Exhibit No.: _____
Issue: ROE
Witness: James M. Anderson
Exhibit Type: Surrebuttal
Sponsoring Party: Summit Natural Gas of Missouri, Inc.
Case No.: GR-2014-0086
Date: August 8, 2014

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-2014-0086

SURREBUTTAL TESTIMONY

OF

JAMES M. ANDERSON

ON BEHALF OF

SUMMIT NATURAL GAS OF MISSOURI, INC.

Jefferson City, Missouri
August, 2014

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****** Denotes Highly Confidential Information ******

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SURREBUTTAL TESTIMONY

JAMES M. ANDERSON

SUMMIT NATURAL GAS OF MISSOURI, INC.

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is James M. Anderson. My business address is 8400 E. Prentice Ave, Suite 500, Greenwood Village, CO 80111.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY AND SCHEDULES IN THIS CASE?

A. Yes. I submitted Direct Testimony, Schedules and Rebuttal Testimony in this case on behalf of Summit Natural Gas of Missouri, Inc. ("SNG" or the "Company") as part of the Company's filings on January 2, 2014 and July 11, 2014.

Q. ARE YOU SPONSORING ANY SCHEDULES IN SUPPORT OF YOUR SURREBUTTAL TESTIMONY?

A. Yes, the following schedules:

Schedule JMA-9, Historical Capital Structure of SNG, and its Predecessors (Highly Confidential),

Schedule JMA-10, Historical Earnings Before Interest, Taxes, Depreciation and Amortization and the Estimated debt Supportable by the EBITDA (Highly Confidential), Schedule JMA-11, the Executive Summary to IIF Private Placement Memorandum (Highly Confidential),

Schedule JMA-12, IIF's independent calculations of the cost of equity for Summit Utilities, Inc. (Highly Confidential) 2009 to 2013, and

Schedule JMA-13, Debt Credit Rating Matrix for SNG, based on Moody's Investors Service rating methodology (Highly Confidential).

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to respond to several issues raised by Staff's Cost-of-Capital Witness, Mr. David Murray, in his Rebuttal Testimony, filed in Case No. GR-2014-0086 in July, 2014, ("Mr. Murray's Rebuttal Testimony").

Q. PLEASE SUMMARIZE YOUR SURREBUTTAL TESTIMONY.

A. Specifically, I will respond to the following topics:

1) Using SNG's shareholders' minimum required return to set the cost of common equity,

2) Staff's risk premium adjustment to SNG's cost of equity capital,

3) Capital structure to be used in this rate case,

4) Interest rates used to calculate revenue requirements,

5) Risks specific to the four divisions in this rate case,

6) Proxy group of utilities used to calculate the cost of common equity

7) Appreciation of the proxy group's stock price, and

8) Mr. Murray's Rebuttal Testimony's conclusions.

III. USING SHAREHOLDERS' DESIRED RATE OF RETURN TO SET THE COST OF COMMON EQUITY

Q. WHAT IS MR MURRAY'S ADVICE ON DETERMINING SNG'S COST OF COMMON EQUITY?

A. Mr. Murray suggests, on page 3, lines 1 to 7 of his rebuttal testimony, the following: "Instead of relying on Mr. Anderson's subjective opinion …. IIF (the private equity fund that holds all of Summit Utilities, Inc. equity) could provide the Commission direct evidence on the minimum required return it used when making the decision on whether to acquire equity interest in the systems already built in Missouri, the Gallatin district and the Rogersville district, and whether to invest in building systems for the Warsaw and Branson districts". Mr. Murray goes on to say that: "Staff believes the most effective way to address the credibility of Mr. Anderson's ROR (rate of return) recommendation would have been to review the investment and performance analysis IIF performs periodically on its investments in Summit Utilities" (page3, lines 14 to 16 of Mr. Murray's Rebuttal Testimony). In other words, if the Staff had more information on IIF, it could have determined if my direct testimony was accurate and if it offers the correct recommendation on the cost of common equity.

Q. HAS SNG PROVIDED THE INFORMATION THAT STAFF REQUESTED ON IIF'S MINIMUM REQUIRED RATE OF RETURN?

A. Not by the time that Mr. Murray prepared his rebuttal testimony, but SNG has since responded to Staff's data requests.

Q. DID YOU HAVE THIS INFORMATION AVAILABLE TO YOU WHEN YOU PREPARED YOUR DIRECT AND REBUTTAL TESTIMONIES?

A. No. These materials were made available to me at the same time that they were provided to Mr. Murray. As such, they played no part in the formulation of my cost-of-capital opinions reflected in my earlier testimonies.

Q. IS IIF A SINGLE INVESTOR OR MULTIPLE INVESTORS?

A. IIF consists of a number of investors that have invested capital in a private equity fund managed by J.P. Morgan Investment Management Inc.

Q. HOW DID THIS GROUP OF INVESTORS MAKE THEIR INDIVIDUAL DECISION REGARDING THE RATE OF RETURN ON THEIR INVESTMENT?

A. A private placement memorandum (PPM) was provided to each investor. Among other things, the PPM set out the targeted internal rate of return (IRR) across the Holding Entities (the portfolio companies like Summit Utilities) of 10% -12%, net of management fees and taxes incurred at or below the level of the Holding Entities, over a medium-term investment horizon of not less than five to seven years. See the last paragraph of page 1 of the Executive Summary of the PPM, attached as the highly confidential Schedule JMA-11.

