSON: Your Honor, I object, it
23 is not necessarily this witness' ability or knowledge
24 to determine why MGE needed to hire Mr. Gillen. The
25 way that question is framed, it calls for Mr.

1 Oligschlaeger to speculate on why MGE, or anyone
2 else, why they hired Mr. Gillen, he doesn't know
3 that. Why they deemed it necessary, he doesn't know
4 that. So accordingly, Your Honor, it's beyond this
5 witness' scope of knowledge.

6 JUDGE WOODRUFF: I'm going to sustain
7 that objection. You can move on to your next
8 question.

9 MR. HERSCHMANN: No problem.

10 Q. (By Mr. Herschmann) You provide what
11 you believe to be two alternative proposals that the
12 Commission could consider for adjustments; is that
13 right?

14 A. If they -- yes, if they do not adopt
15 the Staff position or if they choose not to adopt Mr.
16 Murray's proposal in his direct testimony.

17 Q. And at least we know from Mr. Gillen's
18 JJG-2 chart that there is a means, according to GAAP,
19 of backing out -- segregating Southern Union and
20 Panhandle; right?

21 A. I do not believe Mr. Gillen's schedule
22 demonstrates that, and I do not believe GAAP itself
23 is germane to that point in how to do that for rate
24 purposes.

25 Q. I'm going to ask you on each occasion

1 -- I'm not going to discuss with you rate purposes,
2 I'm going to discuss with you your accounting
3 expertise, okay? That's all I want to focus on.

4 So if you are going to modify your
5 answers because you believe it's different for
6 rate-making purposes, that's not going to be any
7 focus for my questions. I'm going to discuss -- my
8 questions are going to be limited.

9 MR. FRANSON: Your Honor, I want to
10 object. Is there a question in here somewhere, or is
11 there a --

12 JUDGE WOODRUFF: He's giving an
13 explanation to the witness. Your objection is
14 overruled.

15 MR. HERSCHMANN: Let me put up on the
16 screen, this may help you.

17 Q. (By Mr. Herschmann) Now, Mr.
18 Oligschlaeger, this would reflect Southern Union's
19 shareholder equity as of December 31st, the actual
20 shareholder equity in the 10-Q, and then your two
21 different proposals. Do you see those? One is the
22 removal of \$521,350,000 on the first line; right?
23 And that's based on your calculations of the \$437
24 million from the Texas sale; is that right?

25 A. Yes.

1 Q. Okay. And that's cash that Southern
2 Union had in the bank; right?

3 A. Yes.

4 Q. And the other is taking half of 168.7
5 million which is the proceeds from the common stock,
6 \$175 million offering; right?

7 A. Yes.

8 Q. How did you determine according to
9 GAAP whether or not a portion of the \$168.7 million
10 came from common stock or equity units?

11 A. The 168 million was the value of the
12 common stock issuance. My intent in the surrebuttal
13 testimony was address the amount that needed to be
14 backed out of Panhandle equity. The equity units,
15 it's my understanding, are debt, and therefore, would
16 not have to be backed out as equity because they are
17 debt by definition.

18 Q. Was the money given to Panhandle's
19 prior owners?

20 A. The cash paid by Southern Union to CMS
21 to purchase Panhandle went from Southern Union's
22 hands to CMS's hands.

23 Q. And to raise some of that cash, as you
24 say, Southern Union issued common stock in equity
25 units at the same time; right?

1 A. That's my understanding.

2 Q. Then they got money in the bank;
3 right?

4 A. I believe so.

5 Q. And they took that money that was in
6 the bank and they gave it to someone else in order to
7 get the ownership of the pipelines; right?

8 A. In order to obtain an equity interest
9 in Panhandle.

10 Q. Well, you mean a stock shareholder
11 equity? Are you talking about a shareholder equity
12 in Panhandle, or you mean an equity interest that
13 they own an asset now?

14 A. Pan -- I'm sorry, Southern Union has
15 an equity investment in Panhandle.

16 Q. And they own an asset; right?

17 A. They own the assets that are -- can be
18 found on Panhandle's books and records, yes.

19 Q. So are you saying that in purchasing
20 Panhandle, Southern Union's shareholder equity went
21 up \$581,729,000?

22 A. That amount has nothing to do with
23 Panhandle equity. Panhandle equity was liquidated
24 through the transaction.

25 Q. Right. So are you saying that in

1 purchasing Panhandle, Southern Union's total equity
2 went from 946 million and then added on another
3 \$581,729,000 in total shareholder equity?

4 A. That -- your reference to Panhandle
5 confused me. Can you repeat that question, please?

6 Q. Sure. You said that Southern Union
7 got an equity interest in Panhandle when they bought
8 the assets; right?

9 A. Yes.

10 Q. And are you saying that by buying the
11 assets and giving away \$581,729,000 in cash, all of a
12 sudden, the shareholder equity went from 946,502,000
13 up another 581 million?

14 A. No, I am not.

15 Q. It didn't change the shareholder
16 equity when they bought the asset; right?

17 A. If you're talking about Southern Union
18 equity, actually there were changes because they did
19 issue common stock and treasury stock in order to
20 accomplish the purchase.

21 Q. Right. I'm going to talk about the --
22 right now let's focus on the -- and I'm going to get
23 to the stock issuance in relationship to it. But you
24 said that Southern Union gave the cash and then had a
25 greater equity interest; right?

1 A. They had a greater equity -- well,
2 they had zero equity interest in Panhandle prior to
3 the acquisition, they had an equity interest in
4 Panhandle after the acquisition.

5 Q. And did they give up something to get
6 the equity interest?

7 A. They gave up cash in the amount
8 specified in the annual report and in the 10-K, and
9 they had to issue some common stock in equity units
10 and use some working capital as well in order to
11 accomplish the transaction.

12 Q. Why don't we talk about the 10-K and
13 how they accomplished it.

14 A. Yes.

15 Q. This \$581,729,000 in cash; right?

16 A. Well, there's also transaction costs
17 as well, which I believe were a cash transaction,
18 too, but that's a separate.

19 Q. Okay. The reason -- from the
20 581,729,000, they have \$437 million in cash; right?

21 A. Well, that was one of the sources of
22 cash used to make the cash payment to Panhandle.

23 Q. And that was cash?

24 A. To CMS.

25 Q. Right. That was cash; right?

1 A. That is cash.

2 Q. And when the \$437 million in cash was
3 sitting in the bank, did you put that in the category
4 or add it to the 946 million to make it 1.4 billion?

5 A. Cash, sir, is an asset, it is not an
6 equity amount.

7 Q. We're in agreement on that; right?
8 Cash is different; right? It's not an equity amount;
9 right?

10 A. Now, cash can be obtained from equity
11 sources or debt sources, but, no, it is not. It is
12 an asset.

13 Q. And so when Southern Union had the
14 \$437 million in cash, that was exclusive of the
15 946,502,000 of shareholder equity that they had, it
16 was in addition to it; right?

17 A. It's not in addition to it because
18 they're not both -- that's an apples and oranges
19 statement. The 946 is their equity balance and the
20 437 was part of their cash balance, an asset.

