Q. The Missouri Public Service Commission. We'll --
A. No.
Q. -- go out from there. No?
Are you aware of any Missouri Public Service Commission decisions that have denied floatation costs in the rates?
A. Yes.
Q. And what decisions are those?
A. Specifically I can't identify decisions for you, but in at least two Aquila cases that I'm aware of or UtiliCorp cases.
Q. And is Aquila the predecessor or the -- yeah, the predecessor of UtiliCorp?
A. Yes. No. Aquila is the successor.
Q. The successor. I'm sorry. The successor. And how did you become aware that the Commission disallowed floatation costs in the Utilicorp/Aquila cases?
A. I was a witness in those cases.
Q. And did you recommend a floatation cost adjustment?
A. I did.
Q. And did the Commission deny it?
A. Yes.
Q. And why did they do that?

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A. I don't know why they did it. They just did it.
Q. Okay. There was nothing in the Report and Order that indicated why?
A. Not that I can remember.
Q. Have you ever testified in any rate case proceeding or regulatory proceeding recommending that floatation costs be denied?
A. I don't remember having done so.
Q. When you were with the Commission Staff, did you ever testify that floatation costs should be denied?
A. I don't know, but I doubt it. May have, may not have. That was 30 years ago.
Q. Are you aware of any Missouri Public Service Commission decision that has allowed the recovery of floatation costs in rates?
A. No, sir, but as I indicated, I'm not a student or a regular reader of Missouri decisions.
Q. For Missouri cases that you've participated in, other than the Aquila case, did you recommend inclusion of floatation costs?
A. I believe so.
Q. And what cases were those, sir?
A. I've testified in a number of cases here.

Almost uniformly I've recommended floatation costs, except in unusual circumstances, and I can't think of any offhand.

Q. And are you aware of any of those cases that you've personally testified in here before the Missouri Public Service Commission where the Missouri Public Service Commission has approved floatation costs in rates?

A. No, I'm not.

Q. Have they disapproved them in every case that you've offered them up?

A. That I'm aware of, yes.

Q. So based on your experience here before the Missouri Public Service Commission, the Commission has been consistent in rejecting floatation costs?

A. They have.

Q. Now, you indicated that Southern Union Company recently issued some equity?

A. That's correct.

Q. Do you know if Southern Union Company has plans to issue any equity in the near future?

A. I'm under the impression that they do.

Q. And where did you get that impression?

A. Conversations with employees of the company and public statements of the company in connection with the objective that the company achieved a 55 percent debt ratio.

Q. And what employees of the company did you speak with?

A. Mr. Marshall.

Q. And who is Mr. Marshall?

A. Mr. Marshall is here in the room today.

Q. What's his -- he's the treasurer of the company, is he not? Do you know?

A. I believe he is, yes.

Q. And what did Mr. Marshall tell you with respect to Southern Union Company's plans to issue equity?

A. The company is totally committed to its plan, which includes the maintenance of a 55 percent debt ratio, which can only achieved by issuance of new equity.

Q. And did he tell you the time frame in which the company was going to issue that new equity?

A. Did you say time frame?

Q. Yes, sir.

A. We discussed that, and although a time frame has not been set, I believe that Mr. Marshall has discussed it with some commissions.

Q. And what commissions has he discussed it with?

A. I believe he's discussed it with the

Pennsylvania commission.
Q. How about the Rhode Island commission?
A. I don't know.
Q. How about the Massachusetts commission?
A. I don't know.
Q. How about the Missouri commission?
A. I don't believe so.
Q. And how much equity did Mr. Marshall tell you the company was anticipating on issuing?
A. We didn't get to a definitive amount.
Q. Did he ballpark it?
A. 100 million or more.
Q. Did he ballpark the time frame at all, within the next year? I'm trying to bookend it.
A. I think within the next year would be an impression that I have, perhaps sooner.
Q. And did he --
A. It's something that's not scheduled at this point.
Q. And you indicated that you had seen that from public statements made by the company. What public statements, sir?
A. Well, on the webcast for the earnings announcement this month, they indicated, again, their commitment to achieving 55 percent debt ratio.

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Q. So 45 percent equity?
A. That's correct.
Q. And where are they at now?
A. Depending on whether or not you include short-term debt, depending on the retained earnings and so on, in the range of 40.
Q. They're at 40 right now?
A. I said they're in the range. I'm not sure where they are right this minute.
Q. They're in the range of 40 right now?
A. (Nods head.)
Q. Is that including or excluding the Panhandle debt?
A. I would say that's probably including. They might be at 35 right now.
Q. Now, how does that differ from the equity ratio that you've got in your testimony, and what's the basis of that difference?
A. The testimony, I assume, since we've discussed it in some depth --
Q. Your direct testimony.
A. -- has a calculation based on the consolidated capital structure at June 30th, 2003, wherein the Panhandle debt was subtracted from the total debt and the balances are the capital structure. 35 percent or so

equity ratio is a simple consolidated ratio.

Q. So that's the equity ratio that investors are looking at?

A. Right this minute?

Q. Yes, sir.

A. I doubt it, because there hasn't been anything published recently. The last published item would have been March. There's no interim publication minute by minute.

Q. And what would the last March published item be?

A. I don't know.

Q. You don't know?

A. No.

Q. Would it be higher than 35 percent or lower than 35 percent?

A. I suspect it would be lower.

Q. Lower. So that's the debt -- or the equity ratio that investors would be thinking about?

A. That they would see today, yes.

Q. You talked with Mr. Berlin about your proxy companies a little bit, and you indicated that you disregarded two companies, Semco and Energen?

A. That's correct.

Q. And you said that Semco had dividend

problems. Explain those dividend problems to me.

A. My recollection is that at the time I excluded the company, they had a very high dividend yield, which was an indication that dividend was going to be reduced.

Q. And why is that an indication that dividend's going to be reduced?

A. I think typically when a company prepares to reduce its dividend, the price of the stock is bid down in anticipation of that reduction.

Q. And have you checked to see if indeed Semco has reduced its dividend?

A. No, I have not.

Q. Would that be something easy to do?

A. Yes.

Q. And if Semco hasn't reduced its dividend, do you believe it would be appropriate to utilize Semco in your study?

A. I'd have to look at it again, and I wouldn't have any problem if it fit into the group.

Q. What was the impact of taking Semco out of your study, sir?

A. I don't know exactly, but I would suspect that it probably reduced the overall return on equity recommendation.

Q. It reduced it. What would the impact have been if you'd kept Semco in on the dividend yield?
A. It probably would have increased it.
Q. And that would have shown -- closed the gap between the dividend yield and the earnings, would it not?
A. No. It doesn't have anything to do with dividend growth. Their yield, their current yield was quite high at the time I was reviewing ValueLine.
Q. And then the other one was Energen?
A. Energen.
Q. And is it safe to say that Energen is not a pure-play natural gas distribution company?
A. It's a natural gas distribution company. It owns the old Alagasco properties which serve a major city and -- several major cities in Alabama. But the problem is that they enjoy just tremendous success in their exploration and production activities, and that success has given them very high earnings growth, which I thought would distort the results of my analysis.
Q. Now, you indicated that your comparable companies you took them from ValueLine; is that correct?
A. That's correct.
Q. And why is ValueLine the appropriate item to use?
A. I suspect there are many sources that are

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usable. ValueLine happens to be the source that I used.

Q. And why?

A. Because it's a reliable, longstanding publication that's considered authoritative by virtually every analyst in the business, widely quoted, widely used as a source.

Q. Is Moody's considered authoritative in the business?

A. Very much so, except Moody's material is very dated.

Q. What other sources are considered authoritative in the business?

A. I think Standard & Poor's is, but not for the same kind of data as ValueLine.

Q. Anything else? Any other ones?

A. I noticed earlier this morning that your witness used Turner. Turner is considered authoritative as a pocket guide for certain things.

Q. Is it authoritative for earnings growth?

A. It's not something that I would use.

Q. Is it authoritative for the items that Mr. Allen used it for?

A. I'm not sure what all he used it for.

Q. Let me ask you, what items don't you view Turner as authoritative for?

A. I don't know what Turner has in it. I used to subscribe to Turner and found it less than useful and ended up dropping my subscription.

Q. Do you know if other analysts use Turner?

A. I think some do, but I think, by and large, far more analysts use ValueLine than any of the other sources, and I do think that Moody's is pretty much dropped to the wayside. It used to be the primary source.

Q. And what's your basis for saying that most analysts use ValueLine?

A. I participate in a great number of these proceedings and have participated in a great number over the years, and the majority of the analysts which I come in contact with have used ValueLine.

Q. Did Mr. Murray in this case use ValueLine?

A. He did.

Q. Mr. Allen use ValueLine?

A. I think Mr. Allen used Turner. I don't know if he used ValueLine or not.

Q. What standards does ValueLine use to screen their companies to determine if they belong in the natural gas distribution set?

