exhibits at this time.

JUDGE JONES: Is that 88, 89, 90?

MR. MEYER: And associated HC for 90.

JUDGE JONES: And is there also 1088, 1089, 1090?

MR. MEYER: Yes.

JUDGE JONES: Are there any objections?

MR. SWEARENGEN: Company has none.

MS. O'NEILL: No objection.

JUDGE JONES: Exhibits 87, 88, 89 -- I'm sorry 88, 89, and 90 and 1088, 1089 and 1090 are admitted into the record.

(Exhibit Nos. 88, 89, 90, 1088, 1089 and 1090 were received into evidence.)

MR. MEYER: I will tender the witness for cross examination.

JUDGE JONES: Is there cross-examination from the Office of Public Counsel?

MS. O'NEILL: No questions, your Honor.

JUDGE JONES: And any questions from Aquila?

MR. SWEARENGEN: I have a few, Judge.

JUDGE JONES: Please proceed.

CROSS-EXAMINATION BY MR. SWEARENGEN:

Q. Good morning, Mr. Murray.

A. Morning.

Q. How are you today?
A. Pretty good. How are you doing?
Q. Fine. Thank you.
Let me just try with you to frame up the issue in this case, if I can. Is it fair to say that one part of this cost of capital issue is how much equity should be considered in a capital structure for rate-making purposes?
A. Capital structure is an issue.
Q. Okay. And how much equity --
A. Is a part of that capital structure, that's correct.
Q. -- is part of that capital structure?
And then another piece of that, along the lines of the equity side, is how much should that equity cost, how much return on common equity should be authorized; is that fair?
A. That's correct.
Q. And you, for the Staff, have used Aquila -- the Aquila, Inc. corporate capital structure as of December 31, 2002; is that not correct?
A. That's correct. As the test year.
Q. That's the test year of capital structure of the parent corporation, Aquila, Inc.?
A. That's correct.
Q. And what is the equity ratio of that capital

structure?

A. The equity ratio for purpose of rate making as of test year December 31st, 2002 for Aquila, Inc. is 35.31 percent.

Q. And that's the equity ratio you think the Commission should adopt in this case for rate-making purposes?

A. That's correct.

Q. And what is your understanding of what the company thinks the equity ratio should be?

A. They base it -- they base their equity ratio on what they term allocated capital structure, which comprises of what they claim is 47.5 percent equity ratio.

Q. Now, is it fair to say that you have done a discounted cash flow or DCF analysis of a group of companies to determine what you think the authorized return on equity ought to be as a result of this case?

A. Yes.

Q. And that's a range -- you've calculated a range of 8.64 to 9.64 percent; is that true?

A. That's correct.

Q. And what's the midpoint, 9.1?

A. 9.14, that's correct.

Q. And what is your understanding of the company's position as to the appropriate return on equity in this case?

A. The company's position is the 12 to 12.5, which I believe is a midpoint of 12.25.

Q. Thank you.

Would you agree that equity is the highest cost of capital, generally speaking?

A. Generally speaking in the capital structure, that's correct.

Q. And so the more equity that is determined to be in the capital structure for rate-making purposes, the greater the revenue requirement?

A. Well, it depends on, like I said, the capital -- if the capital structure is optimal, you could have actually less equity in a capital structure and -- and it -- assuming that business risk is held constant, you could have a high rate of return if you have a very leveraged company then one that is -- you know, is at the optimal capital structure. So it's the ultimate rate of return that determines the revenue requirement is my point.

Q. Well, if equity is the highest cost of capital, if you have more equity in that capital structure, the revenue requirement associated with that would be greater, would it not?

A. Like I said, the rate of return is the ultimate number. If you have more equity in the capital structure, assuming all risk is held constant such as business risk, then that return on equity, because there would be less financial risk, would be -- you know, could be lower and also the cost of the debt could be lower.

So, therefore, it's -- it's -- your overall rate of return, it's really hard to determine exactly what is the optimal point where you'll have the lowest cost of capital. So it -- you could have a high cost of capital at 100 percent debt level that's higher than if you had some equity in your capital structure.

Q. Let's bring it back then to this case and the recommendations of the parties here. You're arguing for a 35 percent equity ratio and the company's arguing for a 47 percent equity ratio. Given that difference, in your mind, isn't there a significant revenue requirement difference between the two proposals?