21 Q. And you're certain about that; right?

22 A. Am I certain that the 437 million was
23 cash?

24 Q. Yes.

25 A. I am certain of that.

1 Q. So Southern Union gives the \$437
2 million in cash away, goes ahead and issues three
3 million shares for \$48.9 million; right?

4 A. That's correct.

5 Q. And then they go ahead and raise
6 additional funds from this \$300 million equity
7 offering that included common stock in equity units;
8 right?

9 A. Those are the sources described in the
10 annual report in 10-K.

11 Q. And that's how they raised the money
12 to give away the 581 million, right?

13 A. According to the documents, yes.

14 Q. Now, you make the suggestion if you
15 look at the slide that's before you on your
16 proposals, the first one on B is that there be an
17 adjustment to the total equity removing \$437 million
18 from the Texas sale and half of 168.7 million, and
19 you come to the conclusion that the adjusted equity
20 level should be 425,152,000; is that right?

21 A. Yes, and that number pertains to
22 Southern Union's local gas -- local distribution
23 company operations.

24 MR. FRANSON: Your Honor, if I may,
25 what is this? And just for purposes of the record,

1 we got questions referring to something, I don't know
2 that there's been any indication of -- I'm not
3 necessarily objecting to it, I just want to know what
4 it is so there's some record of what it is.

5 MR. HERSCHMANN: Right now it's a
6 demonstrative, if it will help. I'll ask the next
7 question and if the witness agrees, I'll offer it
8 into evidence, maybe it'll assist.

9 Q. (By Mr. Herschmann) And for proposal
10 two, your suggestion is that the Commission just
11 remove half of Southern Union's total equity, so that
12 would be the 473,251 which is half of 946,502; is
13 that right?

14 A. That is correct.

15 MR. HERSCHMANN: At this time I would
16 offer Exhibit 41.

17 MR. FRANSON: As long as the witness
18 agrees the whole thing is fair and accurate, which I
19 don't think it is exactly what was proposed, then I
20 have no objection.

21 Q. (By Mr. Herschmann) Mr.
22 Oligschlaeger, if you'll look at Exhibit 41, does
23 that accurately reflect the calculations that you
24 provide in your testimony in summary form?

25 A. Yes, they do.

1 MR. HERSCHMANN: I'd offer Exhibit 41
2 for identification into evidence.

3 MR. FRANSON: Staff has no objection,
4 but I would ask that we have a little bit better
5 title or something for it. And also are we going to
6 have paper copies distributed to the parties?

7 MR. HERSCHMANN: Sure. We'll do that.

8 MR. FRANSON: Okay. No objections
9 with those understandings, Your Honor.

10 JUDGE WOODRUFF: I'm just calling it
11 equity chart on my list. Exhibit 41 will be admitted
12 into evidence.

13 Q. (By Mr. Herschmann) What I'd like for
14 you to do now is look at what we have put on the
15 board, and if we can deem this marked as Exhibit 42
16 for identification, do you see that this reflects the
17 June 2003 offerings that we have been discussing from
18 Southern Union?

19 A. Well, I hate to retread ground that
20 was first plowed by Staff Witness Murray, but these
21 are not the numbers that actually appear for the most
22 part or perhaps entirely in the 10-K and the annual
23 report. Those amounts add up to 290,000 -- or 290
24 million.

25 Q. Okay. And I'll go with the same

1 ground rules as before. I'll take into account the
2 calculations. I just want to know generally
3 speaking, presume it's 290, do the percentages work
4 out under gross proceeds and percentage to total for
5 the common stock equity units in the total?

6 A. I don't have a calculator. They look
7 in the ballpark.

8 Q. And in your testimony, your
9 surrebuttal testimony, you refer to the raising of
10 the \$121 million. Do you recall that?

11 A. Yes, I do.

12 Q. And looking at the percentages of
13 common stock and equity units that were issued in
14 relationship to the June offering, do you see how if
15 you take the percentages of each one, you total up to
16 the 121 million?

17 A. That's the way the math works, yes.

18 MR. HERSCHMANN: Okay. With that, I'd
19 offer Exhibit 42 for identification into evidence.

20 MR. FRANSON: And again, as long as
21 this is -- Judge, what are we going to call this
22 thing?

23 JUDGE WOODRUFF: I called it equity
24 and equity units offering chart.

25 MR. FRANSON: Okay. And Your Honor,

1 also I think this is one of those times it's not
2 necessarily being offered as exact numbers, it's
3 being more percentages and they're in the ballpark, I
4 think it's more that rather than exact.

5 MR. HERSCHMANN: I completely agree
6 with that.

7 MR. FRANSON: And with that being said
8 and understood, Staff has no objection to it.

9 JUDGE WOODRUFF: All right. Exhibit
10 42 will be received into evidence.

11 MR. FRANSON: Also, Mr. Herschmann, I
12 assume we'll be getting paper copies of that.

13 MR. HERSCHMANN: Absolutely.

14 Q. (By Mr. Herschmann) If you will look
15 at now what we will deem marked as Exhibit 43, your
16 first proposal, sir, deals with the removal of the
17 \$521,350,000; right?

18 A. The first alternative offering in my
19 testimony, yes.

20 Q. And if you look at the column that
21 says actual 31 March 03, do you see that that
22 reflects a common equity of 778,367,000, according to
23 the March 31st Form 10-Q report of the Southern Union
24 Company?

25 A. That is how it is cited and sourced on

1 this slide.

2 Q. And do you have any reason to believe
3 -- once more, have you reviewed the 10-Q from March
4 31st, 2003, previously?

5 A. No, I have not.

6 MR. HERSCHMANN: And we'll do the
7 subject to check, but if I make the representation.

8 MR. FRANSON: Your Honor, hold on.
9 Subject to check is as taboo and as forbidden as we
10 can get, and Staff objects and will not agree to
11 that.

12 JUDGE WOODRUFF: Yes. That is above
13 bear with the Commission.

14 MR. HERSCHMANN: Not a problem at all.
15 I will use a different term.

16 Q. (By Mr. Herschmann) As an expert, I'm
17 going to ask you to assume a fact which I think is
18 the basis for why you are here. So assume that the
19 \$778,367,000 number accurately reflects Southern
20 Union's March 31st, 2003 Form 10-Q report. Do you
21 see that?

22 A. Yes, I do.

23 Q. Now, sir, according to your proposals,
24 Southern Union lost \$353,215,000 under proposal one
25 from its shareholder equity besides the moneys that

1 they gave to CMS during the Panhandle acquisition;
2 right?

3 A. Well, I'm sure I wouldn't agree if I
4 understand how these numbers worked. I don't
5 understand how these numbers work or where you got
6 the 353 million figure.

7 Q. Sure. Take the 425 million -- I'm
8 sorry, the 521,350,000, and if you could deduct that
9 from the 946, can you tell me what that number turns
10 out to be?

11 A. 521.3 from 946?

12 Q. Yes.

13 A. By my calculations, that would leave
14 424 million point 7.

15 Q. I'll do a little better with my math,
16 and I apologize. Let's look at the actual March 31st
17 column. Okay? If Southern Union's shareholder
18 equity on March 31st was 778,367,000, and we deduct
19 your proposed adjustment of 425,152,000, then there's
20 \$353,215,000 of common equity that no longer would
21 exist on Southern Union's balance sheet from the
22 March 31st to December 31st calculations that you are
23 proposing; right?