A. I don't believe they have a rigid standard.

Q. What standard do they use, do you know?

A. No.

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Q. Is it important for you to know?
A. No.
Q. Why isn't it important to know?
A. It has no impact on the analysis.
Q. So it's your belief that all of those comparable companies that are included in Standard & Poor's are similarly situated to Southern Union Company?
A. No. They're natural gas distribution companies, classified as such by ValueLine. ValueLine is what I use, not Standard & Poor's.
Q. I'm sorry. ValueLine. Excuse me.
A. So long as you do the analysis probably, you don't have a problem if there are some differences between the sample companies -- and I generally try to avoid referring to them as comparable companies -- the sample companies, the proxy companies. You just don't have a problem if you do the analysis properly.
Q. And it's your view that you've done the analysis properly?
A. That's right.
Q. You also talked about the greater risks with Mr. Berlin that MGE is facing. Are you aware that Missouri Gas Energy has a new rate design recommendation in this case?
A. I'm aware that they are asking for a

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different rate design. I'm not familiar with the rate design that they're requesting.

Q. And are you aware that that rate design would reduce the volatility, if approved would reduce the volatility of the company's earnings due to weather?

A. Yes.

Q. And are you -- do you believe that that would make the company less risky?

A. It should.

Q. Everything else remaining the same?

A. It should.

Q. And do you believe it would be appropriate to reduce the company's return on equity, assuming that the Commission approved that rate design?

A. Several decisions in a regulatory decision have to be made simultaneously, and that is one decision which I believe a balance should be struck between regulatory decisions which reduce risk and the recommended return or the return that the Commission decides.

Q. Well, let me ask you this: Let's assume that the Commission accepts MGE's recommendation in this case with respect to the rate design. Would you recommend a reduction in your 12 percent return on equity, assuming the Commission adopted MGE's proposal?

A. I suspect I would be very favorably

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disposed to do something like that, yes.
Q. And how much of a reduction would you look at?
A. I don't know. I haven't thought about that.
Q. Has anyone from the company asked you to think about that?
A. No.
Q. How many of your comparable companies have a weather mitigation clause?
A. Several.
Q. Which ones?
A. I don't know off the top of my head, but several have some sort of weather mitigation.
Q. And when you say some sort of weather mitigation clause, what do you mean?
A. Something that moderate the fluctuation in revenue related to weather.
Q. Would that be, for example, a fixed charge, customer charge?
A. Well, it could be anything. I mean, there are a lot of ways to approach weather mitigation, raise the customer charges, natural gas minimum --
Q. Well, I'm trying to understand, Mr. Dunn, you've told me that several of your comparable companies

have weather mitigation, and I'm trying to understand what type of weather mitigation they have. Do they have a weather mitigation clause, do they have a fixed customer charge, do they have the type of rate design that MGE is proposing?

A. I have a partial analysis of those companies. I don't happen to have it with me. I haven't reviewed it in the last few weeks. I can't tell you specifically the types of weather mitigation clauses they have, but many of the companies have weather mitigation clauses.

Q. So if I asked you a Data Request to recover that partial analysis, you could provide that to me?

A. That's right.

Q. You also indicated that one of the risks faced by Missouri Gas Energy was propane?

A. That's right.

Q. Do you know what the level of pene--

A. Excuse me. If I could correct you, it's not propane. It's the competition from propane.

Q. Competition from propane. Okay. Do you know what Missouri Gas Energy's penetration level is in the Kansas City area for residential space heating?

A. I imagine it's quite high.

Q. When you say quite high, over 90 percent?

A. I would assume.
Q. And what about in the St. Joe area?
A. I would assume in the older part of town it's the same.
Q. I'm talking about overall.
A. Well, overall is one of those kinds of approaches to things where you mask what's going on. Overall, you might have 90 or 95 or 98 percent penetration, but at the periphery, at the margin where things are changing, where growth is occurring, you might be losing business or not competing effectively.
Q. Have you seen any studies conducted by MGE that indicate what amount of business propane is taking away?
A. No, I haven't.
Q. Have you seen any studies conducted from M-- by MGE or on MGE's behalf that indicates that electric heat pumps are taking any of its business away?
A. I haven't seen any studies conducted by MGE, but as I told you, I believe, earlier or Mr. Berlin, that Kansas City Power & Light advertises that their efficient heat pump is the most efficient and effective way to heat and cool in the Kansas City area now.
Q. Do you know how effective that advertising is?

A. No, I don't.

Q. Have you had occasion to look to see how many new customers KCP&L is getting online with their heat pumps?

A. No, I haven't.

Q. Do you know if Missouri Gas Energy is experiencing any growth?

A. They are experiencing some, yes.

Q. Do you know if that indicates that they're getting a share at least of the market?

A. I'm sure they're getting a share of the market.

Q. Are you aware of any customers who are converted from natural gas -- and I'm talking about residential small general service customers -- who've converted from natural gas to propane?

A. No, I'm not.

Q. Have you seen any studies that indicate that conversion rate?

A. No.

Q. Do you live in the Kansas City metropolitan area?

A. I do.

Q. Where do you live?

A. I live on the Kansas side about two blocks

into Kansas, 435 and Stateline.
Q. In Leawood?
A. Yes.
Q. See any propane tanks in Leawood?
A. No. Leawood's an area of houses that are 40 and 50 years old.
Q. See any propane tanks at 135th and Stateline?
A. Don't see any propane tanks, but I see a lot of houses out there, including a lot of houses in Leawood, that do have heat pumps.
Q. Do you make it to go around the houses, the new builds in the Kansas City area and check whether they have heat pumps or not?
A. No, but I'm aware of what goes on in my neighborhood and I've seen most of the changeouts have been to heat pumps.
Q. How many changeouts have occurred in your neighborhood?
A. I have a friend who happened to have recently put in two heat pumps to replace natural gas.
Q. And was that a Missouri Gas Energy customer?
A. No. He happened to be a Kansas customer.
Q. So you're aware of one customer and that

was a Kansas Gas Service customer?
A. I've seen other heat pumps. There happens to be a heat pump two doors down from us.
Q. And that's not a Missouri Gas Energy customer either?
A. But I would assume that the pattern that exists in Kansas is similar to the pattern that exists two blocks across the street.
Q. And that's based on no study that you've done?
A. That's right.
Q. That's just your anecdotal evidence?
A. That's it.
Q. On page 50 of your direct testimony, going over to page 51, you indicate that it's reasonable to anticipate that the cost of equity will be increasing from its current lower levels?
A. That's correct.
Q. What study did you do to determine that?
A. There's no specific study associated with that statement. The fact of the matter is that interest rates and capital costs all tend to be related. It's a very well-established principle in finance that the capital market line indicates the relationship between a number of a wide variety of different types of

instruments, and those instruments, the capital market line tends suggest that all of those instruments move in concert. When they go up, they all go up; and when they go down, they all go down.

Q. As an expert do you review return on equity decisions from other jurisdiction?

A. Yes, I do.

Q. And have you reviewed that type of information recently?

A. I have reviewed and displayed in my testimony information in connection with previous decisions which shows a gradual increase since year 2001 in return on equity decisions.

Q. And what page is that you're looking at in your testimony?

A. That would be on page 52.

Q. And where was that information taken from, sir?

A. It was taken from the RRA, which is the -- I can't remember at the moment what the acronym stands for.

Q. If I told you that was Regulatory Research Associates --

A. Associates.

Q. -- would you agree with me, sir?

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A. Yes, I would.

Q. And when you say it's increasing, give me an idea of how -- how is this determined? How do they determine these numbers, if you know?

A. They simply take the decisions, list them, and then average them.

Q. Do they take settled decisions?

A. Yes.

Q. And if it's a settled decision, is there a return on equity determination generally?

A. Sometimes there is, sometimes there isn't.

Q. And from 2000 to 2003, does that indicate that there's been about a 34 basis point increase? Is that how I would read that, sir?

A. From 2000?

Q. From 2002 to 2003?

A. Yes, sir.

Q. 34 basis point?

A. Yes, sir.

Q. And that to you indicates that there's a trend?

A. Well, from 2001 to 2002, there's also been a slight increase. We're not talking about trend.

Q. Have there been any decreases there, sir?

A. We're not talking about trend. The

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discussion that we're having started about cycles and movements and cost of capital up and down through time, not about trends.

Q. Are there any decreases in the cost of capital?

A. There are.

Q. And was the trend down in those years?

A. The trend was down in prior years.

Q. Okay. Have you seen any information that's newer than the information listed on page 52 there for '03?

A. I have, but I haven't analyzed it.

Q. You haven't analyzed it. Okay. Were you here yesterday when I took the deposition of Mr. Quain?

A. The first part. I was not here when you questioned Mr. Quain.

Q. Okay. Let me hand you the Regulatory Research Associates January to March 2004 regulatory study, and is that -- is that the item that you're talking about, sir?

A. This is the type of document, yes.

Q. Okay. And does that indicate major rate case decisions January through March 2004, sir, on the front cover?

A. Yes, it does.

Q. And does it indicate there that the average gas equity return authorization for the first quarter of 2004 was 11.1 percent?

A. Yes, it does.

Q. Does that indicate that it was up slightly from 10.99 percent?

A. For the calendar year 2003?

Q. Yes, sir.

A. Yes.

Q. So you don't have in your testimony the end date of the calendar year 2003, do you, sir?

A. No, I don't.

Q. And what does it indicate there that the final average was for the calendar year 2003?

A. In my testimony?

Q. No, sir. On the Regulatory Research report.

MR. MICHEEL: And why don't I just go -- I've got a stapled one, and we'll go ahead and make that Deposition Exhibit 3.