Q. WHAT WOULD THE REQUIRED TOTAL RATE OF RETURN ON AN INVESTMENT BE IN ORDER TO EARN A NET RATE OF RETURN OF 10% TO 12%?

A. The total return would need to exceed the <u>net</u> return of 10% to 12% by the amount of the cost of the management fees and any taxes. This could mean that the total return would need to be 12% to 14%, depending on the amount of fees and taxes.

Q. DID MANAGEMENT OF IIF PERFORM ANY ANALYSIS TO DETERMINE WHAT A REASONABLE COST OF COMMON EQUITY SHOULD BE FOR SUMMIT UTILITIES, GIVEN ITS RISKS?

A. Yes, J.P. Morgan engaged KPMG and Ernst & Young to perform an independent analysis of the cost of common equity for Summit Utilities for 2009 to 2013. These analyses vary slightly from year to year, but have set the appropriate cost of equity to be between 12.25% and 13%. This rate included a risk premium, for risks associated with Summit Utilities had averaged 4.74% over the period from 2009 to 2013, ranging from a low of 4.5% to a high of 5%. See Schedule JMA-12, IIF's independent calculation of the cost of equity for Summit Utilities, Inc. 2009 - 2013.

Q WHAT IS THE AUTHORIZED RATE OF RETURN ON EQUITY FOR CNG?

A. CNG's authorized rate of return on equity is 11.7% based on its actual capital structure on December 31, 2012 (set in a 2013 rate case).

Q IF IIF LOOKS FOR SUMMIT UTILITIES TO EARN AN OVERALL RATE OF RETURN ON EQUITY OF 12.25% to 13%, WHAT RATE OF RETURN ON EQUITY WOULD SNG NEED TO EARN FOR IIF TO REALIZE ITS OBJECTIVE?

A. SNG would need to achieve a rate of return on equity of 13.1% for IIF to realize a rate of return on equity of 12.625% for the combined utilities and to meet its investors' expectations. This calculation is based on CNG's authorized rate of return on equity and SNG's net utility plant being two-thirds of the combined net utility plants of SNG and CNG on December 31, 2013. Summit Utilities of Maine was not included in this calculation because it was not in operations during the SNG's or the Staff's test periods used in this rate case.

Q. HOW DOES IIF'S TARGET RATE OF RETURN AND THE INDEPENDENT ANALYSES OF THE COST OF COMMON EQUITY COMPARE WITH YOUR AND STAFF'S FINDINGS?

A. IIF's private placement memorandum suggested that investors could earn a net return of 10% to 12%. After adjusting the net return to the required total return of 12% to 14%, the average rate of return of 13% to be earned on the investment in SNG is more in line with my recommended rate of 15% than with Staff's recommended rate of 10.3%. The independent analyses' cost of equity capital of 12.25% to 13% is slightly above the mid-point between my recommendation and Staff's recommendation, but is consistent with the 12% rate that the Company used as its cost of common equity to calculate the weighted cost of capital in Schedule TDP-3, Exhibit 1. The average risk premium in the independent analyses of 4.74% is very much in line with my risk premium of 4.4% (see my direct testimony, table 6 on page 55), but more than double the risk premium of 2% calculated by Staff.

Q. HOW DOES THE AVAILABILITY OF IIF MATERIAL SOUGHT BY MR. MURRAY ADDRESS THE CREDIBILITY OF YOUR RATE OF RETURN

RECOMMENDATION?

A. Mr. Murray's point made in his rebuttal testimony was that the credibility of my rate of return recommendation should be tested by looking against "the investment and performance analysis IIF performs periodically on its investments in" Summit Utilities. Those materials show that investors' expected returns on those investments are much higher than Staff's midpoint recommendation of 10.3% ROE and, further, that the risk premium assigned to the Summit Utilities investment is squarely in line with my independent assessment. I believe those insights strongly support the credibility of my ROE recommendations for SNG in this case.

IV. STAFF'S ADJUSTMENTS TO SNG'S COST OF EQUITY

Q. DOES STAFF BELIEVE THAT SNG'S COST OF EQUITY SHOULD BE HIGHER THAN OTHER UTILITIES?

A. Yes. On page 4, lines 1 and 2 of Mr. Murray's Rebuttal Testimony, he said "….Staff agrees that SNG's cost of equity is higher than other Missouri gas utilities".

Q. HOW DOES STAFF PROPOSE TO ADJUST FOR SNG'S HIGHER COST OF EQUITY?

A. Staff proposed an estimated debt credit rating for SNG that, in Staff's judgment, represents the Company's creditworthiness. Using its estimated credit rating, Staff makes a judgment on the interest rate that SNG's debt might bear for a twenty-year term. The estimated interest rate appears to be based solely on the current interest rate paid by Summit Utilities' other natural gas utility, CNG. The Staff then compares that estimated interest rate to the interest rates paid by other credit rated utilities to calculate its risk premium adjustment to the cost of common equity. According to Mr. Murray's Rebuttal Testimony, he believes this is a better approach because "Mr. Anderson wants the Commission to simply rely on his judgment on each of these individual risk premium adjustments (page 4, lines 5 to 6), but relying on the Staff's judgment on credit ratings and interest rates "….removes the bias and estimation error" (page 4, line 12).