24 A. I totally fail to understand where you
25 are coming from, sir.

1 Q. Sure. You're making a suggestion to
2 this Commission that they remove 420 -- I'm sorry,
3 425 million -- let me try this one more time. I
4 apologize.

5 Your adjusted recommendation to the
6 Commission is that the equity be reduced to
7 425,152,000 based on proposal one; right?

8 A. First of all, it's inaccurate to say
9 it's a recommendation. This does not reflect the
10 Staff's recommendation in how to treat capital
11 structure in this case.

12 Q. Let --

13 A. Second of all --

14 Q. I'm sorry. I thought we covered this
15 just a moment ago --

16 A. Well, you're inaccurately stating what
17 my position is, sir.

18 Q. Did you make certain proposals for
19 adjustments to Southern Union's consolidated equity,
20 on capital equity, shareholder equity?

21 A. I suggested certain alternative
22 approaches to Staff Witness Murray's alternative
23 approach, which is an alternative -- both -- all
24 three are alternatives to the Staff position in this
25 case.

1 Q. And the proposal you are suggesting is
2 that, under proposal one, that there be an adjustment
3 made of \$521,350,000 from Southern Union's
4 shareholder equity; right? Didn't we just cover this
5 on slide 41?

6 A. Well, you're mischaracterizing what
7 the Staff's position is, sir.

8 Q. I'm asking did you do these
9 calculations. Your calculation was a proposal to
10 make a certain adjustment of \$520,350,000; right?

11 A. My alternatives are suggested in case
12 the Commission wants alternative means to allocate
13 the total Company Southern Union equity between its
14 Panhandle slash pipeline operations and its Southern
15 -- or its MGE slash LDC operations.

16 Q. Let me try this. Can you put Exhibit
17 41 back up? And I think we just covered how you came
18 to the \$521,350,000 number; right?

19 A. I believe we did.

20 Q. And you came out with the number
21 425,152,000 adjusted; right?

22 A. That would be the amount the
23 Commission should allocate to Southern -- or to MGE
24 for capital structure purposes if it finds reason to
25 accept the alternative approach.

1 Q. Okay. Now can we go to Exhibit 43,
2 please. Under your proposal that you are saying this
3 Commission should consider and adopt, what happened
4 -- what happens under your proposal to the \$353
5 million in equity that Southern Union used to have?
6 Did they just lose it under your proposal, or should
7 the Commission just ignore it?

8 A. I hate to sound like a broken record.
9 I have no idea how the \$353 million number was
10 calculated.

11 Q. If you take the \$778 million number
12 from the 10-Q and you make your proposed adjustment,
13 right, it would bring it down to \$425 million, what
14 is the mathematical differences?

15 A. Okay.

16 MR. FRANSON: Mr. Oligschlaeger, do
17 you need a calculator?

18 THE WITNESS: No, if I am just given
19 even verbal instruction, I can do the math, believe
20 me.

21 Well, first of all, obviously you're
22 comparing a March 31 Southern Union number which I
23 have not had the opportunity to review the source
24 documents --

25 Q. (By Mr. Herschmann) Mr.

1 Oligschlaeger, I'm just asking the math first, and we
2 can get to the next part. We'll move much quicker if
3 you'll just answer the questions. Does the math come
4 out correctly?

5 A. When you subtract the number you
6 specified from the other number you specified, the
7 result will indeed be in the neighborhood of 353
8 million.

9 Q. And under proposal two, if we do the
10 same math, we take the 778,000 -- 778 million from
11 the 10-Q and we go with your adjusted number on
12 December 31st, then there's a \$305 million that's now
13 left; is that correct?

14 A. That appears to be accurate.

15 Q. Sir, is the relevance, do you believe
16 that March 31st would be prior to the purchase of
17 Panhandle?

18 MR. FRANSON: Excuse me, what year?

19 MR. HERSCHMANN: Sure. It's Exhibit
20 31 in evidence, it's the 10-K that reflects on June
21 11, 2003, Southern Union acquired Panhandle.

22 Q. (By Mr. Herschmann) So do you see
23 that prior to acquiring Panhandle, Southern Union had
24 on its books \$778,367,000 worth of shareholder
25 equity?

1 MR. FRANSON: Mr. Herschmann, you
2 still didn't get -- there's a date on this document
3 and you haven't given the year, you keep saying March
4 31st.

5 MR. HERSCHMANN: I think it says '03.
6 I'm sorry.

7 THE WITNESS: Up till now, I had
8 assumed that was a 2004 document.

9 Q. (By Mr. Herschmann) I apologize. If
10 Southern Union had \$778,367,000 worth of shareholder
11 equity prior to acquiring Panhandle, presume that's
12 based on the March 31st, 2003 Form 10-Q report, okay?
13 And the Commission makes the adjustments that you are
14 suggesting, Southern Union ends up losing from its
15 common equity 353 -- 215 million dollars based on
16 proposal one; right?

17 A. No, I disagree. First of all,
18 obviously my alternative proposals dealt with
19 December 31 financial statistics. The Company made
20 significant changes to its equity balance between
21 March 2003 and December 2003, among other things,
22 issuing common equity and treasury stock, at least in
23 part to fund the acquisition of Panhandle and to
24 maintain a more balanced capital structure in light
25 of that transaction.

1 Q. Were all those changes increases in
2 common equity?

3 A. There is a schedule in your Form 10-K
4 which lays out all of the different changes to the
5 components of stockholders' equity. This, at least
6 in the document I have looked at, between June 30th,
7 2002, June 30th, 2003. Indeed some changes to some
8 components were positive or increases, some were
9 negative or decreases. The net change was an
10 increase of I believe about 235 million.

11 Q. So you think it's appropriate to
12 recommend to this Commission that they make
13 adjustments taking away from Southern Union's
14 shareholder equity \$521,350,000 under one proposal,
15 \$473,251,000 under a second proposal, even though the
16 \$437,000 [sic] that was paid out was just cash;
17 right?

18 MR. FRANSON: Your Honor, that is what
19 I call a compound multi-layered question, and I'm
20 going to object on that basis. Compound questions
21 are simply inappropriate generally, and I object on
22 that basis.

23 JUDGE WOODRUFF: Your response?

24 MR. HERSCHMANN: I'll let the question
25 stand and let Your Honor rule.

1 JUDGE WOODRUFF: Could you read it
2 back to me? It's getting a little late in the day.

3 THE REPORTER: So you think it's
4 appropriate to recommend to this Commission that they
5 make adjustments taking away from Southern Union's
6 shareholder equity \$521,350,000 under one proposal,
7 \$473,251,000 under a second proposal, even though the
8 \$437,000 [sic] that was paid out was just cash;
9 right?

10 MR. HERSCHMANN: 437 million.

11 MR. FRANSON: That does not look to me
12 like a compound question. The objection is
13 overruled. It's a long question, but it's not
14 compound.

15 THE WITNESS: My proposal, again, is
16 for the Commission under the alternative approaches,
17 not the recommendation of the Staff, is to allocate
18 these amounts to Panhandle for purposes of setting a
19 capital structure in this case.