A. I believe so.

Q. And what would that be? Can you quantify that?

A. I don't -- I think the two issues combined in the last reconcilement I saw was 20 million, but that's with capital structure and return on equity.

Q. So together, capital structure and return on equity results in about a $20 million difference, in your judgment?

A. That's based on some accounting records that I've been told about as far as the reconcilement.

Q. Would you agree that all other things being equal, a lower equity ratio should be accompanied by a higher cost of equity, all other things being equal?

A. All other being equal such as business risk, that's correct.

Q. And a lower equity ratio should be accompanied by a higher cost of debt as a general proposition. Is that a fair statement?

A. Assuming you hold everything constant, it's the same company and the same business risk, same -- which includes -- business risk includes all sorts of risk such as regulatory --

Q. All other things being equal.

A. Everything being equal, that would be a logical -- that's financial theory.

Q. Thank you.

And for a given firm, would you agree the cost of equity should always be higher than cost of debt because equity returns are subordinated to interest payments?

A. I agree with that.

Q. Do you have your Direct Testimony there in front of you?

A. Yes, I do.

Q. If you'd turn to page 5 and there I believe -- are you there?

A. Yes, I am.

Q. Beginning on line 33 you set out part of the decision in what is commonly referred to as the Hope Natural Gas case; is that true?

A. Yes.

Q. And part of that Hope decision discusses the rate-making process; is that true?

A. Yes.

Q. And that's the process that we're in before the Commission in connection with this case. Would you agree?

A. Yes.

Q. And in connection with that, would you agree that, as you've indicated at line 33 of your testimony, that the United States Supreme Court held in that case that the return to the equity owner should be commensurate with returns on investments and other enterprises having corresponding risks?

A. I believe that's what was stated in that case in 1944, that's correct.

Q. And then as you note on line 35, that decision goes on to state, That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and attract capital?

A. That's correct.

Q. And over at the top of page 6 of your Direct Testimony at lines 1 and 2, you indicate by I think paraphrasing the Hope case that the Hope case restates the concept of comparable returns to include those achieved by any other enterprises having corresponding risks. Correct?

A. That's correct.

Q. Then over on page 7 of your Direct Testimony, referring to lines 3 through 5, you state, The courts today still believe that a fair return on common equity should be similar to the return for a business with similar risks.

A. Yes.

Q. But not as high as a highly profitable or speculative venture. Correct?

A. Yes.

Q. And I assume that continues to be your testimony today as it was in your Direct Testimony that was filed earlier in this case?

A. That's my testimony. I just wanted to clarify that there has been a transition in rate of return analysis where rate of return witnesses recommend the cost of capital -- cost of common equity capital.

When making recommendations, I think

Dr. Murray earlier had indicated that the DCF model is his primary model and that is a cost of capital model. And so -- and actually this is quite consistent with the cost of service principle of rate of return rate base regulation where the objective of the rate of return analysis is to determine what the -- you know, the cost of capital is to the utility.

Q. Right. I'll ask you about that in a minute. I'm just focusing on what the Supreme Court has said about that.

My question is, would you agree that what the courts have said with respect to a fair return is the standard that this Commission should follow?

A. Like I said, there are other things that have to be taken into consideration. We are looking at cost of capital. Like I said, there's been that transition.

Yes, there's a court case there, but as far as I am aware, there's been no challenge on using a cost of capital analysis which is the primary analysis used by many commissions in this country to determine what is a fair recommended rate of return, not a comparable earnings analysis, which this Staff has not done since I've been here.

Q. Okay. Let me make sure I understand then. Are you saying that what the court has said in the Hope case and the related cases do not have to be followed by this Commission in determining what the fair rate of return is?

A. I'm not a lawyer. I just know that what has occurred has been a transition to a cost of capital analysis.

Q. So you would think then that perhaps maybe the Commission isn't following what the court has said. Would that be your testimony?

A. I would say if you look at page 4 of my Direct Testimony under the Bluefield there's references to returns generally being made at the same time, part of the country as, you know, another company return achieved by other companies, and then item three where it says, Return -- a return sufficient to assure confidence in the financial soundness of the utility, item three being one of the significant items.

And then within the Hope case, as you pointed out, that a return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and attract capital. I feel that, you know, the Commission needs to adhere to that and a cost of capital recommendation that is reasonable will allow that.

Q. Okay. Thank you.

I take it you wrote that portion of your testimony starting with your discussion of the Bluefield case on page 4 over through I guess page 7 we just talked about?