(DUNN EXHIBIT NO. 3 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

THE WITNESS: Could you repeat the question, please?

BY MR. MICHEEL:

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Q. Yes, sir.

On the front page there, does it indicate that the average for calendar year 2003 return on equity was 10.99 percent?

A. It does.

Q. So if you updated your testimony on page 52, line 24 for year to date, the ROE there would be 10.99 percent, would it not?

A. It would.

Q. And is that lower than the 11.03 for calendar year 2002?

A. Yes, it is.

Q. Does that indicate that the trend is going down?

A. Down to flat.

Q. But it's something different than what you have in your testimony?

A. It is.

Q. And did you intend to update your testimony for the year end 2003?

A. I believe I explained to you earlier that the custom here has generally been not to update the rate of return testimony unless there's some reason to do so.

Q. And does this document, Exhibit 3, also indicate that the first quarter return on equity for this

year is 11.1 percent?
A. It does, before determinations.
Q. And so that indicates to you that it's flat; is that correct?
A. I would say so.
Q. And you still believe it's increasing?
A. I do.
Q. But that's not what the empirical evidence shows, is it?
A. I believe because the empirical evidence, which tends to lag reality, doesn't necessarily indicate that it's flat or up. This data is, for what it's worth, the report and decisions which are made by various commissions tied to specific points in time.
Q. Is that the kind of data that you relied on in doing your testimony, Mr. Dunn?
A. It's something that I included in my testimony as a piece of information which should be helpful.
Q. And is it information that you rely on in your work as an expert?
A. From time to time, yes.
Q. Do you know if it's information that Mr. Quain, another expert for this company, has relied on in doing his work?

A. I think you'll have to ask him about that.
Q. Have you reviewed Mr. Quain's testimony?
A. I have read it quickly.
Q. Did you note that Mr. Quain specifically cited the Regulatory Research Associates?
A. I thought he did, yes.
Q. Do you know that I got that document from Mr. Quain yesterday in his deposition?
A. No, I don't.
Q. You had a discussion with Mr. Berlin regarding the comparable companies, and you indicated that it was not inappropriate to exclude as a comparable company a company that was below investment grade. Did I misunderstand you?
A. I think you did.
Q. Okay. So it is appropriate to exclude a company as a comparable company if it is below investment grade?
A. Are you trying to use a double negative or single negative? I thought your first question involved a double negative.
Q. No. If it did, I'm not trying to trick you. I'm just trying to understand. Is it appropriate to use a comparable company that is rated below investment grade?

A. It's not inappropriate.
Q. It's not inappropriate?
A. That's correct.
Q. So you would use one --
A. I would.
Q. -- that is below investment grade?
Did you use any companies as comparable companies what were below investment grade?
A. I don't know.
Q. And why would it be appropriate to use a below investment grade company as a comparable?
A. You're talking -- when you talk about investment grade companies, bond ratings, not common stock.
Q. Yes, sir. I'm talking about --
A. There's a big difference between common stock and bonds.
Q. I'm talking about bond rating. And just for the record, it has to be BBB- or above in Standard & Poor's to be investment grade; is that your understanding?
A. Yes.
Q. And that's what we're talking about when we're talking about investment grade?
A. That's correct.
Q. Okay. For bond ratings?

A. And I didn't select my companies on the basis of bond rates. It's that simple. And I don't think that bond ratings are the proper methodology to select companies for a study of return on equity.

Q. And why is that?

A. Bonds are a completely different kind of security than equity security, and the costs are different. And the costs may or may not be related.

Q. So you think that's an inappropriate screen?

A. I don't think that it is the right way to go about it. I don't want to use the word inappropriate, because it seems to have a little more emotional baggage with it than necessary, but it's not the way that I think an analyst would go about selecting companies.

Q. Are you aware of any analysts that have gone about selecting companies that way?

A. I've seen probably every selection methodology possible, but I don't think most people select their companies based on the bond rating.

Q. What was your first -- I noticed in your appendix that you graduated from UMKC in 1967?

A. That's correct.

Q. Did you get a job right after you graduated?

A. I did.

Q. What did you do?

A. I worked at General Motors.

Q. And what did you do for General Motors?

A. I started as a clerk, and after a series of transfers and promotions, ended up as a foreman on the line, which was part of their normal progression, and decided that I just didn't like that kind of work.

Q. And then you went back and got your master's degree?

A. That's correct.

Q. At UMKC also?

A. That's correct.

Q. You graduated 1970?

A. That's correct.

Q. And what did you do after you graduated?

A. After I graduated from there, I went to work here.

Q. Here being Missouri Public Service Commission?

A. Yes, sir.

Q. In what capacity did you work here?

A. I was the chief of economic research.

Q. And what did you do in that capacity?

A. Well, I did several things. Many of the things that are done by the analysts here, but at that point in time, we were in the process of setting up the department and not only did we work on setting up the department, but we also worked on integrating computers into the system and I also did rate of return testimony for the Commission.

Q. Now, when you came to the Commission after graduating with your master's degree from UMKC, was the first time that you gave rate of return testimony before the Missouri Public Service Commission?

A. Yes.

Q. And what training did you have before you did that?

A. I was pretty fortunate in that my predecessor, whose name was Terry Smith, was available to spend some time with me prior to his moving on to his next job. And I can't remember whether it was two or three or four months, but he took the time to introduce me to a number of people, gave me the opportunity to go to a class at I believe it was Irving Bank, opportunity to go to classes at NERC. We spent a great deal of that two or three months developing a background in the utility business.

Q. And then you just filed testimony on rate of return?

A. I don't think I filed it that quickly. I have no idea from this point of view how quickly I filed testimony, but I don't think it was immediately. It was sometime down the road.

Q. Did you feel you were an expert when you filed that first time here?

A. Quite frankly, I haven't thought about it.

Q. Well, think about it now. Were you presented as an expert witness in the case?

A. I don't know that that was much of an issue back then, but my testimony was offered and accepted by the Commission.

Q. Well, did they have rate cases back then or did they do it in a different way?

A. They had cases, but initially there was no argument about whether or not this individual is an expert or that individual's an expert. At some time much later in the game, someone moved to strike my testimony on the basis that I was not an expert.

Q. And what was the result of that?

A. I believe the Commission accepted the testimony for what it was worth.

Q. What was it worth?

A. That was their decision.

Q. And what was their decision? Did they accept your position?

A. Frankly, I don't know. I don't recall whether they adopted my testimony.

Q. Has Southern Union Company had any problem attracting equity capital in the last five years?

A. Well, that's a question that's almost impossible to answer. I don't think that you can say that they've had a problem attracting equity. It certainly would have been easier when they wanted to attract equity to have better earnings.

Q. Do you know if they've issued any equity within the last five years?

A. Yes.

Q. Has it been a successful offering?

A. There was more in the order of private placement, the most recent offering.

Q. Is that the $11 million offering that we've talked about?

A. The 3 million share offering, yes.

Q. Are you aware that Southern Union Company issued equity when it -- when it sought to purchase Panhandle Eastern Pipeline?

A. That's the 3 million share offer.

Q. That's the 3 million share offering? You think it was 3 million?

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A. I think it was.

Q. Okay. Let me hand you a copy of Southern Union Company's annual report in 2003, and I've highlighted some items, an area there. If you could just read that into the record.

A. In addition to using proceeds from its Texas asset sale to fund the Panhandle acquisition in May 2003, Southern Union initiated concurrent common stock and equity linked unit offerings. After a successful road show presentation to major sectors of the investment community, Southern Union issued nearly 11 million new shares of common stock at $16 a share and 2.5 million in new equity units at $50 a unit. The equity units pay a cash coupon 5.57 percent and were issued with a maximum conversion premium of 22 percent over the company's stock price of $16 per share.

Q. Does that --

A. We were talking about two different offerings. There was a $3 million -- or 3 million share payment to the prior owner of Panhandle in connection with the transaction.

Q. Okay. Does that indicate -- just so we'll get on the same line, does that indicate that Southern Union Company issued 11 million shares of common equity?

A. It does.

Q. And that's common stock?
A. It is.
Q. And they just did that recently?
A. They did.
Q. And does it indicate that they had any problems doing that?
A. It says they had a successful road show presentation. However, I believe the stock was higher priced before that transaction or somewhat higher priced.
Q. Has Southern Union Company had any problems that you're aware of in attracting debt financing in the last five years?
A. Every offering to attract new capital requires a substantial effort on the part of the company. You can call that problems or you can just call it the ordinary course of business, but to attract capital requires a substantial effort.
Q. That wasn't my question, Mr. Dunn, and we'll go along quicker if you just answer the question I ask.
Has the company in your -- to your knowledge, had any problems securing debt financing in the last five years?
A. I think the answer that I just gave you that it required a substantial effort to achieve sales and

attract new capital is an answer to that question. Whether or not you want to interpret those as problems or just the normal course of business, that's the situation that the companies find themselves in, and that's the situation that Southern Union found itself in.

Q. Do you know whether in the last five years Southern Union Company has placed any debt in the market?

A. I believe they have.

Q. Do you know whether or not Southern Union Company has a billion dollar shelf registration at the Securities and Exchange Commission?