20 And I, for the life of me, cannot
21 understand why the fact that 437 million of this came
22 in cash from Southern Union from the sale of its
23 Texas properties has anything to do with the
24 proposals to allocate a reasonable portion of the
25 equity to Panhandle under the Company's approach to

1 capital structure.

2 MR. HERSCHMANN: I hate to do this,
3 but I move to strike the last answer. And if you can
4 answer the question I asked with a yes or no.

5 MR. FRANSON: Your Honor, before --
6 okay, before we go there, that question, like many of
7 Mr. Herschmann's questions, have presumptions. For
8 the witness to be asked to answer yes or no, it is
9 only reasonable and appropriate that the witness has
10 to agree with all of the presumptions in his
11 questions. This witness doesn't agree with them and
12 he answered appropriately.

13 JUDGE WOODRUFF: I'm going to go ahead
14 and strike the response with the admonition to the
15 witness that if you don't agree with the assumptions
16 that are being made in the question, say I can't
17 answer that question because I don't agree with the
18 assumptions. And that way we won't get a
19 nonresponsive response.

20 MR. HERSCHMANN: You can read back the
21 question, and make the change and make it into
22 millions, I would appreciate it.

23 THE REPORTER: So you think it's
24 appropriate to recommend to this Commission that they
25 make adjustments taking away from Southern Union's

1 shareholder equity \$521,350,000 under one proposal,
2 \$473,251,000 under a second proposal, even though the
3 \$437 million that was paid out was just cash; right?

4 THE WITNESS: I certainly believe that
5 if the Commission decides to adopt an alternative
6 approach, they should adopt the alternative
7 approaches I have suggested, with the further caveat
8 I certainly do not understand the relevance of your
9 reference to the 437 million.

10 Q. (By Mr. Herschmann) Let me see if I
11 can clarify it for you, then. Southern Union had
12 \$437 million in cash; right?

13 A. They had more than that, but they had
14 that amount relating to the sale of its Texas
15 properties.

16 Q. And they gave it away; right?

17 A. They got something in return, I
18 wouldn't say they gave it away.

19 Q. But they gave -- they had the cash on
20 their books and they gave the cash to somebody;
21 right?

22 A. In order to obtain equity, yes.

23 Q. You are not saying that they gave away
24 \$437 million in cash and then got \$437 million in
25 shareholder equity that went directly to the

1 shareholder equity component; right? They got an
2 asset which was pipes in the ground. I thought we
3 covered this before.

4 Let me withdraw it. Let me see if I
5 can clarify. Let's see if you can work with me.

6 Did Southern Union take \$437 million
7 and give it to CMS, at least part of the acquisition?
8 It's a yes or no.

9 A. I'm sorry, can you repeat that?

10 Q. Sure. As part of the acquisition of
11 CMS, which now is Panhandle Eastern Pipeline, did
12 Southern Union give \$437 million to the CMS owners of
13 the pipeline?

14 A. Well, they gave more than that, but
15 one component was the \$437 million.

16 Q. And under your propose -- now that
17 money was gone, right, they gave it away, they had it
18 in the bank and they gave it to somebody; right?

19 A. It is no longer in Southern Union's
20 possession.

21 Q. And even though that was no longer in
22 Southern Union's possession, your proposal number one
23 is to say -- take the \$437 million out of shareholder
24 equity as a proposal, and then in addition take a
25 percentage of the additional moneys that they raised;

1 right?

2 A. Through common stock issuance and the
3 equity units issuance, that is my proposal as a
4 reasonable means to quantify the equity that should
5 be assigned to Panhandle Eastern for purposes of this
6 case.

7 Q. So your recommendation then, we'll
8 start with proposal one, is to say that this
9 Commission should take away \$520,350,000 from
10 Southern Union's shareholder equity, even though it
11 gave away \$437 million in cash in the same
12 transaction that's encompassed in your \$521 million
13 number; right?

14 I'd really like to try to get a yes or
15 no answer to that.

16 A. It's impossible.

17 Q. I assure you it's not impossible.

18 MR. FRANSON: It is impossible. It's
19 been stated, so.

20 Q. (By Mr. Herschmann) You are unable to
21 answer that as a yes or no?

22 A. My --

23 Q. Is that -- is the answer to that that
24 you cannot answer that question as a yes or no?

25 A. Can I hear the question again?

1 MR. HERSCHMANN: Can you read it back,
2 please. I'm sorry.

3 THE REPORTER: So your recommendation
4 then, we'll start with proposal one, is to say that
5 this Commission should take away \$520,350,000 from
6 Southern Union's shareholder equity, even though it
7 gave away \$437 million in cash in the same
8 transaction that's encompassed in your \$521 million
9 number; right?

10 THE WITNESS: The question makes
11 assumptions I cannot agree with. The 437 million is
12 part of the overall total investment of Southern
13 Union in Panhandle. And whatever part that relates
14 to equity is, should be backed out if the Commission
15 accepts Southern Union's proposal to have a
16 stand-alone capital structure in this case without
17 Panhandle.

18 Q. (By Mr. Herschmann) Are you saying
19 the \$437 million in cash that Southern Union gave
20 away is now shareholder equity? Because I thought
21 beforehand you said cash is different. So are you
22 now saying the 437 million is the shareholder equity,
23 so they should give away \$437 million in cash and
24 then you should take away another \$437 million of
25 shareholder equity plus the other adjustments? Isn't

1 that your recommendation, sir?

2 A. Let me explain it this way. Prior to
3 the transaction, you had 437 million of cash, CMS had
4 437 million of equity investment in Panhandle. After
5 the transaction, CMS had 437 million in cash and you
6 had 437 million of equity investment in Panhandle.

7 Q. Is that shareholder equity, sir, or is
8 that pipeline in the ground? You just told us cash
9 was different. I just want to know are you now
10 saying that the \$437 million that we gave away and
11 since we got an asset, it just increased the Southern
12 Union total shareholder equity from whatever number
13 it was to an additional \$437 million?

14 A. Well, your questioning --

15 Q. It's a yes or no question, sir.

16 A. No.

17 Q. You are not saying that; right?

18 A. I'm not saying that -- well --

19 MR. FRANSON: I'm going to have to
20 object here. First of all, we need one person,
21 whether that's Mr. Herschmann or Mr. Oligschlaeger
22 talking at a time.

23 Number two, Mr. Herschmann
24 consistently is asking questions that cannot be
25 answered yes or no. He also consistently puts in

1 many assumptions. This witness is entitled to
2 answer, that is what the rules of evidence require.
3 The fact that Mr. Herschmann may not like those
4 answers is irrelevant.

5 JUDGE WOODRUFF: Your objection is
6 overruled. You can ahead and answer the question.

7 THE WITNESS: Can you read back the
8 question, please?

9 THE REPORTER: Is that shareholder
10 equity, sir, or is that pipeline in the ground?

11 THE WITNESS: To start there, what
12 Southern Union purchased were the net assets of
13 Panhandle, which is not just assets, it's assets less
14 liabilities. And according to the fair market value
15 of the assets and liabilities it purchased, the
16 assets exceeded the liabilities by \$679 million,
17 which constitutes Southern Union's equity in
18 Panhandle.