A. Yes.

Q. I think what you just said in response to two questions ago, that you think what the Commission is doing does comport to those cases?

A. Yes, I do.

Q. Okay. And would you agree then that the standard for a fair return, which has been cited in your testimony and has been cited by the courts and regulatory bodies, speaks in terms of returns being earned by companies of comparable risk?

A. That may be one of the standards that is considered.

Q. You have some doubt about that? You say it may be?

A. I just cited that there were three items, and one of those is the financial soundness and ability to attract capital. There are several items that are mentioned. That's both in the Hope and Bluefield case.

Q. Look over at page 5 of your Direct Testimony, if you would. And down in line -- beginning on line 33 where you quote the Hope case.

A. Yes.

Q. And does it not say that, By that standard, the return to the equity owners should be commensurate with returns on investments and other enterprises having corresponding risks?

A. Yes. And then it says, That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and attract capital.

Q. Fine. Thank you.

Would you agree that risk is extremely important to what we are doing here today?

A. Yes.

Q. Is it possible for you to determine through publications what returns utilities are actually earning? Is that possible to determine?

A. There is -- obviously Mr. John Reed referred to Regulatory Research Associates. I, myself, do not regularly look at that -- you know, that information.

Whenever I do my analysis to recommend a cost of capital, I'm looking at economic models, cost of capital models which are the discounted cash flow model, the capital asset pricing model and the risk premium model.

But if I were so inclined to want to review that, such as seeing an S&P report -- basically when I was reviewing some comments from S&P to find out what type of allowed ROEs are being -- are being ruled on in other states commissions I can -- you know, I can come across that obviously.

Q. Okay. That wasn't really my question. My question wasn't what was being allowed. My question was, can you determine in some instances what companies are actually earning?

A. I can review Value Line information, but those -- you have to take that with a grain of salt because obviously with the companies that are followed by Value Line, they're just like much -- you know, any other utility company out there. They have other operations within -- within their consolidated operations that are not just utility -- a regulated utility.

Q. Well, let me ask you this. If I'm an investor and I want to invest in a utility company and I want to know what return that company is earning, is there some way for me to find that out?

A. If you're investing in a consolidated utility and you're going to invest in a stock that comprises all the operations of that utility, yes, you can use Value Line to determine what the earned ROE was in any given past year for the last 15 years maybe.

Q. What about Empire District Electric Company? How would you characterize that company?

A. It's predominantly a regulated electric distribution utility and -- well, integrated utility, I'm sorry. But they do have -- you know, they get involved in some nonregulated investments as well.

Q. And can you go to some publication or some source and find out what they're actually earning?

A. Are you referring to Empire and the consolidated operations or are you referring to Empire Missouri jurisdictional utility operations?

Q. I'm talking about Empire.

A. Consolidated operations, like I said, Value Line -- you could refer to Value Line and find out exactly what they're earning.

Q. And would you believe that information to be accurate?

A. For consolidated operations, I would.

Q. Would that be true with any other figures that Value Line might publish for any other utility companies?

A. They're usually accurate. Sometimes they're revised a year or two later because of certain accounting changes.

Q. You mentioned authorized returns. Is there some way for you to determine or verify what regulatory agencies are authorizing for utility companies?

A. Mr. John Reed, he cited Regulatory Research

Associates. I believe that to be the -- you know, one of the main research organizations out there that, quote, allowed ROEs in various jurisdictions.

Q. Is there another way to determine that information other than referring to that source?

A. I believe C.A. Turner Utility Reports may have some allowed ROE indications, but I don't believe they have the dates of those allowed ROEs. So that information, especially if it's going back you know 10 years from now, would be of limited use because that obviously reflects a different economic and capital market environment than we have now.

Q. Can you access in some fashion, electronically or otherwise, the decisions issued by other state agencies, for example, the Kansas Corporation Commission?

A. If I was inclined to -- to look at their website, I'm sure I could.

Q. Have you ever done that?

A. Maybe in context of the last Aquila case to see what the witness Mr. John Dunn was doing in the Westar Energy Case I looked at their website. But as far as looking at their allowed ROEs, I don't know that I gave that much consideration.

Q. Have you ever looked at any decisions of other Public Utility Commissions or Public Service Commissions and read those decisions where they discussed the authorized returns that they were allowing for the companies under their jurisdiction?