Q. IN YOUR OPINION, DID STAFF ACCURATELY CALCULATE THE DEBT CREDIT RATING AND INTEREST RATE FOR SNG?

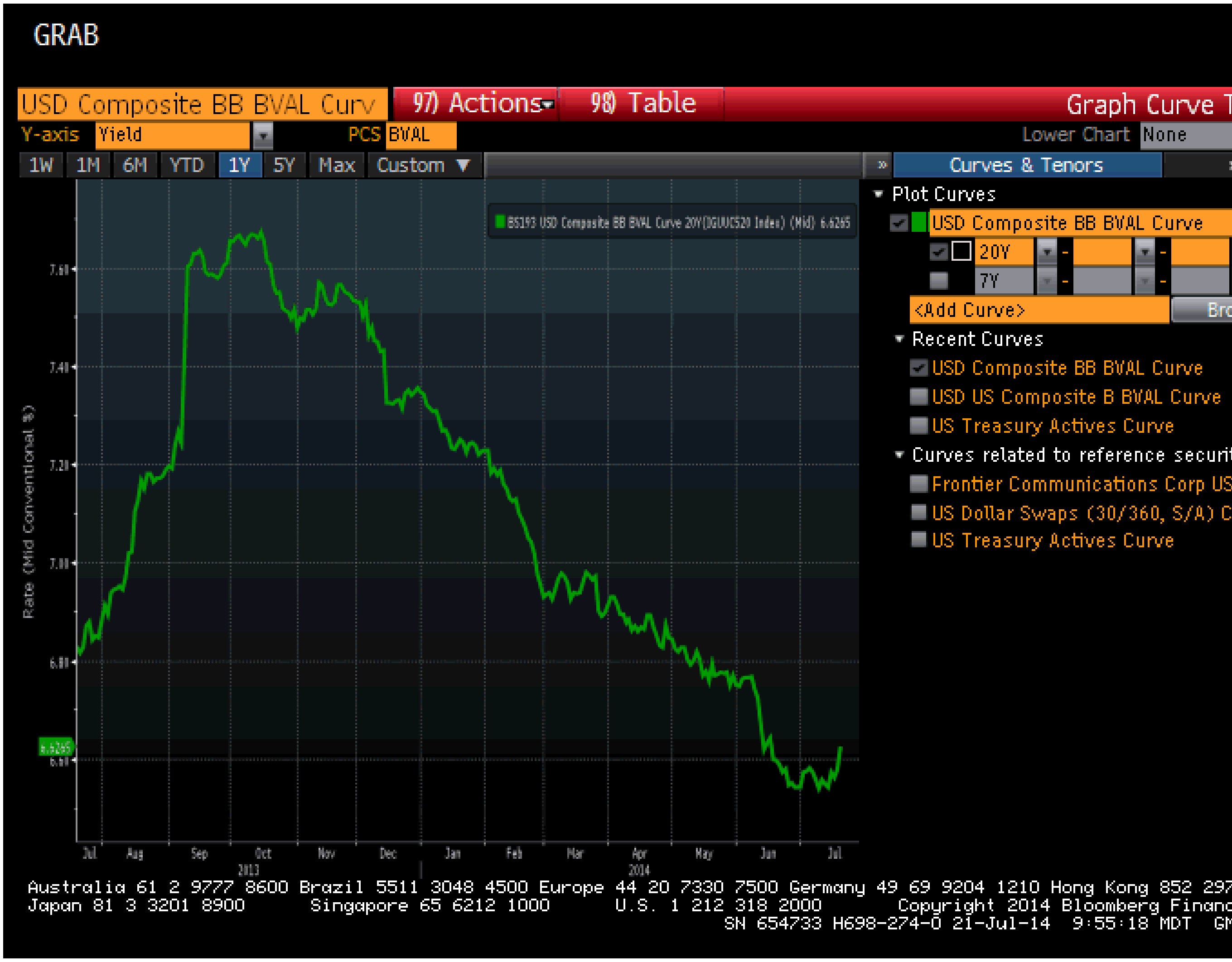
A. No. See my rebuttal testimony beginning on page 3, line17 through page 7, line 11, and see Schedule JMA-13, Debt Credit Rating Matrix for SNG that supports my opinion that SNG would receive a 'B' debt credit rating and not the 'BB' that Staff suggested.