19 Q. (By Mr. Herschmann) Sir, is the
20 investment in Panhandle already eliminated in
21 consolidation?

22 A. To the extent the investment in
23 Panhandle or the equity investment in Panhandle can
24 be found in both the Panhandle stand-alone financial
25 statements as well as the total Southern Union

1 consolidated financial statements, then you would
2 have to eliminate that amount as being double
3 counted.

4 Q. I want to make sure that I understand
5 what you're saying because I guess I'm having a
6 little bit of confusion here. You told us \$437
7 million in cash is not shareholder equity; right?

8 A. It used to be cash, now it's
9 shareholder equity.

10 Q. Let's start with -- it will be much
11 easier, I promise you, if you'll let me ask you the
12 questions and you'll just answer the questions. Mr.
13 Franson can get up, he can let you expand all he
14 wants, but I promise you it will be much quicker if
15 you just answer the questions I ask you.

16 Did you tell us before that cash is
17 different than equity?

18 A. Cash is an asset and equity is an
19 element of -- well --

20 Q. Is it different? It's a yes --

21 A. It is different, yes.

22 Q. Okay. Thank you. Now, when Southern
23 Union had the \$437 million in cash, according to the
24 way you're calculating things, could it just say it
25 has another \$437 million in shareholder equity?

1 Would it just go to the equity side?

2 A. Cash is not equity, you cannot count
3 an amount both as an asset and as equity.

4 Q. Right. So when Southern Union gave
5 away the \$437 million in cash and got an asset, did
6 Southern Union's shareholder equity all of a sudden
7 go up another \$437 million? Yes or no.

8 A. No, but I'd like to explain why.

9 Q. When Mr. Franson gets here, I'm sure
10 he'll make you do that. All right?

11 So it didn't go up another \$437
12 million; right? Shareholder equity number didn't go
13 up another 437 million; right?

14 A. That's correct.

15 Q. And yet when you make your proposals
16 to this Commission, you suggest that they take out
17 \$437 million from the total shareholder equity;
18 right? It's a yes or no.

19 A. As an alternative, I suggest that the
20 437 million be a component, yes.

21 MR. HERSCHMANN: Okay. Thank you.
22 Ask to strike the first part of the answer.

23 JUDGE WOODRUFF: Yes.

24 MR. FRANSON: Your Honor, I understand
25 you have ruled; however, the questions continue to

1 call for more than a yes or no answer. I understand
2 Mr. Herschmann wants specific things. I've been
3 there, done that, too. But you don't always get
4 them.

5 The questions, if they call for a yes
6 or no answer will get a yes or no answer, but
7 consistently he isn't doing that.

8 JUDGE WOODRUFF: I have already ruled
9 your objection is overruled.

10 Q. (By Mr. Herschmann) And just look at
11 proposal two for a moment. Okay? In your proposal
12 two, you suggest that the Commission simply take half
13 of Southern Union's total shareholder equity and use
14 that as a proposed capital structure; right? For a
15 proposed capital structure; right?

16 A. As part of one, yes.

17 Q. How long have you been with the
18 Commission?

19 A. Since September 1981.

20 Q. And did you ever work on the St. Joe
21 Power & Light case?

22 MR. FRANSON: Your Honor, objection as
23 to relevance.

24 JUDGE WOODRUFF: Overruled.

25 MR. FRANSON: Well, at least which St.

1 Joe Light & Power case? There's been multiple.

2 MR. HERSCHMANN: I only know about the
3 1993 one.

4 MR. FRANSON: Okay. That tells me
5 which one, thank you.

6 Q. (By Mr. Herschmann) Were you here at
7 all during the testimony for the last couple days?

8 A. Yes, off and on.

9 Q. And do you read Commission decisions
10 and orders in cases?

11 A. Not all of them, but most of them and
12 most of the important ones I hope to.

13 Q. And do you believe that there's a
14 means of computing a hypothetical capital structure
15 other than your picking the deleting of the \$437
16 million or half of the shareholder equity?

17 A. There are many ways to compute
18 hypothetical capital structures.

19 Q. And have you ever looked at computing
20 hypothetical capital structures based on the
21 comparable companies to MGE?

22 A. I have not personally done that.

23 Q. Do you have, in your two proposals, do
24 you have any sources, any textbooks, anywhere that
25 says your proposals are an accepted methodology

1 that's used in how to do this?

2 A. No, I suggested these approaches based
3 upon my own evaluation of the evidence as being
4 reasonable ways to proceed if the Commission should
5 decide to reject the Staff's position on this issue.

6 Q. So these are just your thoughts to
7 say, let me give you a couple things I have thought
8 about and these are what I think you maybe want to
9 consider in setting the rates in this case; right?

10 A. I believe they're reasonable, yes.

11 MR. HERSCHMANN: I have nothing
12 further.

13 JUDGE WOODRUFF: No questions from the
14 bench.

15 MR. FRANSON: Your Honor, if Mr.
16 Micheel is first, he informed me earlier that he
17 would not be here and that he had no questions.

18 JUDGE WOODRUFF: Well, there is --
19 since I have no questions, there will be no recross,
20 so we'll go back to redirect.

21 MR. FRANSON: Okay. May I proceed,
22 Your Honor?

23 JUDGE WOODRUFF: You may.

24 REDIRECT EXAMINATION BY MR. FRANSON:

25 Q. First of all, Mr. Oligschlaeger, what

1 was the specific purpose of your surrebuttal
2 testimony?

3 A. The specific purpose of my surrebuttal
4 testimony was to address the criticisms made by
5 Company Witness Gillen to Staff Witness' Murray
6 alternative approach to developing a capital
7 structure in this case that was proffered in case the
8 Commission rejected the primary capital structure
9 recommendation in this proceeding.

10 MR. HERSCHMANN: Objection, Your
11 Honor. If I could clarify. Mr. Murray did not
12 propose a different capital structure at all in any
13 of his testimony.

14 MR. FRANSON: Your Honor --

15 MR. HERSCHMANN: He did a calculation
16 and he said he ignored the calculation because it
17 would be worse for Southern Union. And I'll rely on
18 his testimony that's at least been drafted and
19 prepared. But I don't think there's any question
20 that -- he testified today he never proposed a
21 hypothetical capital structure.

22 MR. FRANSON: Your Honor, quite
23 frankly, if Mr. Herschmann wants to testify about his
24 interpretation of Mr. Murray's testimony, he needs to
25 get up here under oath and do it.

1 I move that his -- his comments, and
2 there was no objection in there that I heard, his
3 comments need to be stricken. And I so move.

4 MR. HERSCHMANN: And I will address
5 that. I will object for the record, and I'll ask
6 counsel to proffer a good faith basis based on this
7 record for anywhere where Mr. Murray has proposed a
8 hypothetical capital structure or any other capital
9 structure for this proceeding other than
10 consolidated. And I will rely on the record that's
11 been put forth before Your Honor all day today.