A. No.

Q. You never have?

A. No. I -- there's many things that go on -- I have -- I have enough stuff to do here as far as doing my economic analysis using the DCF model and the capital asset pricing model. As far as what goes on in the specifics of cases throughout this country, I would be working 24/7 to be able to keep up with that.

Q. Turning to page 1 of your Direct Testimony, you state there that you're currently employed as a financial analyst for the Missouri Public Service Commission?

A. Yes.

Q. And is that your present position today?

A. Actually, I've been reclassified. I'm an auditor.

Q. And what does that mean?

A. It just means I have a different title.

Q. Okay. Your job functions are still the same?

A. I'm identified as a financial analyst, just to let you know.

Q. And am I correct that you're the only Staff witness who's testifying in this case with respect to cost of capital issues?

A. Yes.

Q. Over at page 2 of your Direct Testimony at line 16 you state, My testimony is presented to recommend to the Commission a fair and reasonable rate of return for Aquila, Inc., d/b/a Aquila Networks MPS and Aquila Networks L&P. Correct?

A. Correct.

Q. Then there's a following question on that page which is, Have you prepared any schedules to your analysis of the cost of capital for MPS and L&P? And your answer is, Yes; is that correct?

A. That's correct.

Q. And MPS and L&P are the Missouri operating divisions of Aquila; is that true?

A. That's correct.

Q. And would you agree with me that those operating divisions have hard assets in the ground here in Missouri?

A. Yes.

Q. And what would those assets consist of, to your knowledge?

A. Generation and distribution facilities, transmission facilities.

Q. Anything else that just comes to find?

A. Those are the main assets that I know are associated with the regulated electric utility. They may have some obviously natural gas distribution as well and storage maybe.

Q. And would you agree that those assets have been financed in some fashion?

A. Yes.

Q. And that would be with some amount of debt and some amount of equity?

A. Yes.

Q. And would you agree that those assets that you have described generally are the assets that are subject to this Commission's jurisdiction?

A. That's correct.

Q. I think you mentioned this earlier in response to one of my questions. Turning to the bottom of page 5 you mention that the -- what the Hope case stands for, in your opinion, and you noted that these returns that are authorized by regulatory agencies should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital. Correct?

A. That's correct.

Q. Given that, would you agree with me that one of your responsibilities as the Staff's chief financial witness in this case is to make sure that the Staff's recommendation in this proceeding did not impair the financial health of Aquila's MPS and L&P operations?

A. My duty is to recommend a fair and reasonable rate of return for MoPub and St. Joe operations, which a fair and reasonable rate of return would not impair the financial health of MPS and L&P.

Q. So your answer would be yes, that you would consider that to be one of your responsibilities?

A. Yes.

Q. And in connection with that, would you agree with me that as the Staff's chief financial witness in this case, you can't make your recommendation in a vacuum?

A. No.

Q. You don't agree with that?

A. Repeat the question. I'm sorry.

Q. Would you agree with me that as the Staff's chief financial witness, you can't simply make a cost of capital recommendation in a vacuum?

A. That's true, I can't make it in a vacuum. There's many things you have to look at, economic market, capital market environment, correct.

Q. And would one of the things you would have to look at would be the ramifications of your recommendation with respect to the financial integrity of Aquila's operating divisions. Wouldn't you agree with that?

A. Yes. I would test the reasonableness of my recommendation, that's correct.

Q. You would test it with respect to the financial integrity of the operating divisions?

A. When you refer to "financial integrity," I assume you've referring to my pre-tax interest coverage calculation that is --

Q. Well, let me ask you this. What is your definition of financial integrity?

A. Financial integrity would -- we would like to see utility companies with a triple B investment grade credit rating. Of course, that's not possible with some companies because of the fact that they're associated with other operations.

Q. If you would, please, turn back to page 5 of your testimony.

A. Yes.

Q. At the bottom, The return should be sufficient to assure confidence in the financial integrity of the enterprise.

And in this case the enterprise is MPS and L&P. Correct?

A. That's correct.

Q. So as to maintain its credit and to attract capital.

Do you agree with that?

A. Yes.

Q. Okay. And, therefore, do I understand you to say that you would test your recommendation in this case against L&P and MPS's ability to maintain this credit and attract capital?

A. Unfortunately, this is -- I'm just going to get into what is difficult about when you're evaluating or trying to determine what -- you know, what rate of return is going to attract -- be able to attract capital, maintain the credit rating of MoPub and St. Joe.