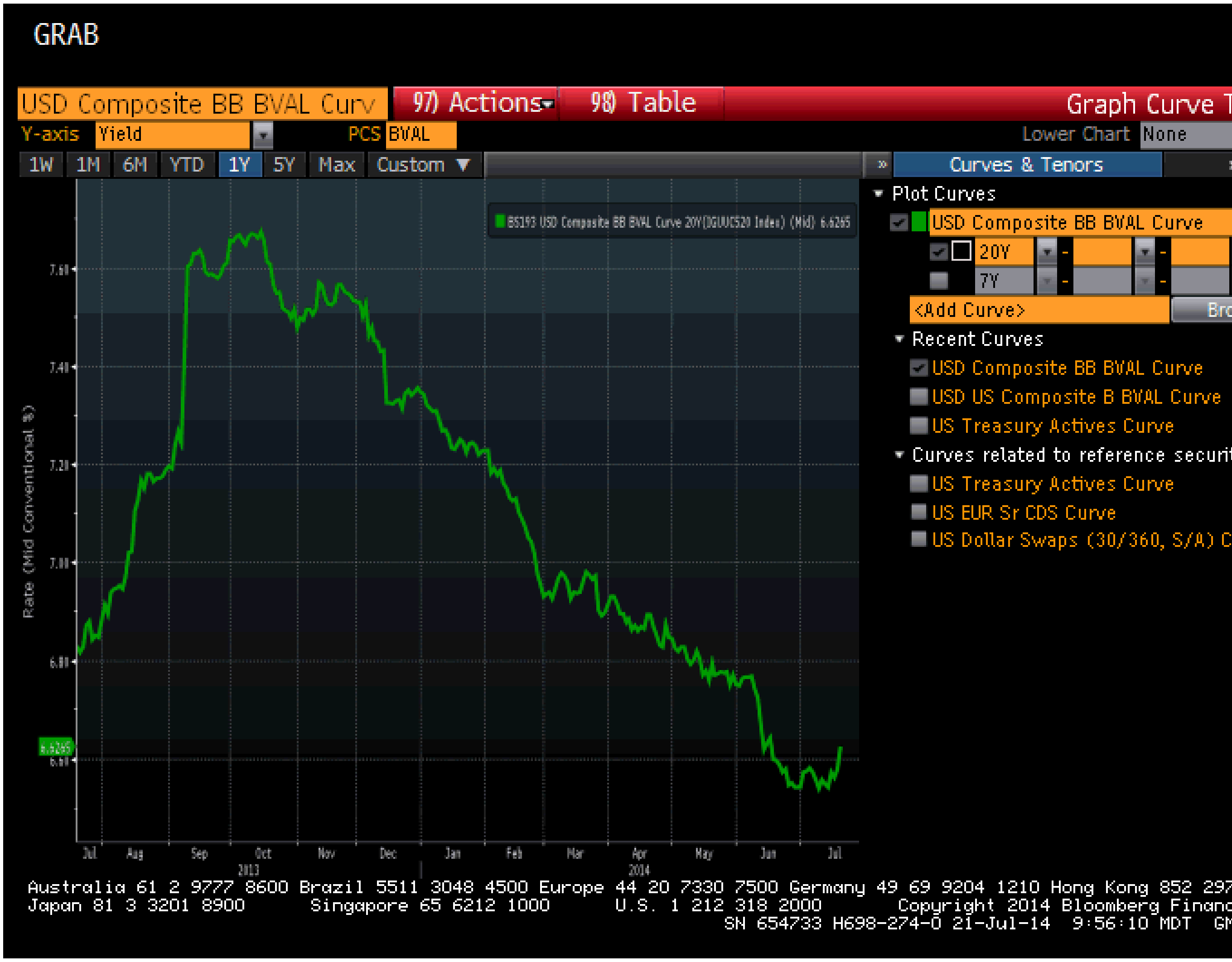
Q. IS THE INTEREST RATE THAT STAFF USED FOR SNG'S DEBT TO CALCULATE ITS RISK PREMIUM THE MARKET INTEREST RATE FOR OTHER DEBT WITH A SIMILAR CREDIT RATING?

A. No. See the graphs below. According to Bloomberg Finance L.P., the market interest rate for 'BB' (Staff's estimated debt credit rate for SNG) twenty-year debt at December, 2013 was 7.35%. For a 'B' rated debt the interest rate for twenty-year debt was 7.60% at December, 2013.

Graphs of 20-Year Interest Rates for ‘BB’ & ‘B’ Rated Debt

Pages 9 and 10





V. CAPITAL STRUCTURE

Q. DOES STAFF PROPOSE USING A CAPITAL STRUCTURE OTHER THAN SNG'S ACTUAL CAPITAL STRUCTURE FOR RATEMAKING PURPOSES?

A. Yes. Staff has proposed a debt to equity ratio of 60% to 40%.

Q. HAS STAFF VOICED SOME RESERVATIONS ABOUT ITS RECOMMENDED CAPITAL STRUCTURE?

A. Yes. Staff states that it is not certain that this is the correct ratio for the four divisions in this rate case, saying: “Although admittedly this is a somewhat subjective process that requires informed judgment” on lines 14 and 15 of page 6 or Mr. Murray’s rebuttal testimony.

Q. WHY DID STAFF PROPOSE THIS DEBT TO EQUITY RATIO?

A. Staff selected this ratio because: 1) in an service area certificate application filed in November, 2011, the Company had targeted a capital structure of approximately 60% debt and 40% equity, 2) in Staff’s judgment, without the Lake of the Ozarks division, the other four divisions would have a capital ratio of 60% debt to 40% equity, and 3) Staff claims that Summit Utilities’ other natural gas subsidiary, CNG, has a debt to equity ratio of 60% to 40%.

Q. IN THE INTERVENING SEVERAL YEARS SINCE THE FILING OF THAT APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY HAS SNG BEEN ABLE TO ACHIEVE A DEBT TO EQUITY RATIO OF 60% TO 40%?

A. No. SNG’s earnings before interest, taxes, depreciation, and amortization have not been sufficient for lenders to lend enough debt capital to enable the company to reach that ratio. See Mr. Rick H. Lawler’s Rebuttal Testimony for SNG for more information.

Q. HAS SNG OR ITS PREDECESSORS HAD A DEBT TO EQUITY RATIO OF 60% TO 40% IN THE PAST?

A. No. See Schedule JMA-9 for historical debt to equity ratios of SNG and its predecessors for the past seven years. The highest debt level was obtained by MGU in 2009, with a debt to equity ratio of 57% to 43%. Since the merger in January, 2012, the highest level of debt for SNG was at the end of 2013, with 43% debt to 57% equity ratio.