12 MR. FRANSON: Your Honor, I will agree
13 the record is what the record is. The question to
14 the witness has been asked and answered. And
15 objections are simply too late. What we started with
16 was Mr. Herschmann's interpretation of the evidence,
17 which he is certainly entitled to, however -- it's
18 just asked and answered, Your Honor, and I would like
19 to proceed with my next question.

20 JUDGE WOODRUFF: I'm going to deny
21 both objections. Proceed with your next question.

22 Q. (By Mr. Franson) Okay. Mr.
23 Oligschlaeger, was your testimony about capital
24 structure, and Mr. Murray and Mr. Gillen and anything
25 else in here, was it strictly limited to accounting

1 aspects of the capital structure or did it include
2 other things?

3 A. It includes aspects of the rate-making
4 issue of capital structure and how best to proceed on
5 this -- on issues in terms of formulating an
6 appropriate capital structure for rate purposes for
7 MGE in this case.

8 Q. Okay. Are the -- by accounting, I'm
9 using the GAAP standards in rate making. Are they
10 always consistent with each other?

11 A. The Commission frequently deviates
12 from GAAP standards in how it sets rates for
13 utilities, and in fact, in this case both the Staff
14 and the Company have deviated from GAAP standards in
15 formulating their requested rate allowances for
16 certain expense revenue and rate based components in
17 this proceeding.

18 MR. HERSCHMANN: I'm going to object
19 and move to strike as nonresponsive.

20 JUDGE WOODRUFF: Overruled.

21 Q. (By Mr. Franson) Well, Mr.
22 Oligschlaeger, would the record reflect, I'm not
23 necessarily asking you where, but would the record
24 reflect somewhere that the Company has deviated from
25 GAAP in one of its proposals?

1 A. No, that is so routine, it is usually
2 not commented on.

3 Q. Okay. Mr. Oligschlaeger, how long
4 have you been with the Commission?

5 A. Since September 1981.

6 Q. Are you familiar with generally since
7 1981 about Commission decisions?

8 A. In general terms, yes.

9 Q. Have there been times when the
10 Commission has, in fact, deviated from GAAP for
11 rate-making purposes?

12 MR. HERSCHMANN: Objection, Your
13 Honor, beyond the scope of cross. I never addressed
14 the Commission's application of GAAP under any
15 circumstances.

16 MR. FRANSON: Oh, on the contrary --

17 JUDGE WOODRUFF: I'll overrule the
18 objection. You can proceed.

19 Q. (By Mr. Franson) Do you remember my
20 question?

21 A. Yes, I do. There have been on
22 numerous occasions where the Commission has deviated
23 from GAAP in its rate-making decisions. Just very
24 quickly and with respect to OPEV's and FAS-106 in the
25 1990s as well as routinely in regard to how it treats

1 items like bad debt expense and injuries and damages
2 claims.

3 Q. Mr. Oligschlaeger, you were asked
4 questions by Mr. Herschmann about JJG-1 and JJG-2.
5 What are those, JJG-1 and JJG-2?

6 A. JJG-1 and JJG-2 are two hypothetical
7 financial statements that are attached to Company
8 Witness' Gillen rebuttal testimony.

9 Q. Okay. During your testimony, I
10 believe you said those were not relevant. Why did
11 you say that?

12 MR. HERSCHMANN: Objection, Your
13 Honor, it was in his direct testimony or in his
14 surrebuttal testimony, and I never addressed it again
15 at all in cross-examination.

16 MR. FRANSON: Your Honor --

17 JUDGE WOODRUFF: If you could clarify.

18 MR. FRANSON: This witness was asked
19 questions by Mr. Herschmann, rather extensively,
20 about schedules JJG-1, JJG-2. And at one point
21 during that, Mr. Herschmann -- I'm sorry, Mr.
22 Oligschlaeger said they were not relevant. And I'm
23 following up on that. And those were inquired and
24 that was -- and it was right here during this
25 testimony.

1 MR. HERSCHMANN: I think you -- I
2 moved to strike the answer, and you granted the
3 motion, because I asked him to look at it and would
4 those schedules comply with GAAP as it said in his
5 surrebuttal. And he said yeah, but I don't think
6 they're relevant. And I moved to strike it, and you
7 granted it. I don't think that opens the door for
8 him to raise it on redirect now.

9 JUDGE WOODRUFF: I disagree, I think
10 you did open the door. I'm going to overrule your
11 objection. You can answer the question.

12 Q. (By Mr. Franson) Do you remember the
13 question, Mr. Oligschlaeger?

14 A. Yes, I do.

15 Q. Please answer.

16 A. Numbers can be formulated consistent
17 with generally accepted accounting principles, but
18 yet be not only irrelevant, but perhaps even
19 nonsensical in terms of their ultimate results.

20 The Company has presented in Mr.
21 Dunn's -- I'm sorry, in Mr. Gillen's rebuttal
22 testimony and Mr. Dunn's surrebuttal testimony two
23 approaches to capital structures with a -- with
24 Panhandle excluded that purport to be compliant with
25 GAAP, but yet would result in the allocation of zero

1 or very little of its equity to its pipeline
2 operations which it filed for rate purposes.

3 That would be totally inappropriate
4 and would result in Missouri customers paying costs
5 related to non regulated components of Southern
6 Union's business.

7 Q. Mr. Oligschlaeger, Mr. Herschmann
8 asked you about purchasing accounting. What is
9 purchasing accounting?

10 A. I believe you mean purchase
11 accounting.

12 Q. Purchase accounting, thank you. What
13 is purchase accounting?

14 A. Purchase accounting is the current
15 approved method by which companies are required to
16 account for the costs of business combinations.

17 Q. Okay. Let me ask you, Mr.
18 Oligschlaeger, should the Commission consider GAAP in
19 the Southern Union capital structure for rate-making
20 purposes in this case?

21 MR. HERSCHMANN: Objection, Your
22 Honor. I don't think this is an area I touched upon
23 ever as to the application of GAAP for rate-making
24 purposes. I specifically told this witness I'm not
25 addressing his opinion on rate-making purposes at

1 all, ever. All I want to do is talk about his
2 accounting specialty.

3 MR. FRANSON: Your Honor --

4 JUDGE WOODRUFF: Go ahead.

5 MR. FRANSON: If I may. Mr.
6 Herschmann went to great lengths -- he knows
7 perfectly good and well this witness testified about
8 accounting and rate making and the capital structure
9 and how it applies to both of them. They're not
10 necessarily the same thing.

11 He tried very diligently to limit his
12 questions, but, Your Honor, this witness did not
13 simply testify about accounting and its relation to
14 capital structure. He also testified about the rate
15 making-aspects thereof. Those are very intertwined
16 and they cannot be separated despite Mr. Herschmann's
17 diligence attempts to do so.

18 JUDGE WOODRUFF: Mr. Herschmann
19 limited his cross-examination to the accounting
20 aspects, and on redirect you are limited to what he
21 asked in his -- in his cross-examination. So I'm
22 going to sustain that objection.

23 Q. (By Mr. Franson) Okay. Mr.
24 Oligschlaeger, to your knowledge, has this Commission
25 ever considered consolidation entries per GAAP in

1 ordering capital structures in Missouri rate cases?