A. I believe they do.

Q. And what's that shelf registration for, if you know?

A. There's no telling what it's for. It's preregistration.

Q. You're an investor in Southern Union Company, are you not?

A. I am.

Q. Have you received any information as a shareholder of Southern Union Company that indicates that the company's having problems issuing debt or equity?

A. I have not.

Q. In your research into whether or not you're going to buy stock in the company, did your research indicate to you that they had any problems issuing debt or equity?

A. I think in that area we have to go back to the original answer, that they expend a substantial amount of effort to raise capital, and you can interpret that as problems or not. People are not beating their door down like they are at General Motors to get capital placed with the company, or General Electric. Those companies actually operate banks where people can deposit funds on a short-term basis.

Q. Could I have the annual report back, sir?

I want to talk for a while about the discounted cash flow method. Are you familiar with that method?

A. I am.

Q. And is that a generally accepted method to determine the cost of common equity?

A. It is.

Q. And is that one of the methods that you utilized in this rate proceeding?

A. It's the primary method I used.

Q. And is that a method that Mr. Murray utilized in this proceeding?

A. It is.

Q. And is that a method that Mr. Allen

utilized in this proceeding?

A. Yes.

Q. And is the discounted cash flow method of determining the cost of common equity the most accepted methodology for ratemaking purposes?

A. Every survey I've seen says that it is at the moment.

Q. And it's more accepted than, for example, the capital asset pricing method?

A. That's correct.

Q. Or the risk premium analysis method?

A. That's correct.

Q. Why is that, sir?

A. I can't explain why it is. I think it's probably a superior model. It's been less subjected to criticism than the other two.

Q. And has that model been subjected to peer review articles in various finance journals?

A. I don't believe that the discounted cash flow model, as we use it in the regulatory environment, is something that's been the subject of peer review articles.

Q. Has the discounted cash flow method been accepted by numerous public service commissions for use?

A. It has.

Q. Has the discounted cash flow method been

accepted by numerous courts for use in determining the return on equity for a regulated utility company?
A. To the extent that courts do that, I'm not aware of whether or not courts have been accepting it.
Q. Is there a disagreement between yourself, Mr. Murray, and/or Mr. Allen as to the proper discounted cash flow formula?
A. Yes.
Q. Okay. And first of all, what are your disagreements with Mr. Allen regarding the discounted cash flow formula?
A. I think Mr. Allen uses the sustained earnings method of calculating the growth, which is something that I don't agree with.
Q. And when you say sustained earnings, is that the BR method used?
A. That's correct.
Q. Do you know who Dr. Myron Gordon is?
A. I do.
Q. Is he a recognized expert in the field?
A. He's the individual who I understand has the contract with the Federal Power Commission to publicize the discounted cash flow model.
Q. And did he write a book regarding the discounted cash flow method?

A. He did, back in the '70s.

Q. And is the BR growth rate, the discounted cash flow growth rate that Dr. Gordon uses?

A. That was what he used in his book in the '70s.

Q. And is that an accepted book, authoritative book?

A. Well, I think the field has moved beyond that.

Q. So it's your --

A. It's certainly a book that everybody has looked at, at one time or another. It is not a book, I don't think, that one would cite for the source of the DCF model.

A. Have you read any peer-reviewed articles that criticise the BR growth rate?

A. When you say peer-reviewed articles, I don't know if I've read articles. I know that, for example, Dr. Morin's book is critical of that approach.

Q. Does he say it's an inappropriate approach?

A. I don't know if he uses that word. I think he's just critical.

Q. Why is he critical?

A. I don't remember his criticisms exactly. I think he says that it's circular, and I -- I'm not sure if he says that it's backward looking, but it is. And it is one of those methodologies that if a company does poorly, the calculation will lead to a very poor growth rate. So that you're doomed if you have a few bad years under that particular set of circumstances to get worse every year thereafter, so long as that particular model is applied to determining your costs of capital.

Q. And what are your specific criticisms of the BR growth rate?

A. Well, I think that last one is my criticism. I'm not sure that that's Dr. Morin. If you have a few bad years, it leads to a permanent downward trend so long as the model's applied in that manner.

Q. Other than the BR growth rate being circular, as you just discussed, are there any other problems with it?

A. I think that it's backward looking. It does not take into account the changes which occur and which are likely to occur, and this process is supposed to be forward looking.

Q. Any other problems?

A. I haven't really thought in-depth about that, because I don't see that method very much any more, but that's all I have at the moment.

Q. You don't see that method very much?

A. Anymore. I've seen it in the past a great deal.

Q. And how far in the past? I mean, we've been doing it for 30 years, so give me a ballpark on what you mean in the past.

A. It's one of those things that you see less and less. I have not seen it in the prior two years.

Q. And is it your belief that Mr. Allen primarily used the expected BR growth rate or did he use a historical looking growth rate?

A. I have not, as I told you earlier today, spent the time on Mr. Allen's testimony to be prepared to discuss his testimony.

Q. Are there any other problems with the use of the discounted cash flow formula that you're aware of in Mr. Allen's testimony?

A. I'll have to say that I really haven't studied Mr. Allen's testimony to the point where I'm prepared to tell you everything that I might find.

Q. Let's talk about Mr. Murray's testimony. You've studied that a little bit more comprehensively.

A. I did.

Q. What are the problems with Mr. Murray's application?

And let me -- before you answer that

question, both Mr. Murray and Mr. Allen use the same DCF formula, do they not?

A. I believe they did.

Q. And your dispute, at least initially, with Mr. Allen here is the growth rates he utilized; is that correct?

A. Have you got a copy of Mr. Allen's testimony that I can look at? I told you, I'm not prepared to discuss it, but I'll take a look at his testimony and comment, if you will.

Q. Well, if that will help you, I'd like to know what you think the problems are.

A. Just so you understand this is not comprehensive.

Q. I understand that, Mr. Dunn. It's discovery. You're free to change your mind. You may have to explain why, but that's all right.

MR. SWEARENGEN: Do you want to take a break?

MR. MICHEEL: If you want to, that's fine.

MR. SWEARENGEN: Would it help you to have just a few minutes?

THE WITNESS: Well, there's no way I can develop a comprehensive comment on Mr. Allen's testimony in five or ten minutes, or fifteen or twenty minutes.

MR. MICHEEL: I mean, I was ready to go on to Mr. Murray, but you seem to want to go back to Mr. Allen, and I'm fine with that, Mr. Dunn.

THE WITNESS: I was?

MR. SWEARENGEN: No. He's ready to go on, so you don't need to do that.

THE WITNESS: Oh, okay. If you're ready to go, I am.

MR. MICHEEL: I asked about Mr. Murray, and you said, do you have a copy of Mr. Allen's testimony, and I said sure.

THE WITNESS: Okay.

MR. SWEARENGEN: I think he misunderstood you.

THE WITNESS: I was under the impression the question was Mr. Murray, Mr. Allen and you all used the same DCF model, which is not true.

BY MR. MICHEEL:

Q. And my question was, what were the infirmities that you saw with respect to Mr. Murray's use of the DCF model?

A. Mr. Allen states the model inappropriately in his direct testimony.

Q. Okay. Now, I was asking you about Mr. Murray.

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A. And Mr. Murray, I believe, states it appropriately, but applies it inappropriately. He states the model on page 25, and it is my recollection from the brief review of his exhibits that he does not apply that particular formula.

Q. Now, you indicated that Mr. Allen -- I know I'm back to Mr. Allen now -- states the model inappropriately?

A. That's correct.

Q. And --

A. If you look at the open page on Mr. Allen's testimony --

Q. And why does he state the model inappropriately?

A. The appropriate statement of the model is D1 over PO plus G, which is the statement which appears on page 25 of Mr. Murray's testimony, beginning at line 13; whereas Mr. Allen states the model as D over P plus G. And he goes on, Mr. Allen, beginning on line 7, to say that D over P is the current dividend yield, which is, in my opinion, an inappropriate statement of the model.

Q. So you don't even think he's got the model statement correct?

A. Well, unless he changes what he does later on, the statement of the model is incorrect.

Q. Okay. Any other problems with Mr. Murray's testimony other than his application of it?

A. Testimony in general, or just the application of the DCF?

Q. Application of the DCF.

A. The application of the DCF, the majority of which appears on Schedule 15, I believe, calculations that is, in his application are, I believe, inappropriate. What actually happens on Schedule 15 is that for a 10-year period on Schedule 15-1, Mr. Murray calculates the compound growth rates using beginning points and end points for dividends, earnings and book value, and then he does the same thing for a 5-year period on 15-2, then on 15-3 he averages those together.

And then he goes to page 16 and takes that amount and also lists three separate projections of growth rates and averages those together, and again averages the projected average with the historic average. I just think that's way too many averages. That's got too many things that are, in some cases, obviously incorrect buried in them.

Q. And your problem there is with his growth rate calculations?

A. That's the growth rate calculation. Dividend calculation I'm not sure about. I know that some of his dividends are historic and some of them are the D1 dividend. And I don't know which and I don't know why he's done what he's done without analyzing it further.