Q. HOW MUCH DEBT WAS INCURRED BY SNG TO FINANCE CONSTRUCTION OF THE SYSTEM AT THE LAKE OF THE OZARKS?

A. $53 million of debt was incurred by SNG to finance the construction of the Lake of the Ozarks division according to Staff Report – Revenue Requirement Cost of Service at page 17, lines 17 and 18.

Q. HOW MUCH OF SNG'S DEBT WAS USED FOR THE FOUR DIVISIONS IN THIS RATE CASE?

A. At December 31, 2013, SNG had a total of ** [redacted]** of outstanding long-term bank debt. After financing the construction at the Lake of the Ozarks division, **[redacted]** of the debt is allocable to the four divisions in this rate case.

Q. WHAT IS THE SIZE OF SNG'S COMBINED RATE BASE FOR THE FOUR DIVISIONS IN THIS RATE CASE?

A. After adjustments agreed to by the Staff and SNG, the combined rate base of the four divisions was **[redacted]** at December 31, 2013.

Q. WHAT IS THE APPROXIMATE AMOUNT OF EQUITY USED TO FUND THE COMBINED RATE BASE OF THE FOUR DIVISIONS IN THIS RATE CASE?

A. With a combined rate base of **[redacted]**, financed by [redacted]** of debt, the amount of equity used to finance the combined rate base of the four divisions would be **[redacted]**.

Q. WHAT IS THE APPROXIMATE DEBT TO EQUITY RATIO FOR THE FOUR DIVISIONS IN THIS RATE CASE BASED ON THESE AMOUNTS?

A. The debt to equity ratio for the four divisions in this rate case is approximately 42% to 58%.

Q. IN YOUR OPINION, IS THIS A REASONABLE ESTIMATION OF THE DEBT TO EQUITY RATIO FOR THE FOUR DIVISIONS IN THIS RATE CASE?

A. Yes.

Q. DO YOU AGREE WITH MR. MURRAY'S CONTENTION THAT SUMMIT UTILITIES' OTHER GAS UTILITY SUBSIDIARY (CNG) HAS A CURRENT DEBT TO EQUITY RATIO OF 60% TO 40%?

A. No. At December 31, 2013, CNG's debt to equity ratio was actually lower than 60% to 40%. CNG had **[redacted]** of outstanding debt and **[redacted]** of equity, for a debt to equity ratio of 57.4% to 42.6%.

Q. HOW CAN CNG MAINTAIN A DEBT TO EQUITY RATIO OF 57.4% TO 42.6%?

A. CNG can carry more debt in its capital structure because of the greater number of customers. These metrics have induced lenders to lend more to CNG as a ratio of its equity than SNG has been able to obtain. For 2013, CNG's earnings before interest, taxes, depreciation and amortization

(EBITDA) were **[redacted]**. Its debt was 5.58 times its EBITDA. CNG had 20,023 active meters at the end of 2013 compared to 14,763 active meters for the four divisions in this rate case, or 36% more. At 57.4% debt, CNG's debt per active meter is **[redacted]**. With 42% debt, SNG's four divisions' debt per active meter is **[redacted]**. The debt per active meter is almost the same for CNG and SNG's four divisions, but the greater number of customers at CNG allows lenders to extend more debt capital to that company.

Q. IS CNG FINANCIALLY SIMILAR TO SNG'S FOUR DIVISIONS IN THIS RATE CASE AS MR. MURRAY SUGGESTS IN HIS REBUTTAL TESTIMONY?

A. No. The numbers set out above demonstrate that, financially, CNG is substantially stronger than SNG's four divisions in this case, particularly when it comes to earnings. CNG had 46% more EBITDA than SNG, even including the Lake of the Ozarks division. See Schedule JMA-10 for SNG's 2013 EBITDA.

VI. INTEREST RATES

Q. DID YOU MAKE A RECOMMENDATION ON THE INTEREST RATES ON SNG'S DEBT TO BE USED IN THIS RATE CASE?

A. In his rebuttal testimony on page 11, line 8, Mr. Murray said that I recommended a 3.21%. I did not make a recommendation on an interest rate for SNG's debt in either my direct or rebuttal testimony; however, 3.21% is the interest rate on the Company's current debt and the Company used that rate in its cost of service study filed in this case.

Q. DID STAFF MAKE A RECOMMENDATION FOR THE INTEREST RATE TO BE USED ON SNG'S LONG-TERM DEBT IN THIS RATE CASE?

A. Yes, the Staff recommended that 5% be used for the cost of debt, see Mr. Murray's Rebuttal Testimony, page 11, line 9. Staff notes that the 3.21% interest rate is the rate on the Company's existing short-term loan that is due at the end of 2015. In Staff's judgment, 5% would be the rate that SNG's four divisions in this case could obtain on a twenty-year loan.

Q. IS STAFF'S JUDGMENT ON THE INTEREST RATE FOR A TWENTY-YEAR LOAN FOR THE FOUR DIVISIONS IN THIS CASE REASONABLE?

A. In the Staff Report Revenue Requirement Cost of Service (the "Staff Report"), on page 36, lines 4 to 14, Staff guestimates SNG's debt credit rating would be 'BB' based largely on an interest rate that the Company used in a 2012 application to the Commission and Staff's understanding of the credit rating agencies' processes and procedures for assigning credit ratings (page 35, lines 23 and 24 of the Staff Report). If Staff is correct about the 'BB' credit rating, the current interest rate for a 'BB' twenty-year debt is 6.8%, see the graph on page 10 above.