2 MR. HERSCHMANN: Objection, same
3 objection.

4 MR. FRANSON: Your Honor, this is an
5 accounting question. Mr. Herschmann went into GAAP
6 and tried very -- I understand your ruling, but I
7 still don't agree. But in here, this is a GAAP
8 question. GAAP was so fundamentally intertwined with
9 Mr. Herschmann's questions that I think this is a
10 very fair question.

11 JUDGE WOODRUFF: I'm going to overrule
12 that objection. You can go ahead and answer this
13 question.

14 MR. HERSCHMANN: If I could be heard
15 for a second.

16 JUDGE WOODRUFF: Certainly.

17 MR. HERSCHMANN: I think the question
18 was, should this Commission apply GAAP.

19 JUDGE WOODRUFF: No, I think it was
20 has it ever applied GAAP in the past.

21 MR. FRANSON: That was my question,
22 has it ever been.

23 MR. HERSCHMANN: I think it's for
24 rate-making purposes, which would be directly outside
25 of exactly what it says. We can read back the

1 question.

2 MR. FRANSON: That's fine. Why don't
3 we read back the question.

4 JUDGE WOODRUFF: Go ahead.

5 THE REPORTER: Mr. Oligschlaeger, to
6 your knowledge, has this Commission ever considered
7 consolidation entries per GAAP in ordering capital
8 structures in Missouri rate cases?

9 MR. HERSCHMANN: I renew my objection.
10 It's exactly what you just ruled upon. It's a nice
11 creative way to get around the last objection, but
12 it's the exact same question in different clothing.

13 MR. FRANSON: Actually it isn't,
14 Judge. The question is, has the Commission ever
15 considered consolidation entries per GAAP in ordering
16 capital structures, those are the two things we're
17 talking about here, in Missouri rate cases. That's
18 what we're talking about.

19 Now, I didn't say anything about
20 rate-making purposes, I said have they followed GAAP
21 in consolidation entries in ordering capital
22 structures. Capital structures and GAAP in rate
23 cases, not rate making, that doesn't come into it.
24 What have they done --

25 JUDGE WOODRUFF: All right. I've made

1 my ruling. We need to move on. Your objection is
2 overruled. You can answer the question.

3 THE WITNESS: Not to my knowledge.

4 Q. (By Mr. Franson) Thank you. Does
5 FAS-71 allow companies such as Southern Union to
6 deviate from GAAP when so ordered by regulatory
7 commissions?

8 MR. HERSCHMANN: Objection, Your
9 Honor, this is again -- maybe I'll just give a
10 standing objection.

11 JUDGE WOODRUFF: That would be fine.

12 MR. HERSCHMANN: I'll have a standing
13 objection of every time he tries to get this witness
14 to testify about accounting and tie it to rate-making
15 proceedings, since I limited my questions
16 specifically only to his accounting expertise,
17 totally unrelated to any rate proceedings.

18 JUDGE WOODRUFF: Your continuing
19 objection is noted. You can go ahead and answer the
20 question.

21 THE WITNESS: Can you repeat the
22 question.

23 Q. (By Mr. Franson) Yes. Does FAS-71
24 allow companies such as Southern Union to deviate
25 from other GAAP things when so ordered by regulatory

1 commissions?

2 A. Under some circumstances it does.

3 Q. Okay. Mr. Oligschlaeger, one of the

4 --

5 MR. FRANSON: Oh, by the way, are you
6 going to offer No. 43 that was up there?

7 JUDGE WOODRUFF: We'll deal with that
8 later.

9 MR. HERSCHMANN: If you want it, well,
10 sure.

11 JUDGE WOODRUFF: I was going to ask
12 that later as well. Go ahead and continue your
13 question.

14 MR. FRANSON: Well, I don't know that
15 I've got -- I don't remember which one of your things
16 this came from since I don't have the exhibits.

17 Q. (By Mr. Franson) But anyway, Mr.
18 Oligschlaeger, is there really any way to determine
19 if exactly 58.33 percent of the equity was used in
20 acquiring Panhandle? Do you understand my question?

21 A. Yes, I do. In terms of what portion
22 of the common stock issuance and the equity unit
23 issuance actually went into -- was part -- financed
24 part of the purchase price of Panhandle, no, there is
25 no way that one can do that. One would have to make

1 reasonable estimations or assumptions as to how to
2 allocate those costs.

3 Q. Okay. Mr. Oligschlaeger, is cost or
4 the assets Southern Union bought from CMS which --
5 okay, come back.

6 Mr. Oligschlaeger, is the cost of the
7 assets Southern Union bought from CMS, which included
8 this \$437 million in cash, recorded on the balance
9 sheet as an asset?

10 A. On Panhandle's or on Southern Union's?

11 Q. Well, on Panhandle's first.

12 A. Well, the assets which were purchased
13 by that for those amounts are the net assets. Both
14 the assets and the liabilities are included on the
15 books and records of Panhandle.

16 Q. What about Southern Union?

17 A. They would appear on Southern Union's
18 total consolidated financial statements as well.

19 Q. Are assets supported by both debt and
20 equity?

21 A. In general it is assumed that, for a
22 utility, that all of its assets are supported
23 generally by both debt and equity sources.

24 Q. So the assets that Southern Union --
25 well, they acquired, I believe, from CMS represented

1 or supported by the equity amount of the \$437 million
2 cash payment?

3 MR. HERSCHMANN: I'll just enter my
4 leading objection.

5 MR. FRANSON: He might have something
6 there, Judge.

7 JUDGE WOODRUFF: Sustained.

8 MR. HERSCHMANN: That must have been a
9 first, then.

10 MR. FRANSON: I agree, it was a first.

11 Let me see if I can rephrase that
12 question, Judge.

13 Q. (By Mr. Franson) Okay. Did the
14 assets -- did Southern Union acquire assets from CMS?

15 MR. HERSCHMANN: I'm going to object,
16 that's not leading.

17 MR. FRANSON: Not as leading, no.
18 It's late, Mr. Herschmann.

19 THE WITNESS: They acquired the net
20 assets of Panhandle which are both assets and
21 liabilities.

22 Q. (By Mr. Franson) Okay. Is any of
23 that represented by -- is any of that represented by
24 the \$437 million cash payment?

25 A. Well, the 437 million cash payment was

1 used to make the equity investment into Panhandle.

2 Q. Okay. Mr. Oligschlaeger, do you know
3 when this \$437 million was actually taken out of
4 Southern Union's bank account, approximately?

5 A. I would assume it would be the date of
6 the transaction of June 11, 2003.

7 Q. And that 437 million was received from
8 the seller, I believe, the Texas assets of the Texas
9 properties of Southern Union?

10 A. That is correct.

11 Q. And in regard to Southern Union's
12 consolidated capital structure -- well, strike that.

13 Did -- did Southern Union's
14 consolidated capital structure at the time it sold
15 its Texas assets consist of a significant portion of
16 equity?

17 A. Based upon my general knowledge and
18 the testimony earlier of Staff Witness Murray, at
19 least 30 to 35 percent of its capital structure
20 consisted of equity at that time.

21 MR. HERSCHMANN: Your Honor, I'm going
22 to move to strike that answer since the only
23 conceivable source would have been hearsay.