Q. All right. I think I'll move on off of their testimonies, just to speed things up.

(AN OFF-THE-RECORD DISCUSSION WAS HELD.)

BY MR. MICHEEL:

Q. Mr. Dunn, what is the result of the DCF, the discounted cash flow analysis that you conducted in this proceeding before you make any MGE-specific adjustments? I want to say it's on page 50 of your testimony, but I'm not certain, but I think that's where it appears, on line 9 or line 11.

A. It's 10.9 percent to 11.9 percent.

Q. And you call the 10.9 percent your bare bones cost of common equity; is that correct?

A. That's correct.

Q. Okay. Now --

A. It's actually the proxy company's cost of equity.

Q. Okay. And that 10.9 percent that you calculated there, is that using a growth rate of 6 percent found on JCD-5, and specifically on JCD-5, the BK value, column D?

A. No.
Q. No, it is not?
A. It is not.
Q. Okay. Well, I'm looking at the dividend and the growth yield that you have. You have a 6 percent growth on page 50 there, sir?
A. Yes, sir.
Q. And then you have a total 10.9 percent. I'm trying to understand where that 6 percent growth came from.
A. 6 percent growth is discussed in some detail on pages 37 through 45.
Q. And how did you arrive --
A. And that's the process. I examined the historic growth rates produced by the companies, the proxy companies, the 5-year and the 10-year period as recorded by ValueLine.
Q. Okay.
A. I also reviewed the ValueLine forecast and the forecast of a group of analysts as reported by Thompson Financial.
Q. And how did you arrive at the 6 percent growth rate?
A. It was my conclusion after the review of all that data.

Q. It was your conclusion. There was no calculation?

A. There was no calculation.

Q. That's just your belief that the growth rate should be 6 percent?

A. That's correct.

Q. And the same thing if I asked you about the 7 percent growth rate, that equals the 11 -- that's used to get the 11.9 percent?

A. That's correct.

Q. There's no specific way you did that, that's your expert opinion?

A. That's right.

Q. After you did -- arrived at the 10.9 percent, I want you to take me through all the upward or downward adjustments that you've made to your return on equity. And if you could take me through them one by one and tell me how much they increased or how much it decreased and what the adjustment was about. And I didn't see, quite frankly, any downward adjustment. Am I correct in that assumption?

A. I believe you are.

Q. Okay. Well, let's just go with all the upward ones, then, that you did. Why don't you list them first, and then we'll go through them one by one.

A. First adjustment is shown on page 48, and this is an annualization adjustment, annualize the historic yield or the yield that we're looking at to the yield which would be associated with the first full year of ownership after the acquisition of the security.

Q. Okay. What's the next adjustment, upward adjustment?

A. That adjustment is on page 49, and it is adjustment for pre-offering pressure and floatation. And I believe it is discussed earlier.

Q. Okay. That's the floatation cost adjustment. What's the next one, sir?

A. Those are the only adjustments to the dividend yield getting to the proxy company return that I'm aware of.

Q. Did you make any other adjustment to your recommendation, for example, due to the risk for MGE?

A. There was an adjustment to the benchmark cost of common equity to make it specific for MGE.

Q. And what adjustment was that, sir? Was there only one adjustment there?

A. There was only one adjustment there, and that adjustment, the discussion of it begins on page 53, and the adjustment involved a conclusion on my part that the upper limit of the range plus 10 basis points was the appropriate return.

Q. Are you recommending any other adjustments?

A. No.

Q. For example, a management efficiency adjustment?

A. There is an addition to the rate of return for management efficiency, which is the adjustment which corresponds to the negative adjustment which the Commission made in a prior case with MGE.

Q. I want to take you through each of those individually. The first one that we talked about was the annualization adjustment appearing at page 48; is that correct?

A. Yes.

Q. Could you explain to me specifically the impact that the annualization adjustment has on your recommendation in this case?

A. It increased the base dividend yield from 4.5 percent to 4.6 percent.

Q. And why did you make the adjustment, sir?

A. That adjustment is to increase the dividend yield to reflect the amount of money which would be received by shareholders during the first full year of ownership.

Q. And why is that the appropriate adjustment to make?

A. That is the adjustment to put the dividend yield into the D1 format, which is what we had spoken of earlier. Shareholders don't buy last year dividend; shareholders buy the dividend going forward.

Q. Any other reasons, sir, for doing that?

A. No, sir.

Q. Next adjustment that you talk about is the floatation cost adjustment. Could you tell me what the impact that adjustment has on your recommendation in this case, sir?

A. That raises the dividend yield component from 4.6 percent to 4.9 percent.

Q. And why do you believe that adjustment is appropriate?

A. Because I believe that Southern Union will continue to raise new equity. I believe it's appropriate to allow Southern Union a return which is sufficient to cause their stock to trade at a higher level than would be the case absent this adjustment. And secondly, to accommodate expenses associated with the offering itself, including commissions and fees.

Q. Now, you also talked about an adjustment you made at page 53 of your testimony respecting the specific risk for MGE.

A. That's correct.

Q. Why don't you explain that adjustment and tell me specifically how that's an increase?

A. After the first two adjustments that we discussed, we reached the return on equity for the proxy companies of 10.9 percent to 11.9 percent. Now, the appropriate way to do a proxy company analysis or a pure-point analysis is to select your group of companies, and after the group of companies is selected, to analyze them and derive a return or a return estimate for that group of companies.

Now, regardless of how careful or what effort is put into selecting the group of companies, there's no way that a group of companies selected for this purpose can be identical to the company, the subject company in your analysis. Consequently, you need to compare the risk levels of the subject company to the risk levels of the proxy group, and that's what this adjustment is a consequence of that, that comparison.

I compared the two using a standard deviation and a coefficient of variation, which indicates that Southern Union, particularly MGE and its MGE properties, has greater risk than the proxy group. Consequently, they're entitled to a higher return on equity. And the adjustment was to compress the range which was originally 10.9 percent to 11.9 percent, to the upper limit of the range, and add 10 basis points.

Q. Which took you to the 12 percent?

A. 12 percent.

Q. And then you also -- let me ask you about that. You talked about the standard deviation and the coefficients?

A. Of variation.

Q. Of variation. Did you provide that analysis in your testimony?

A. No, I did not.

Q. Did you provide that analysis in your work papers?

A. It will be, yes.

Q. Well, have you -- you haven't provided your work papers to us yet?

A. You have made a Data Request, and response to that particular Data Request is in there.

Q. Why don't you explain to me what the standard deviation was in your analysis and how many statistical points went into your analysis?

A. I believe there were -- I don't have that analysis in front of me, but I believe there were 5 years in the analysis, and it was a calculation of the standard deviation of return on MGE over the 5-year period and a similar calculation for the proxy group in the 5-year period.

Q. And when you say return for MGE, MGE doesn't have its own stock, does it?

A. It isn't a return on stock in this particular case. It's a return on rate base.

Q. So this is a return on rate base that you're talking about --

A. That's correct.

Q. -- with your standard deviation?

A. That's correct.

Q. And are you comparing that to return on rate base for other companies?

A. That's correct.

Q. And what did that show? What were the results?

A. Showed that there was greater variability in the return on rate base for MGE than for the comparable companies.

Q. And what were the five -- was it all your comparable companies that you used?

A. Yes, it was.

Q. And tell me about the coefficient of variations.

A. The coefficient of variations is simply the

standard deviation divided by the average.
Q. And what was the result of that?
A. Same result. The result doesn't change. It's a more convenient number to use because the coefficient of variation is in the units that are being measured, in this case percentage points, and coefficient of variation turns it into a percentage statement.
Q. Do you believe that your study is a particularly valid study?
A. I think it's acceptable.
Q. What makes it acceptable in your mind?
A. I think it indicates that there is greater variation, and variation is synonymous with risk in the eyes of the shareholder.
Q. If MGE had an individual shareholder or multiple shareholders, would they see variation?
A. They would see variation in earnings and that variation would be interpreted by them as risk as compared to the proxy group. The proxy group in this particular case is the same as the sector.
Q. Does MGE have its own stock?
A. No.
Q. Why wouldn't you try to adjust --
A. Adjust?
Q. Excuse me -- for the risks that we're

talking about when selecting your proxy companies, as opposed to after selecting you proxy companies?

A. It's impossible to do.

Q. It's impossible to do, in your mind?

A. I believe it is. I think that I share that view with most every serious analyst in the field. Some sort of risk adjustment is essential after a proxy company analysis.

Q. How did you come to your decision to add 10 basis points? Why is 10 appropriate?

A. There is no particular magic in the 10. I would have recommended the upper limit of the range regardless, simply because we're setting what I perceive to be a ceiling on earnings here, as opposed to an earnings level about which earnings will fluctuate in the future. So the totality of the risk adjustment is only 10 basis points.

Q. In the last five years that you've provided cost of capital testimony, have you ever recommended anything but the upper end of your range?

A. I can't remember whether or not I have, but it is my inclination to always recommend the upper limit simply because the rate decision becomes the ceiling on rates. If we were going to be establishing here a point about which future earnings would fluctuate, then we

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wouldn't be talking about the upper limit of the range.