Q. WHAT INTEREST RATE DO YOU THINK SNG'S TWENTY-YEAR LOAN WOULD BEAR?

A. As discussed in my rebuttal testimony (line 6 of Page 5 to line 7 of page 7), I believe that SNG could not obtain a 'BB' credit rating but would most likely receive a 'B' credit rating, see Schedule JMA-13 Debt Credit Rating Matrix. A twenty-year loan rated 'B' currently bears an interest rate of 7.25%, see the graph on page 11 above. Because utility company debt generally bears a slightly lower rate than other corporations, SNG would probably be in the 6.5% to 7.0% range for its twenty-year debt for the four divisions in this rate case.

VII. RISKS SPECIFIC TO THE DIVISIONS IN THIS RATE CASE

Q. DO THE FOUR DIVISIONS IN THIS CASE HAVE RISKS THAT ARE SPECIFIC TO THEM?

A. Yes. While construction is complete in these divisions (all four divisions were constructed by SNG or its predecessors, except for a 767-customer system purchased in Gallatin and Hamilton), the other risks itemized in my direct testimony still apply to these divisions. Specifically, these risks are:

1. The low rates of return achieved in these divisions prior to 2013 before the start of construction at the Lake of the Ozarks, see Schedule JMA-1, from 2007 to 2012,
2. The small number of customers in the four divisions,
3. The high ratio of residential to commercial customers,
4. The lack of geographical and economic diversity, see Schedule JMA-8
5. SNG's high investment in utility plant per customer, see Schedule JMA-3

6. The heavy dependence on revenues from the volume of gas sold rather than revenues from fixed charges see Schedule JMA-4
7. Lack of frequent rate increases,
8. Non-publicly traded company, and
9. No dividend payments see Schedule JMA-5.

Q DOES STAFF BELIEVE THAT THE RETURN ON EQUITY SHOULD BE ADJUSTED FOR RISK FACTORS SPECIFIC TO THE FOUR DIVISIONS?

A. Yes. Mr. Murray said on page 16, lines 19 to 21 of his Rebuttal Testimony: "If the underperformance is associated with the risks specific to the districts that are the subject of this rate case, then some consideration to the allowed ROE or the equity ratio may be appropriate".

Q. DID STAFF GIVE ANY CONSIDERATION TO THE ALLOWED ROE DUE TO THE SPECIFIC RISK FACTORS OF THE FOUR DIVISIONS IN THIS RATE CASE?

A. Generally no, because of Staff's concerns that the customers in the divisions subject to this rate case would pay higher rates due to the risks of expanding into the Lake of the Ozarks (page 16, line 13 to 15 of Mr. Murray's Rebuttal Testimony). Staff did consider a risk that is specific to the four divisions – the risk associated with the high ratio of residential customers to commercial customers, but said that this was a benefit to SNG because: "…..residential demand is often considered less correlated to economic swings than commercial demand. During the recession of 2008 and 2009, commercial customers either went out of business or cut back on operations, which reduced the financial performance of many utilities, such as Kansas City Power & Light Company", see page 17, line 4 to 8 of Mr. Murray's Rebuttal Testimony. SNG's four divisions not only do not have extensive business commercial customers, but the divisions are devoid of major government and not-for-profit commercial customers. There are few U.S. or State government facilities in the four divisions, other than rural post offices. Local government offices tend to be much smaller in SNG's four divisions than local government facilities in metropolitan areas. In the four divisions, there are no major not-for-profit organizations such as universities, colleges, medical centers, or hospitals and the businesses that depend on such institutions. Governments and not-for-profit entities are the types of commercial customers that often increase capital expenditures during a recession and do not go out of business or cut back. During the last recession, the federal government economic stimulus efforts were concentrated on capital expenditures on state and federal governmental facilities. Few of the federal government's capital expenditures were made within SNG's four divisions. During the recession, due to the low median family income within the four divisions (see Schedule JMA-8), SNG's residential customers reduced usage, which had a dramatic impact on the Company because of its high dependence on gas sales volumes rather than fixed charges.

In Schedule JMA-1, the annual earnings as a percent of equity for the

Company and several other Missouri gas utilities are presented. The impact of the 2008-09 recession on gas utility's earnings can be seen in that Schedule. Atmos increased its return on equity from 8.7% in 2007 to 8.8% in 2008 and Laclede increased from 11.6% in 2007 to 11.8% in 2008 and then improved to 12.4% in 2009. In 2008, MGU had a return on equity of 1.9%, down from 3.3% in 2007, and SMNG suffered a loss on return on equity in both 2008 and 2009 of -6.2% and -7.5%, respectively. Judging by Laclede's earnings as a percent of equity, the 2008-09 recession did not have the same impact on natural gas sales in St Louis as it apparently did on electric sales in Kansas City.