Q. Well, let me ask you this. Can you answer that question yes or no and then give an explanation? Can you do that?

A. Repeat the question, please.

Q. Well, the question is, you've come up with a recommendation and you said you've tested that against something. And my question is, have you tested that, in accordance with the Hope case, against it should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and attract capital? Have you tested your recommendation with that standard in mind?

A. Yes.

Q. Okay. Let me ask you, earlier you indicated that you agreed that the legal precedent for a fair rate of return speaks in terms of returns being earned by companies of comparable risk. And you said that risk was important in this process; is that true?

A. Yes.

Q. And is it your belief that you've tried to apply that legal principle in this case in your testimony?

A. I took all the considerations that were indicated in the Hope and Bluefield case as far as things that should be weighed to determine what is reasonable.

Q. In connection with that, you have proceeded to select a group of six companies which you believe to be of comparable risk to Aquila; is that true?

A. Comparable to MoPub and St. Joe, that's correct.

Q. And those companies are set out in your testimony in various schedules; is that true?

A. That's correct.

Q. And what are those companies? Can you just rattle off the names for us, please?

A. Cleco, DPL, DQE Hawaiian Electric, IDACORP, NSTAR.

Q. And, once again, would it be your testimony that your goal here is to be consistent with the Hope case and find a group of other enterprises having corresponding risks to Aquila's MPS and L&P operations?

A. That's correct.

Q. Now, with respect to risk, would you agree with me that what we're talking about basically are two types of risk, one being business risk and the other financial risk?

A. That's correct.

Q. And would you agree that business risk is the risk which reflects items that could impact the business operations of a company?

A. All sorts of items, that's correct.

Q. Can you give us some examples for electric utilities?

A. Regulatory economic management, which competition doesn't play as much a part with a regulated utility, but just certain environmental factors, etc.

Q. Weather is that --

A. Weather exactly.

Q. -- a business risk?

How about rate of economic growth in the service area? Is that a business risk?

A. That's a risk. That's part of economic risk.

Q. Whether or not the company would have nuclear generation in its generation mix, would that be a business risk?

A. That's correct.

Q. And then would you agree there's another type of risk called financial risk?

A. Yes.

Q. And I think looking at your Surrebuttal Testimony at pages 7 and 8, if you could turn to that, please.

A. Yes.

Q. There in your Surrebuttal Testimony at the bottom you talk about financial risk and you offer a definition of -- or a generally accepted definition of financial risk; is that true?

A. That's correct.

Q. And that definition appears at the top of page 8?

A. Yes.

Q. And according to you, that generally accepted definition of financial risk is the ability of a company to meet its debt obligations; is that true?

A. That's true.

Q. What is the source of your generally accepted definition of financial risk as you have defined it there on page 8?

A. General knowledge.
Q. General knowledge?
A. I mean, I've went to college and had a finance curriculum, I've been working here for some time. I couldn't tell you exactly if I -- I didn't have a specific textbook where I came up with this definition, if that's what you're asking.
Q. That was going to be my next question. Did you have a textbook in college that had that definition of financial risk in it that you recall?
A. It may not have had this specific wording. Obviously that would be plagiarism.
Q. Looking again at your definition, the ability of a company to meet its debt obligations, isn't that really interest coverage?
A. Yes. Cash coverage of their debt service.
Q. And so it's really not an accepted definition of financial risk?
A. No. It's one of the things that the credit agencies look at as far as determining -- as far as your -- you could have a large amount of debt in a capital structure at a very -- at a lower interest rate and the ability of the company to meet that debt service is going to be determined by, you know, the cash flow coverage.
And I know that S&P, when they discuss

financial risk indicators, these are the exact ratios they're talking about. It's the coverage of the interest payments that they -- otherwise, if they can't cover it, you know, they're at risk of a default.

Q. Have you ever heard anyone say that a definition of financial risk is a measure of a degree of debt leverage in a company's capital structure?

A. I'd say that's the textbook definition.

Q. You have textbooks at college that had that definition in them?

A. And I think there's other textbooks I've seen that have different definitions. Just as there are many different regulatory textbooks that have different ideas on them.

Q. I think you hit on this earlier talking about risk and you may have thrown it in the category of business risk, but in your mind is there such a thing as regulatory risk?

A. Yes.

Q. And what is that?

A. Just the risk of outcome of proceedings once a rate case starts. Obviously investors are very concerned, as with Aquila in this case, Aquila's investors, as to the outcome of the proceeding as far as, you know, the decisions that are going to be made.