What we're actually doing is setting the ceiling on rates. Very few companies, and this company in particular, have not been able to earn what's authorized. Consequently, the very first day that the rates go into effect is probably the day of maximum earnings, and it trends down from there. So to have any opportunity to earn within the range, you have to start at the stop of the range.

Q. The last case that you talked about that you filed in, was it West Texas Gas case, did you recommend the upper end of that range?

A. I don't remember the details of that particular case. I honestly can't remember.

Q. You just did it a month ago, but you've forgotten?

A. That's right. I didn't spend very much time on it. It was an abbreviated case, very preliminary. It's something that's going to have to be redone shortly.

Q. Did you file testimony in that case?

A. I filed a report to the cities.

Q. And so it's just at the city level there? It hasn't gone to the Texas Railroad Commission?

A. It will go to the -- it's assumed it will go to the Railroad Commission very shortly.

Q. Do you know who's representing the cities in Texas?
A. No.
Q. You don't know the attorneys on the other side?
A. No.
Q. Who's representing West Texas?
A. Sterling Smith is the name that I know.
Q. And he's out of where?
A. Austin, I believe.
Q. And what was your recommendation for West Texas Gas?
A. I don't remember the number.
Q. Do you have a copy of the report if I ask you for it in a DR?
A. Yes. Uh-huh.
Q. Have the cities made the determination about that particular rate increase?
A. Not that I'm aware of. I'm sure that they would have contacted me shortly after the decision was made.
Q. Have the hearings been held or are there going to be held hearings?
A. In my recollection, I've only been involved in hearings at the city level in Texas once or twice, and

they're more on the order of negotiations than hearings, then from there to the Railroad Commission, and for some reason they're anticipating in this particular case that they will go to the Railroad Commission simply because so many cities are involved.

Q. What factors level -- well, let me ask you this: How much of a bump on return on equity are you recommending fore management efficiency?

A. I am recommending a quarter of a percent increase in the rate of return.

Q. And how many basis points would that be?

A. 25.

Q. So you're recommending then, if I understand that right, 12.25 percent?

A. No. It's on rate of return.

Q. Well, I thought you just told me it was on the equity. It's on rate of return?

A. Yes.

Q. So if you said equity, you misspoke?

A. That's correct.

Q. Okay. And what items did you review to determine that our good friends at MGE are -- deserve a management efficiency bump?

A. I don't know that these are items that I reviewed. I looked at an old Empire case from here and I looked at an old case from, I think it was Kansas City Power & Light. My recollection of both of those were around .4, and there was also my recollection recommendation that the adjustment in the MGE case here was about .25 downward.

Q. Okay. And my question is, what management efficiencies did you see in Missouri Gas Energy that led you to believe that they were deserving of a management efficiency bump?

A. I believe that Missouri Gas Energy has spent a substantial amount of money remedying the problems which the Commission perceived in its case two or three times ago.

Q. And what problems were those?

A. I think the biggest problem was the fact that the company was not adequately responsive timewise to the complaints of its customers.

Q. And is it your understanding that Missouri Gas Energy has met all the commitments that it made to the Missouri Public Service Commission in that respect?

A. Either that it has met all the commitments or it's made satisfactory progress so that it is no longer a problem.

Q. And how did you come to that conclusion?

A. I was advised by Mr. Noack.

Q. And what did Mr. Noack tell you?

A. That they had made progress and that there was no problem with compliance with the Commission.

Q. And what areas did Mr. Noack tell you that the company was required to comply with?

A. We didn't go into that kind of detail.

Q. You didn't think that was important to know?

A. My view of it was that the Commission had previously reduced the return allowance for management deficiencies, and now that those problems have been fixed, it was appropriate to increase the return.

Q. Do you think the Commission -- well, let me -- assume that a company is providing below-standard customer service and a commission determines to reduce their return hypothetically, or we can say actually with MGE. You read those orders. That's what they indicated, is it not?

A. Yes.

Q. Let's assume that the company has made strides and it's gotten back to average. Okay? Is it your view that the company should receive a management efficiency bump if it's providing average customer service?

A. Under normal circumstances, I wouldn't

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think that a company should receive a bonus to provide average service, but I think if they've been penalized and they completely overcome the problem, that it might be appropriate to provide an offset to the original reduction.

Q. So they should be rewarded, let's say, hypothetically for being average?

A. Well, for having been penalized and correcting the problem.

Q. Okay. So they should get a reward for bringing their below average service up to average?

A. Or complying with the Commission orders in a timely fashion.

Q. So it's your view that any time a company complies with Commission orders in a timely fashion, they deserve a management efficiency up bump?

MR. SWEARENGEN: Objection, argumentative.

THE WITNESS: If they've been penalized previously for something and they remedy that problem, I think it's appropriate that the penalty structure be symmetrical and that they receive that penalty back. They might not have known the -- or the problem was at the point where it should have been penalized, they might not have believed that in your hypothetical example.

BY MR. MICHEEL:

Q. Is it your view that Missouri Gas Energy is providing outstanding management?

A. It's my view that Missouri Gas Energy is providing very economical management. The statistics I've seen show that Missouri Gas Energy has very low cost per MCF per customer.

Q. Other than the statistics set out in Mr. Noack's testimony, have you seen anything else? Have you undertaken any other studies or looks to see?

A. No, I haven't undertaken any study.

Q. So the entire basis of that is Mr. Noack's testimony and the study included in Mr. Noack's testimony?

A. That's correct.

Q. And you weren't aware -- you're not aware, are you, sitting there today of the commitments that Southern Union Company may have made to the Commission regarding customer service, are you?

A. I have read the Order. I'm not aware of any commitments other than what occurred in those orders, and I also read some follow-throughs by the Commissioners or Commission Staff.

Q. And what follow-throughs were those that you read?

A. They were simply reports by someone who had -- this was over a year ago that I read these, but it was just reports by someone who had apparently done some sort of audit work in connection with the original decision of the Commission.

Q. And why were you reading those reports over a year ago?

A. I read them in preparation for the last MGE case.

Q. Okay. So have you read any reports subsequent to that -- this MGE case?

A. Mr. Noack's report.

Q. And that's it?

A. That's correct.

Q. On page 43 of your direct testimony, you have a list of Thompson Financial expected growth rates over the next five years?

A. Yes, sir.

Q. And could you tell me how Thompson's compiles these growth rates? Do they take a survey of different analysts to arrive at these growth rates?

A. Yes, they do.

Q. How many analysts cover AGL resources?

A. I don't know precisely. It's listed in the documents that I listed previously.

Q. But it's more than one?

A. I think in all cases, it's two or better.

Q. Two or better in all cases?
A. I believe.
Q. And do you know how Thompson arrives -- for example, let's just take the AG&L resources average growth rate. Let's say that there are at least two analysts, they average those analyst's forecast?
A. That's my understanding.
Q. Do you have some work papers that would indicate to us how many analysts are in each of these --
A. Yes, I do.
Q. -- each of these companies?
A. I do.
Q. And are you going to provide those in response to our Data Request?
A. I will.
Q. And when are you going to provide those?
A. Probably first part of next week.
Q. Okay. Does this indicate that the average expected -- and what kind of growth rate are we talking about here, growth in what?
A. Talking about the compound growth rate for five years.
Q. And what average do these analysts say it's going to be?
A. 4.9 percent.

Q. Now, if you could turn to page 50 of your testimony. You used growth rates, did you not, of 6 and 7 percent?

A. That's correct.

Q. And those are considerably higher than the 4.9 percent of the analysts that are following the comparable companies that you utilized; is that correct?

A. They're higher than the analysts' forecasts, yes.

Q. And those analysts are the people who analyze those specific stocks; is that your understanding?

A. Yes, it is.

Q. Let me try to understand why you didn't use the 4.9 percent growth rates of those analysts.

A. Good question.

Q. It is. Help me understand why you didn't use that growth rate.

A. Because I had other growth in earnings forecasts which indicate higher rates, and I also had some historic growth which indicated higher rates.

Q. And what other ones did you have, sir?

A. ValueLine forecasted growth and the ValueLine historic growth.

Q. And what was the ValueLine forecasted growth rate?

A. 7.18 percent.
Q. And what was the historic growth rate?
A. It varies for earnings from 4.37 percent for the 10-year period to 7.18 percent for the 5-year period.
Q. And when you say earnings, is that what we're talking about here, earnings?
A. As I indicated in my testimony, the emphasis is on earnings, given the fact that the growth in dividends has been slowed artificially.
Q. So on page 43, are we talking about earnings also?
A. We are.
Q. Now, the ValueLine number for the forecast 7.18 percent, where do I find that in your testimony, sir?
A. You find it in the testimony --
Q. Or on your schedules. Is it on your schedules?
A. There is a schedule, Schedule 5, which does not tie to the testimony and which I'm at a loss to explain at the moment.
Q. Well, let's talk about Schedule 5, because I'm a little bit confused about that, too, Mr. Dunn. On Schedule 5, what does Schedule 5 indicate here, sir?
A. Schedule 5 is the earnings dividends and

book value forecasts of ValueLine for the proxy group.