Staff also considered one other risk specific to the four divisions – the lack of geographical and economic diversity. Staff maintains that Summit Utilities' investments in Colorado and Maine give Summit Utilities and IIF geographical and economic diversity. This argument by Staff is frivolous, as the Commission is not setting rates for Summit Utilities' subsidiaries in Colorado or Maine, but only in Missouri; therefore, it must consider only the risks faced by the four divisions in this rate case and not SNG's holding company. Any risk mitigation due to having multiple state operations is an attribute of Summit Utilities, not SNG, and has no bearing on SNG's cost of common equity. Mr. Murray is careful to isolate the risks of the Lake of the Ozarks project from the four divisions in this rate case. The opposite should apply to risk mitigation from Summit Utilities' multi-state subsidiaries. IIF owns investments in other utilities and infrastructure companies that provide it with additional diversification, but those investments do not influence the risks associated with the four divisions in this rate case.

Q. NOW THAT CONSTRUCTION IS LARGELY COMPLETE IN THE FOUR DIVISIONS IN THIS RATE CASE, AREN'T THE RISKS CAUSED BY CONSTRUCTION REMOVED FROM THESE FOUR DIVISIONS?

A. No. The risks caused by construction remain long after the construction work is complete. These risks are: 1) the high investment per customer (see, Schedule JMA-3), 2) continued competition from other fuels, 3) low market penetration, 4) untimely rate adjustments for recently completed systems, and 5) the inability to properly leverage the Company's capital structure.

Q. HOW DOES THE HIGH INVESTMENT PER CUSTOMER IN THE FOUR DIVISIONS IN THIS RATE CASE POSE A RISK TO THE COMMON EQUITY?

A. As shown in Schedule JMA-3, SNG's four divisions' investment in net plant per customer is six times greater than Ameren's, the next largest in the table. This large investment poses several risks to SNG. For example, the loss of only a few customers to a competitor or due to the closing of businesses, or the conservation of energy by the installation of more efficient appliances places a considerable strain on the Company's ability to earn a competitive rate of return on equity. SNG's rates are much higher than utilities with a significantly smaller investment per customer similar to the other utilities shown in Schedule JMA-3. Because of the need for higher rates, SNG cannot earn a significant portion of revenues from fixed charges, but it must rely on gas volume sales, see Schedule JMA-4 for the percent of revenues recovered from fixed customer charges. Lenders are reluctant to loan to SNG due to the large investment in net utility plant per customer when compared to the other utilities in the state.

Q. WHY DOES SNG FACE CONTINUED COMPETITION FROM OTHER FUELS IN THE FOUR DIVISIONS?

A. When a gas distribution system is purchased from a land developer, which is the method used to expand by other gas utilities, all of the homes and businesses in that development are connected to the gas system because that maximizes the purchase price (or reimbursement amount) the developer receives. Because 100% of the available market is penetrated by the gas utility, there is no opportunity for propane or any other fuel to compete with the natural gas system. SNG made natural gas service available to existing residents and businesses, all of whom were using another fuel. Some residents and businesses stayed with propane as their fuel supply, which gave the propane companies a continued market within SNG’s gas system. SNG’s higher rates, caused by the large investment in utility plant per customer, offer the propane companies the opportunity to compete for market share.

Q. WHY HAS SNG’S MARKET SHARE REMAINED LOW IN PORTIONS OF THE FOUR DIVISIONS’ SERVCIE AREAS?

A. Low market penetration can result from competitive fuels, but the larger reason is the inability to economically build gas systems to portions of the divisions, thereby reducing the number or customers. This is particularly true in the Warsaw and Branson divisions. Certain obstacles may not be economically overcome, such as boring under a river rather than hanging a gas line from a bridge, which became necessary due to a change in the Missouri Department of Transpiration's procedures made after construction, was begun. Once solutions to such obstacles can be worked out within the Company's economic constraints, market penetration may improve.

Q. WHY HAS MANAGEMENT NOT INITIATED MORE FREQUENT RATE CASES?

A. Rate cases expenses, in total and on a per customer basis, for such small utilities are very expensive. This rate case is estimated to cost $21.91 per customer in the four divisions. If a rate case were conducted after the completion of each major construction project in the four divisions, the $21.91 cost per customer would have been multiplied by four times (after the completion of the Pattonsburg-Jamesport, Warsaw, Branson, and Lebanon projects). Secondarily, the Company has no assurance that some or all of the rate case expenses ultimately would be recovered in rates. The recommendations contained in a recent study on rate case expenses in Missouri would, if adopted by the Commission, prevent SNG from recovering its reasonable and prudent rate case expenses, thus exacerbating the problem by creating an earnings shortfall. Even if rate case expenses are built into rates, because of the Company's dependence on gas volume sales for most of its revenue, all of the rate case expenses may not be recovered from customers if smaller volumes of gas are purchased than projected due to weather, conservation, or economic events.

Q. HOW DOES THE LACK OF LEVERAGE POSE A RISK TO THE COMMON EQUITY HOLDERS OF SNG?

A. A larger amount of debt would reduce the rates that the Company must charge in the four divisions. Debt capital is less expensive than equity capital and the amount recovered from ratepayers for income taxes on the earnings on equity is reduced. Apparently, Staff would agree that rates would be lower, based on their recommended debt to equity ratio to be used for calculating rates in this case. Lower utility rates reduce competition, improved market penetration, and increase customers' satisfaction, which has a corresponding reduction in risks to the common equity holders.

VIII. PROXY GROUP OF UTILITIES

Q. WHY DID YOU NOT ELEMINATE THE COMPANIES IN *VALUE LINE'S* GROUP OF GAS DISTRIBUTION COMPANIES THAT ARE NOT PURE NATURAL GAS DISTRIBUTION COMPANIES?