Q. And all of these risks that we've talked about here this morning, would you agree that they should be considered in the selection of comparable or proxy companies for a cost of capital analysis?

A. Yes.

Q. And these are items that are critically important, are they not, to a cost of capital analysis?

A. Risk is important, yes.

Q. Out of curiosity, I know you talk about your definition of financial risk in your Surrebuttal Testimony on pages 7 and 8. Anywhere in your Direct or Rebuttal Testimony did you discuss your definitions of business risk or financial risk, do you recall?

A. Do you want me to review that right now? Because I don't recall offhand.

Q. You don't recall offhand?

A. There's a lot of testimony here obviously.

Q. I'm not going to ask you to do that, but maybe while we're on a break you could just glance through that and we can come back to that later.

A. Sure.

Q. Turn, if you would, please, to page 26 of your Direct Testimony.

A. Excuse me. I'm taking a note here. Okay. Sorry.

Q. Yeah. That's fine. Page 26 of your Direct Testimony, please.

A. Yes.

Q. I would refer you there to line 8 where you indicate that your Schedule 11 to your Direct Testimony presents a list of market traded electric utility companies --

A. Yes.

Q. -- monitored by Value Line?

And how many companies were on that list, just approximately, do you know?

A. Quite a few. Anywhere from --

Q. Order of magnitude.

A. It's a -- I mean, if you take a look at Schedule 11, obviously I don't have time to count up all the rows, but there's probably 50 to 80, somewhere in there.

Q. And it's from that list that you selected your six proxy companies. Is that a fair statement?

A. That's correct.

Q. And then starting on line 9 you state, The criteria that I used to select the comparable companies are as follows. And you list eight items there; is that true?

A. That's correct.

Q. Now, looking at the first criteria that you use to select your proxy companies, stock publicly traded, would you agree with me that this criteria really has nothing to do with risk as you have defined risk?

A. Well, if a stock's not publicly traded, it may have liquidity risk issues. If it's not publicly traded, then there's not a market -- a recognized market where that stock could be traded, so liquidity risk would be an issue.

Q. What kind of risk is liquidity risk? Is that a business or a financial risk?

A. It's just -- I'm using an analogy. Before ebay, it might have been hard to sell some fairly unique items, but now that that market's been created, people that have unique interests, there's a market there now to buy and sell, so -- that they normally wouldn't be able to sell that and they may have had to offer a hire premium in order to be able to sell something that there really wasn't a market. So if a stock's not publicly traded, obviously you won't have somewhere to go to just offer that -- that stock.

Q. And there's a risk that you can assign to that?

A. Well, a general -- a general conceptual risk, yes.

Q. And then refer to item No. 2, Information printed in Value Line. That's your second criteria?

A. Yes.

Q. Would you agree that that has nothing to do with risk, whether or not information is published in Value Line?

A. Well, obviously investors -- if they're trying to get information on investments that they want to -- that they're considering investing in, it's important to have as much information as possible.

And with Value Line being an independent research service, if -- you know, if they have that information available to them by a recognized research service, that may minimize the risk of them, say, having to make a private equity investment in a company that's not followed by Value Line where they have to rely specifically on a company.

Q. Well, I thought you indicated earlier that a financial risk -- and you said the textbook definition was the amount of leverage in the capital structure; is that true?

A. Yes. But I think you just said general risk and I --

Q. All we're talking -- we're talking about business and financial risk. And my question is, do you define financial risk to mean the amount of leverage in the capital structure; is that true?

A. Yes.

Q. Now, what does whether or not information is printed in Value Line have to do with the amount of leverage in the capital structure?

A. It has nothing to do with the amount of leverage.

Q. Okay. And look at your criteria No. 5, Ten years of data available. Would you agree with me that that has nothing to do with business or financial risk, whether or not 10 years of data is available?

A. Okay. Let's just clarify. When you're referring to business and financial risk, obviously you're referring to the risk of the company. Does not necessarily mean that this is the risk the investor may be taking by investing in a stock when 10 years of data is not available.

Q. I'm talking about the definitions that you gave us earlier. You said what business risk was and you defined that and you gave us some examples and you said what financial risk was, the amount of leverage in the capital structure.

So my question is, with those definitions in mind, what does the fact that whether or not 10 years of data is available have to do with either of those risks?

A. Well, if you have 10 years of data to evaluate the trends in capital structure within any given company, you can evaluate the financial risk over time.