Q. Okay. And what is the average earnings forecast on JCD-5?

A. 6.93 percent.

Q. After what's the dividends forecast?

A. 1.85 percent.

Q. And what's the BK value?

A. 6.0 percent.

Q. And what does BK value mean?

A. Book value.

Q. The book value. Okay. Now, are any of those the 7.18 that you indicated?

A. No.

Q. And where does the 7.18 appear in your testimony, sir, the body of your testimony?

A. I can't find it right this moment. I must have misspoke when I said the 7.18.

Q. The 5 year, there's a 5-year growth rate that says 7.18 in earnings per share?

A. Okay. I have that, yes.

Q. Is that where it is?

A. Yes.

Q. And so was that supposed to be derived from JCD-5?

A. No. That was derived from JCD-4.

Q. Okay. Is that the forecasted growth rate? I'm just trying to understand. I'm confused about some of your numbers.
A. The 7.18 is historic growth rate for a 5-year period.
Q. And I get that from Schedule JCD-4?
A. That's correct.
Q. The earnings column?
A. That's correct.
Q. E. And the forecasted growth rate, you also said, was 7.18. Where did you get that from?
A. I think when I said that, I misspoke. The earnings forecast from ValueLine is 6.93.
Q. Now --
A. It shows on page 5 off JCD-5.
Q. JCD-5, column B?
A. Correct.
Q. Okay. Now, on those ValueLine, is that just one ValueLine individual who makes those growth rate projections?
A. Most likely it -- I shouldn't say most likely. It may have been just one.
Q. And what about JCD-5, is that most likely just one individual?
A. That could have been more than one

individual.

Q. So is it safe to say that you relied more heavily on the ValueLine projected growth rates in coming to your conclusions than you did in the Thompson's 4.9 percent growth in earnings?

A. I would say it's safe to say that I relied more heavily on the ValueLine forecast and the 5-year historic combined than the Thompson, yes.

Q. Because your growth rate projections are closer to those than they are to the Thompson?

A. That's correct.

Q. At page 6 of your direct testimony you indicate that you did a statistical analysis of the risk of MGE, as compared to natural gas distribution companies?

A. That's correct.

Q. And is that the standard deviation that we talked about the study that you're going to provide us?

A. It is.

Q. Is there some reason you didn't attach that study to your direct testimony?

A. I summarized it. The schedule itself's not particularly informative.

Q. At page 14 of your testimony, you indicate that, I guess, bottom of page 13, top of page 14, regardless of the direct supplier of capital, however, every dollar of investment capital used to support MGE's rate base is ultimately supplied by individuals. Many of those individuals live in Missouri.

A. Yes, sir.

Q. How many Missouri shareholders does Missouri -- or does Southern Union Company have?

A. I don't know how many shareholders. I know that Southern Union has an employee stock plan, a 401K plan, both of which creates Missouri shareholders. It also --

Q. When you said --

A. It also has Missouri shareholders, and it also has, like most other companies, fairly substantial institutional ownership, part of which logically must be related to Missouri, since Missouri has pension plans like every other state in the union.

Q. Let's --

A. Finally --

Q. Okay.

A. -- in their last underwriting, Southern Union retained or included in the underwriting group Stifel Nicolaus and AG Edwards, which are Missouri-oriented companies, in an effort to create a Missouri presence in its shareholder group.

Q. How much of the stock is controlled, the

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common stock is controlled by the current president and his family, if you know?

A. I don't know.

Q. If I told that you the Lindamens or trusts controlled by the Lindamens controlled almost 20 percent of common stock, would you be shocked?

A. No.

Q. And how much of the common stock, if you know, of the Southern Union Company is controlled by institutional investors?

A. I would imagine the vast majority.

Q. And when you say vast majority, 80 percent, 70 percent?

A. Well, the remaining 80 percent, assuming that your assertion with respect to the Lindamens is correct, the remaining 80 percent, probably 70 to 80 percent of it.

Q. So that means there's roughly, what, 10 percent of Southern Union's common stock that individuals such as yourself own?

A. I think you're cutting through something here. If you happen to be in the pension plan and the pension plan owns Southern Union Company, you own a part of Southern Union Company. The stock's not -- just because it's owned by a pension plan doesn't mean that it's not owned by individuals. Pension plan's major liabilities are to individuals. If a mutual fund owns Southern Union stock, the owners of the mutual fund, the investors in the mutual fund independently own Southern Union stock.

Q. Indirectly?

A. That's correct.

Q. So let's say that my pension plan owns some Southern Union stock. Do you think I can call up and say, sell the Southern Union, and they're going to say okay?

A. Is that a question?

Q. Yes.

A. I don't think that you have probably any control, unless you have a discretionary pension plan, over the exact holdings in the plan. I think you rely on the trustees of your pension plan to make those decisions on your behalf, and if the trustees don't do a good job, you change trustees or --

Q. So --

A. -- or maybe change pension plans.

Q. Individuals have no control, direct control over what stocks are in their pension plan; isn't that correct?

A. They have control, not absolutely direct.

Q. I said direct control.

A. It depends on whether you believe the election of directors or trustees is direct control. The decisions are made one step away from the individual.
Q. Now, your comparable group company appears to have a debt ratio of 52.8 percent on JCD-2; is that correct?
A. That's correct.
Q. And you're recommending for Southern Union Company debt about 46.1 percent on JCD-11?
A. That's correct.
Q. With respect to your comparable companies, you don't set out how much preferred stock they have. Are you aware of how much preferred stock they have?
A. It should be approximately the difference between the 46 and the 52 and 100 percent.
Q. Okay. And what is that? Do you have a calculator? Can you do the quick arithmetic?
A. I don't -- it's very small number.
Q. So it's smaller than the amount of preferred stock that Southern Union Company has?
A. That's true.
Q. You talk on page 4, lines 11 through 15, about the financial risk that MGE faces due to the leverage in its capital structure, correct?
A. On lines 11 to 15?

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Q. I'm sorry. It would be lines 16 through 18.

A. Are you talking about line 19?

Q. Yeah. Yes. 16 through 19, what are the financial risks which were faced by MGE but not faced by the industry group which you analyzed?

Answer: Financial risk is specifically the risk created by the use of leverage in the capital structure. MGE has a lower equity ratio at 43.3 percent common equity than the group I used.

Do you see that?

A. I see that, and that's correct. I speak of financial risk of MGE beginning on line 19.

Q. And that financial risk is because the capital structure of MGE is more leveraged; is that --

A. That's correct.

Q. And why do you think that Southern Union Company capital structure's more leveraged?

A. At the moment it has to do with the acquisition of Panhandle.

Q. And that was a decision that the company management made?

A. That's true.

Q. And that was part of the company's aggressive growth strategy?

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A. I don't know if that's a proper characterization. If you want to call it that, that's fine.

Q. Do you read the annual reports when you get them?

A. I do.

Q. Have you ever seen a Southern Union annual report that indicates they have an aggressive growth strategy?

A. I have.

Q. And do you know whether or not the Panhandle purchase was part of that aggressive growth strategy?

A. I said if you want to characterize it, that's fine.

Q. Is that how they've characterized it?

A. I hesitate to characterize it that way myself.

Q. But it's a result of their growth strategy?

A. It's a result, it seems to me, of the sale of one asset and the purchase of another, which is, in my view, a better asset than the one that was sold.

Q. And that's going to benefit shareholders such as yourself?

A. I would hope.

Q. Do you know if ratepayers got any say in whether or not Southern Union Company should purchase Panhandle Eastern?

A. It's my understanding they had a very substantial say in it.

Q. It's your understanding that Southern Union Company came to the Public Service Commission and the Office of the Public Counsel and asked them whether or not they should purchase Panhandle Eastern?

A. It's my understanding that they obtained Commission approval for the transaction.

Q. After they had the deal, isn't that correct?

A. I don't think that that's the issue.

Q. Well, that wasn't my question, though, Mr. Dunn. I mean, did they ask our permission before they purchased?

A. The answer is yes.

Q. They did?

A. The purchase, to my knowledge, was not completed.

Q. Before they closed?

A. That's right. The purchase was not complete. Therefore, they went to you and got approval to complete the purchase. They didn't lay out before the

Commission their plans way in advance. The reality of the situation is that they completed the purchase after approval was obtained from the Commission.

Q. Do you think the Commission had the heart to tell them, no, they cannot purchase Panhandle?

A. I don't know whether they did or not. I'm not an attorney. Something not unlike that happened in connection to St. Joe.

Q. Really? Explain that to me.

A. As I understand it, the St. Joe transaction would have been considered null and void by the courts because of the Commission Order.

Q. How did you get that understanding?

A. That was strictly as a consequence of something that was in the newspaper in Kansas City.

Q. You got that from the newspaper?

A. That's right.

Q. On page 7 of your testimony, I'm looking at lines 1 and 2, there you say, current short-term borrowers of the company are scheduled for permanent financing?

A. I see that.

Q. And is that part of your rationale for not including short-term debt in the capital structure.

A. I think unless short-term debt's a permanent part of the capital structure, it probably should never be included in the capital structure. In this particular case, the company has scheduled the retirement of its short-term debt.

Q. Okay. Then you say on page 6 at line 17, the cost of capital is the cost of permanent capital invested and related to the rate base, and short-term capital is primarily used to finance the seasonal cash flow needs of the company's business, do you not?