A. Investors do not put such a fine point on which gas distribution companies distribute only natural gas and which companies distribute a couple of different fuels used for heating. If *Value Line* classifies a particular group of companies as making up the gas distribution category, those companies are generally accepted by investors as the group to which investors compare their distribution company investments and determine a fair cost for their equity investments in the gas distribution industry. The investors in IIF will compare their return received on Summit Utilities with the entire group of *Value Line* gas distribution companies and do not refine the group as Mr. Murray did. For these reasons, using the entire group of *Value Line* gas distribution companies is a better proxy group of utilities for calculating the cost of common equity of SNG.

IX. APPRECIATION OF THE PROXY GROUPS' STOCK PRICE

Q. DO YOU AGREE WITH MR. MURRAY'S SUGGESTION, IN HIS REBUTTAL TESTIMONY, THAT THE APPRECIATION IN THE MARKET VALUE OF THE PROXY GROUP'S SHARE PRICE SHOULD BE IGNORED IN DETERMINING THE COST OF COMMON EQUITY?

A. No. It is true that the market value of the shares of the proxy group of gas distribution companies has recently appreciated; however, all of this appreciation has occurred in the past six to eight months since the end of the Company's original test period (the year ended September 30, 2013) filed in this rate case. Interest rates were dramatically lowered by the Federal Reserve in the fall of 2008. Lower interest rates have been around for the past six years; therefore, it is unlikely that the recent appreciation of the price of utility stocks has been caused by the drop in interest rates.

I used the Total Return model in my Direct Testimony as one of three models to determine the cost of common equity. The change in stock prices of the proxy group is one of the inputs in the Total Return model. As discussed in my Direct Testimony, page 46, lines 19 to 22, utility stocks, as shown by the Dow Jones Utility Index, did not appreciate between December 31, 2007 and October 15, 2013, the period used to calculate the Total Return model in my Direct Testimony. During that period, the Dow Jones Utility Index never exceeded its high of 557.69 set on January 31, 2008. The index stood at 491.68 on October 15, 2013, and on December 31, 2013, the index closed at 490.57. Since December 31, 2013, that index has appreciated, and on June 30, 2014, it hit a new high of 576.98. In the past six months, investors have not suddenly decided that because of low interest rates they would bid up the price of utility stocks.

The recent stock price appreciation of the proxy group is not relevant in this rate case because: 1) it occurred after the end of both the Company's test year and the test year suggested by Staff and 2) there was no price appreciation of the index during the period of time used to calculate the Total Return model. The stock of the proxy group of companies had an average 12.5% rate of return in the Total Return model due principally to the reinvestment of the dividends, and to a lesser degree, to increase in dividend payments, and a minimal stock price appreciation cause by the higher dividends not a drop in interest rates.

X. MR. MURRAY'S REBUTTAL TESTIMONY'S CONCLUSIONS

Q. IN MR. MURRAY'S REBUTTAL TESTIMONY, HE OFFERED FIVE CONCLUSIONS ON WHY YOUR TESTIMONY SHOULD BE DISREGARDED, HOW DO YOU RESPOND TO THOSE FIVE CONCLUSIONS?

A. 1. The information from IIF that Mr. Murray requested has now been provided, either in this Surrebuttal Testimony or by the Company in responses to the Staff's data requests. This material supports my recommendations in my Direct, Rebuttal and Surrebuttal Testimonies.

2. I have demonstrated, in this Surrebuttal Testimony and in my Rebuttal Testimony, that SNG's actual overall debt to equity ratio is the same as the debt to equity ratio for the four divisions in this rate case. Mr. Murray has offered no analytical support for his recommended 60% to 40% debt to equity ratio.

3. This Surrebuttal Testimony provides a reasoned recommendation on the interest rate that SNG's debt should bear if it had established a permanent debt capital structure for the four divisions in this rate case.

4. Mr. Murray suggests dismissing my proxy group of utilities because two of the eleven companies, in his judgment, don't meet his criteria even though *Value Line* and, apparently, its readers (as the two offending companies have been included in the gas distribution industry for some time) are comfortable with all eleven companies included in the category.

5. The Total Return model is not commonly used in utility rate setting, but it is widely used in other financial analyses. The Total Return model is the most common analysis used by investors in determining a fair price for their equity investments or whether or not to continue holding shares of a company. Most brokerage firms make the Total Return model for individual companies available to their clients on their web sites, but they do not make the DCF and CAPM models available.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF JAMES M. ANDERSON

STATE OF COLORADO)
) **ss**
COUNTY OF JEFFERSON)

James M. Anderson, being first duly sworn on his oath, states:

1. My name is James M. Anderson. I work in Greenwood Village, Colorado and I am employed by Municipal Capital Markets Group, Inc. as the Senior Vice President.

2. Attached hereto and made a part of hereof for all purposes is my Surrebuttal Testimony on behalf of Summit Natural Gas of Missouri, Inc. consisting of 27 pages, all of which have been prepared in written form for introduction into evidence in the above-referenced docket.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

James M. Anderson
James M. Anderson

Subscribed and sworn to before me this 6th day of August, 2014.

Erin Campbell
Notary Public

My commission expires: 6/7/16

ERIN CAMPBELL
NOTARY PUBLIC
STATE OF COLORADO