24 JUDGE WOODRUFF: Sustained.

25 Q. (By Mr. Franson) The last answer you

1 gave, what was the source of that information?

2 A. The sworn testimony of Staff Witness
3 Murray.

4 MR. FRANSON: Now, Your Honor, I think
5 that would remove the hearsay objection. And I would
6 ask that it be -- that his answer be put back into
7 the record.

8 JUDGE WOODRUFF: Any response?

9 MR. HERSCHMANN: I think it just
10 proved the hearsay objection.

11 MR. FRANSON: Well, Your Honor -- go
12 ahead.

13 JUDGE WOODRUFF: I agree, it's -- it
14 is hearsay.

15 MR. FRANSON: Your Honor, by
16 definition, almost everything we do here is hearsay.
17 So I'd ask you to reconsider.

18 JUDGE WOODRUFF: Move on to your next
19 question, please.

20 MR. FRANSON: Mr. Oligschlaeger -- Mr.
21 Herschmann, give me just a little leeway and we'll be
22 finished here.

23 MR. HERSCHMANN: Okay. It's a great
24 line.

25 Q. (By Mr. Franson) Mr. Oligschlaeger,

1 do you believe that Southern Union's proposed
2 hypothetical capital structure is in accordance with
3 GAAP?

4 A. As I have stated before, I don't think
5 GAAP is particularly relevant to the determination of
6 whether a capital structure is appropriate for rate
7 purposes or not.

8 Q. Fine. Please answer my question and
9 we can go home.

10 A. All right. Ask.

11 Q. Okay. Do you believe that Southern
12 Union's proposed hypothetical capital structure is in
13 accordance with GAAP?

14 A. If it's hypothetical, it isn't,
15 because under GAAP, the capital structure of a
16 company is stated in actual, real dollars of debt and
17 equity and so on.

18 Q. Okay. Same question, but purchase
19 accounting.

20 A. I'm afraid you're going to have to be
21 more specific what you want.

22 Q. Okay. We'll move on. Does GAAP allow
23 hypothetical capital structures -- let me rephrase
24 that.

25 Does GAAP allow hypotheticals?

1 A. GAAP pertains to real actual costs,
2 not hypothetical costs.

3 MR. FRANSON: With that, Your Honor, I
4 have no further questions.

5 JUDGE WOODRUFF: Thank you.

6 MR. FRANSON: Your Honor, I do need to
7 ask a scheduling, and I know Mr. Hack is still here.

8 JUDGE WOODRUFF: First of all, Mr.
9 Oligschlaeger, you can step down.

10 THE WITNESS: Thank you.

11 MR. FRANSON: Actually, we do have
12 another matter and we still need him up there.

13 MR. HERSCHMANN: Offer Exhibit 43 for
14 identification into evidence.

15 MR. FRANSON: Your Honor, the problem
16 I'm having with 43 is you have to have somebody that
17 agrees with it and agrees with your principles that
18 you're trying to show. And I understand they tried
19 and they got two out of three, but they missed on
20 this last one, Judge.

21 JUDGE WOODRUFF: I saw it when it was
22 up there, but I don't remember what it was. I don't
23 have a copy of it.

24 MR. FRANSON: Maybe we need a copy of
25 it. But I think that we will agree.

1 MR. HACK: These are the only copies
2 we have.

3 JUDGE WOODRUFF: All right. I'll
4 overrule the objection and admit -- Exhibit 43 is
5 admitted into evidence. Okay.

6 MR. FRANSON: Your Honor, I guess I'm
7 asking a scheduling question.

8 JUDGE WOODRUFF: Can Mr. Oligschlaeger
9 step down?

10 MR. FRANSON: Absolutely.

11 THE WITNESS: I thought you weren't
12 done with me.

13 JUDGE WOODRUFF: We're done with you,
14 run quick.

15 MR. FRANSON: Don't go home, but you
16 can get off the stand.

17 Who is first on the list tomorrow? Is
18 it Mr. Quain? And where do we stand, because --

19 JUDGE WOODRUFF: Actually, Mr. Noack,
20 then Mr. Quain.

21 MR. FRANSON: We're just going to
22 continue on down through policy and so forth.

23 JUDGE WOODRUFF: Yes.

24 MR. FRANSON: And if we get further
25 than that tomorrow, I guess we'll cross that bridge

1 when we come to it.

2 JUDGE WOODRUFF: Thank you. And with
3 that, we are adjourned until 8:30 tomorrow morning.
4 Thank you all very much.

5 (Adjourned.)

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1		
2	I N D E X	
3	WITNESSES	
4	All Witnesses:	page
5	John A. Tuck for OPC	
	Direct Examination by Mr. Micheel	582:23
6	Cross-Examination by Mr. Herschmann	585:17
	Questions by Commissioner Clayton	650:12
7	Questions by Commissioner Appling	673:23
	Questions by Commissioner Gaw	678:8
8	Questions by Judge Woodruff	712:2
	Recross-Examination by Mr. Berlin	719:14
9	Recross-Examination by Mr. Herschmann	722:7
10	David Murray for PSC	
	Direct Examination by Mr. Berlin	760:7
11	by Commissioner Clayton	770:22
	Cross-Examination by Mr. Herschmann	797:16
12	Redirect Examination by Mr. Berlin	874:21
13	Mark Oligschlaeger for PSC	
	Direct Examination by Mr. Franson	895:16
14	Cross-Examination by Mr. Herschmann	902:13
	Redirect Examination by Mr. Franson	942:24
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		

1		
2	EXHIBITS	
3	For MGE:	
4	33 Certificate of Compliance dated	
5	08/01/03	
6	Received	858:7
7	34 Certificate of Compliance,	
8	11/10/03	
9	Received	858:7
10	35 Certificate of Compliance,	
11	02/03/04	
12	Received	858:7
13	36 Certificate of Compliance,	
14	05/04/04	
15	Received	858:7
16	37 Letter dated 08/14/03	
17	Received	858:7
18	38 Letter dated 11/13/03	
19	Received	858:7
20	39 Letter dated 02/13/03	
21	Received	858:7
22	40 Letter dated 05/14/04	
23	Received	858:7
24	41 Summary of Calculations of Mr.	
25	Oligschlaeger	
	Received	919:11
	42 Equity and Equity Units Offering	
	Chart	
	Received	921:10
	43 Calculations from Mr.	
	Oligschlaeger's first proposal	
	Received	961:4

1		
2	For OPC:	
3	218 Errata Sheet of John Tuck's	
4	Surrebuttal Testimony	
5	Received	583:16
6	Received	584:22
7	219 CAPM analysis	
8	Received	759:5
9	825 David Murray's Direct Testimony	
10	Received	768:12
11	826 David Murray's Rebuttal	
12	Testimony	
13	Received	768:12
14	827 David Murray's Surrebuttal	
15	Testimony	
16	Received	768:13
17	847 David's Murray's Errata Sheet to	
18	Surrebuttal Testimony	
19	Received	770:2
20		
21	For PSC:	
22	830 Mark Oligschlaeger's Surrebuttal	
23	Testimony	
24	Received	901:7
25	843 Cost of Capital Chart	
	Received	875:15