Q. But what does the fact of whether or not that data is available have to do with the actual business or financial risk of the company?

A. Well, if the data is not available, you don't have any trends to look at as far as what type of financial risk that the company, you know, typically incurred as far as its leverage.

Q. You don't have anything to look at, but what does that fact have to do with the actual business or financial risk of the company?

A. As far as whether that's available has nothing to do with the company specifically.

Q. Okay. And look at No. 8, No Missouri operations. Would you agree with me that whether or not a particular company has utility operations in Missouri has nothing to do with business or financial risk?

A. Obviously every jurisdiction has its own regulatory risk as you referred to, so there could be some risk factors there.

Q. There could be some regulatory risk?

A. Exactly.

Q. But not business or financial risk?

A. No, regulatory is part of business risk.

Q. Would it be fair to say that these items I've focused on, Items 1, 2, 5 and 8, those criteria really don't relate to risk but if they do, it's only in a very remote sense and you just simply used those to help narrow down your sample of companies?

A. If you're going to just pick out those specific items, I'll agree with that.

Q. Turn to your Rebuttal Testimony, if you would, please, page 25.

A. Yes.

Q. There on lines 12 and 13 of page 25 of your Rebuttal Testimony you say, Because smaller utilities operate in a regulated environment just as large utilities do, making an adjustment for firm size is not appropriate?

A. Yes.

Q. And then at the bottom I think of page 24 and the top of page 25 you cite a study that you believe supports that proposition; is that true?

A. That's correct.

Q. Do you know whether or not this Commission has ever made an upward adjustment in rate of return to reflect and recognize the small size of a utility company?

A. I don't believe they have, but -- not as far as my personal experience.

Q. Okay. If they had, would you think that the Commission had made a mistake?

A. That would not have been my recommendation. The Commission obviously weighs the evidence of any case.

Q. That's fair. I understand.

In any event, that wouldn't have been your recommendation and you would testify today that an adjustment for size, in your judgment's, not appropriate; is that true?

A. That's correct.

Q. Then turning back to your Direct Testimony again, please, at page 26 where you listed your criteria there your third criteria states, Total capitalization less than 5 billion; is that true?

A. That's correct.

Q. And that's a criteria related to size. Would you agree?

A. Yes, it is.

Q. But you also testified that an adjustment for size should not be considered; is that true?

A. Yes.

Q. So wouldn't you agree that that criteria, No. 3, really isn't a valid selection metric for measuring risk?

A. No. I wouldn't say that's necessarily the case. Obviously, you know, size is something that analysts think -- think about. But as far as what I'm rebutting is whether or not a specific size premium adjustment should be made especially when it's a division of a larger utility.

I don't think there's anything wrong with trying to limit the size of -- for purpose of selecting your comparable companies initially, but as far as -- you know, if you don't choose comparable companies, if you just choose to eliminate the -- you know, the size requirement, then you want to make a size adjustment, my point is you -- if you want to avoid that, make sure you use a -- you know, use a selection criteria that takes that into consideration if there is a chance.

My point is there's nothing conclusive on a size premium adjustment -- excuse me, a size premium adjustment being made.

Q. If size is a valid selection metric -- which is what you're saying, isn't it?

A. I'm saying it's a metric that I used and it just -- it brings -- it eliminates -- it tries to eliminate that possible argument coming from the company because I know it's used every time.

Q. What is that?

A. That a size premium adjustment should be made. So it just heads off that possibility.

Q. And what companies have made that?

A. Just about every company that comes in here, I believe.

Q. And do you know how has the Commission reacted to that? Do you know?

A. I think I just indicated I didn't know whether they made a size premium adjustment.

Q. And if your knowledge on that subject was incorrect and, in fact, there is a case or cases where the Commission has made an upward adjustment and return because of the small size of a company, would that change your view on this topic?

A. No.

Q. What companies did you eliminate through the use of your third criteria, the size criteria?

A. Okay. We're going to have a lengthy list here.

Q. How many were there? Are they set out in your testimony?

A. Yeah. They're set out on Schedule 11.

Q. And how can I identify those looking at your Schedule 11?

A. Look at column 3, total capitalization less than 5 billion. And then every -- every company where the answer is no was eliminated.

Q. So if size doesn't matter, then those should all be put back in; is that true?

A. I'm saying size can be -- I'm arguing against any size premium adjustment. I'm not indicating that it's not something that should be considered when you're narrowing down your comparable companies.

Q. Well, we're not talking here about the return on equity or premium adjustment though. We're talking about your selection of comparable companies here. You ended up with 6 companies out of maybe 80 you indicated, and I'm trying to figure out how you utilized the Hope standard of risk in selecting those 6 companies.

And your item No. 3, total capitalization less than $5 billion, appears to be inconsistent with later testimony that suggests no adjustment should be made for size.

A. I don't agree it's inconsistent. I -- once again, I'm trying to come up with comparable companies and head off -- basically I realize companies make this argument for a size premium adjustment, you know, over and over. As far as quantifying this specific adjustment, I don't agree with that. And if you want to try to head that off, which I did, you put in a total capitalization less than a certain amount to try to head off that argument.

Q. Let's go in that direction. Let's assume that argument has some validity and this Commission may make such an adjustment and allow a return to a small company. Shouldn't those companies be put back in the pool?

A. No. Because, once again, I would not agree with the size premium adjustment.

Q. Okay. And if the Commission has found otherwise, your opinion would differ from what the Commission has found; is that true?

A. Sure.

Q. Okay. Take a look at your No. 4 criteria there on page 26, Greater than 70 percent of revenues received from electric utility operations.

A. Yes.

Q. And I think you indicated that the application of that criteria eliminated 20 additional companies?

A. Yes.

Q. Were any of those companies what we would refer to as combination companies?

A. You refer to combination. Can you define what you mean by --

Q. Well, what's your understanding of a combination company?

A. I think there was a definition given earlier that a combination company would be a electric and natural gas company. I'm just wanting to make sure you're not referring to diversified company, which diversified companies get into much of the nonregulated energy market trading, etc., etc.

Q. Would you except as a definition of a combination company one that was in both regulated natural gas and regulated electric operations?

A. That may be a portion of their operations, that's correct.

Q. Is Ameren a combination company, for example?

A. Ameren has natural gas and electric operations, that's correct.

Q. And how about Aquila?

A. Aquila has natural gas, electric operations.

Q. Would the fact that the combination company might not have more than 70 percent of its revenues from electric utility operations simply reflect the sale of its -- of natural gas by its natural gas distribution operations?

A. I don't know. I relied on C.A. Turner Utility Reports for this. I don't know what they look at as far as to determine their percent of revenues -- electric revenues as far as the specific details.

Q. Well, let me ask you just -- let's talk about AmerenUE, for example. Do you know whether or not they get more than 70 percent of their revenues from electric operations?

A. AmerenUE, I believe they do. Obviously that's the largest part of their operations.

Q. Let's assume that they got 65 percent of their revenues from electric operations and the remainder 35 percent from natural gas operations. Applying your criteria No. 4, you would eliminate them, is that true, because they don't have more than 70 percent -- 70 percent or greater?

A. Assuming that's the case, that's correct.

Q. Yeah. Just assuming that with me.

A. That would be Ameren Corps, the consolidated Ameren Corporation.

Q. Just pick X company.

A. Any company, yes.

Q. It doesn't matter what company it is. If 65 percent of its revenue is from regulated electric operations, 35 percent of natural gas regulated operations, you would eliminate them; isn't that true?

A. And let's clarify. With C.A. Turner it does, in --

Q. Well, forget about C.A. Turner. Just the hypothetical question, some company, any company, The Jim Swearengen Utility.

A. Well, I still need to clarify. Just electric operations, in general, not regulated electric operations. It's very hard to find any -- you know, any type of source out there, unfortunately, that really breaks down the regulated electric and nonregulated electric. It's a very real problem.

Q. I understand that. What I'm trying to get your rationale here for that 70 percent cut-off point. And my question to you is, 65 percent come from regulated electric operations, 35 from regulated gas. Just assume that to be the case. You would eliminate that company?

A. Exactly.

Q. That's right.

And let me ask you this. Just because 35 percent of that company's revenues came from regulated gas operations, that would not necessarily reflect a higher operating risk for that company, would it?

A. When you refer to "operating," are you referring to business risk?

Q. Sure.

A. I mean, with any given company it's not necessarily going to -- as far as the percent of revenues, there are all sorts of things that come into play that are going to determine the overall risk level of a company such as management and what have you.

This is just something to -- in order to try to achieve electric utilities, which is what MoPub and St. Joe are. And that's what's -- the subject of this case, I should say, is what MoPub and St. Joe are because obviously they have gas operations and steam operations, but