A. I think it's a little more comprehensive statement than that. It says short-term capital is primarily used to finance the seasonal cash flow needs of the company's business, including natural gas purchases and other energy costs, outstanding customer accounts, certain tax payments, maintenance requirements and other working capital requirements.

Q. And I'm trying to understand if the short-term uses cannot be financed with long-term debt or equity. At one point you indicate that they're going to be crossed over into, scheduled for permanent financing; at one point you indicate they could fluctuate. Could you reconcile that for me?

A. You'll have to break that question down for me. I don't understand what you're asking.

Q. You say short-term capital is primarily used to finance the seasonal cash flow needs of the company's business. Right?

A. On and on and on, there were several things.

Q. Right. And then you went on to say, current short-term borrowers are scheduled for permanent financing?

A. Right.

Q. I mean, my question is, is the company continually going to have short-term financing?

A. It will -- in anticipation of long-term financing, short-term financing is used to accumulate -- or short-term financing accumulates and is used by the company to do the financing that we're talking about here, and then when it builds up to a certain point where it's reasonable to finance with longer-term securities, that takes place.

Q. Okay. On page 9 of your testimony at about line 16 through 19, you indicate that we're transitioning -- we're transitioning out -- or excuse me -- at page 8 and 9, that we are currently transitioning from recession to expansion?

A. Yes.

Q. It was my understanding from reading the Wall Street Journal and listening to our president speak that the recession ended, by definition, in the middle of

2002?

A. I believe by definition that's true. We're still in the process of transitioning, and I believe the Federal Reserve, as recently as six months ago, said that the risks of inflation and deflation were about equal.

Q. And have they made any other statements with respect to the risks of deflation?

A. I think they have dropped the risk of deflation from their pronouncements, and that's happened within the past six months.

Q. So that's after you filed your testimony?

A. That's correct.

Q. On page 19 of your testimony, you indicate that there's been a large number of unsuccessful diversification into nonregulated activities and a number of energy market scandals and the like?

A. Yes.

Q. Do you know if Southern Union Company was involved in any of those?

A. I believe that's the next question on the page, and the answer is no.

Q. And so would you agree with me or is it your belief that the market would be aware of that?

A. If they were involved in a scandal, yes.

Q. Or if they weren't involved in a scandal, if these -- if the folks at Southern Union Company, which it appears they have, have run a company that's been untainted by any of those scandals or failed diversification, would the market be aware of that?

A. It should be.

Q. And would they take that into account in valuing Southern Union Company's common equity?

A. You would presume so.

Q. And would they take that into account in valuing Southern Union's debt?

A. You would presume so again, but less so.

Q. You're an investor in Southern Union Company, are you not?

A. I am.

Q. You were aware that they weren't involved in any of the market scandals or unsuccessful diversification, weren't you?

A. I have not seen them mentioned in connection with any of those.

Q. On page 24 of your direct testimony, you indicate that MGE's activities have been insulated from Panhandle so there could be no impact on MGE's cost of capital in any event. And my question to you is, didn't Southern Union issue a bunch of equity and a bunch of debt related to the acquisition of Panhandle Eastern?

A. There was equity issued in connection with the acquisition.

Q. And doesn't that have some impact, that equity issuance on Missouri Gas Energy?

A. I don't believe it has an impact in the sense that it changes things. There is a cycle where the equity ratio is drawn down as a consequence of acquisition and now is being reestablished.

Q. Let me ask you this: In your opinion is the company with a lower equity a ratio more or less?

A. The equity investment is more risk.

Q. And if the equity investment is more risky, what does that mean with respect to the return on that equity investment?

A. It should be higher.

Q. And so by issuing the more shares, the more equity to purchase Panhandle Eastern, didn't Southern Union Company increase its risks for equity?

A. I think it's the other way around.

Q. Or Southern Union Company increase its risk?

A. I think it's still the other way around from what you said. You said, didn't the issue of equity increase the risk. Is that what you meant to say?

Q. I think so.

A. The issuance of equity reduces the risk of equity, reduces the risk of leverage. We're increasing equity balance when you add new equity to that equity balance, which decreases the financial risk of the company.

Q. And the company also issued debt to purchase Panhandle, did it not?

A. I believe it issued a small amount of debt, yes. I think that debt was packaged in with the hybrid security.

Q. Now, we've talked about in your testimony, if I understand it right, you have indicated that it's no longer growth in dividend that investors are looking at, but it's growth in earnings that investors are looking at. Is that a proper understanding of your testimony?

A. I think so.

Q. And where did you get the information or what sources did you use to come to your conclusion that investors now are generally relying on the growth of earnings?

A. I think that the ValueLine investment service in virtually every issue recently has mentioned the decline in the growth rate and dividends per share. I think that there's been a couple of studies done which show a decline in the growth in dividends for electric utilities, and I think there have been numerous comments which have been -- I'm trying to think of the specific citations and they escape me at the moment -- suggesting that dividend growth has changed significantly from historic levels.

Q. And what -- I'm sorry.

A. Finally, I think you can just look at the -- if you had a copy of your witness's testimony, look at the substantial discrepancy between the historic growth in dividends and the historic growth in earnings, and you'll see that dividends are not growing as rapidly. One of the assumptions of the DCF model is that they grow in tandem. I'm not sure whether that's enumerated as an assumption in your witness's testimony, but it is enumerated as an assumption in the Staff testimony. And clearly there. They're not growing in tandem anymore.

Earnings are growing faster and dividends are growing more slowly, which indicates there has been some change in policy. Even if you don't know what it is, you know that there's been a change.

Q. And what studies are you referring to, sir?

A. I told you I can't think of citations offhand, but you made this Data Request and I've accumulated those in the data response.

Q. Okay. And you've got the comments in

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there, too?
A. I believe so. You mean the comments from ValueLine, the study on the electric utility dividends, yes.
Q. Yes, sir. In your direct testimony, Mr. Dunn, you indicate that MGE's depreciation rates are well below the average rates of companies included in your comparison analysis?
A. Yes.
Q. And how did you make that determination, sir?
A. I reviewed a schedule that was prepared by someone from Black & Veatch that compared depreciation rates MGE versus the company.
Q. And do you have a copy of that schedule?
A. That's been included in the response to the Data Request. You asked for that in the Data Request, and that's in the response.
Q. And do you know how that individual from Black & Veatch determined what the depreciation rates were for all those companies?
A. I believe he contacted them.
Q. And would that individual from Black & Veatch be Mr. Sullivan?
A. Yes, sir.

Q. And do you know if Mr. Sullivan is going to be a witness in this proceeding?

A. I believe he is.

Q. Do you think he's filed testimony in this proceeding?

A. I believe he has.

MR. MICHEEL: That's all I have. Thank you very much for your time, Mr. Dunn. I appreciate it.

MR. BERLIN: Nothing else.

MR. SWEARENGEN: I've got just a couple.

CROSS-EXAMINATION BY MR. SWEARENGEN:

Q. Mr. Dunn, just to clarify something, earlier you were asked about the risks that were being faced by, I think, the Missouri Gas Energy?

A. Yes.

Q. And my notes reflect that you answered that question or began to answer that question with a discussion of what I would call regulatory risk. Do you recall that?

A. I remember the notion of regulatory risk has come up a couple of times during the cross-examination today.

Q. And then later I think Mr. Micheel had directed you, and if you would turn to, I think it's around page 4 of your direct testimony, there on line 3 there's a question, are there any risks faced by MGE, and you go ahead on the rest of that page and over on page 5 and discuss the risks being faced by Missouri Gas Energy, is that true?

A. Yes.

Q. The first time you were asked that question and you focused on regulatory risk, you were not in any way modifying your answer that's in your testimony on pages 4 and 5, were you?

A. No, sir.

Q. That continues to be your testimony?

A. Yes, it does.

Q. And then I think this morning you were also asked a question about the Public Counsel's -- Mr. Allen's capital structure that he is proposing --

A. Yes, sir.

Q. -- for the company, and with reference to schedule TA-1, which is a part of his testimony, which I will put back in front of you. And there was some question about your issues or your problems, your concerns with respect to that proposed capital structure, and I think you indicated you hadn't really studied it fully, but you did mention one or two concerns that you had.

Were you reserving the right to offer additional comments in rebuttal testimony with respect to that or have you covered everything that you felt needed to be covered at this time with respect to that capital structure?

A. Oh, no. I expected to be able -- I had no idea that what we were doing today precluded further discussion about any matter in rebuttal testimony, and I tried where possible to preface my remarks with the comment that I was not attempting to be exhaustive; further study was going to be required.

Q. And finally, I think it was the Commission's counsel this morning that asked you some questions about whether the matters you were testifying to or your -- I think he used the word personal opinions, and then I heard him also use the word professional opinions, and then later on expert opinions.

And my question is, your testimony today that you've offered on behalf of Missouri Gas Energy is being offered in your capacity as an expert witness in this proceeding, is that not true?

A. Yes, sir, it is.

MR. SWEARENGEN: That's all I have. Thanks.

(PRESENTMENT WAIVED; SIGNATURE REQUESTED.)

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CERTIFICATE OF REPORTER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, KELLENE K. FEDDERSEN, RPR, CSR, CCR, and Notary Public within and for the State of Missouri, do hereby certify that the witness whose testimony appears in the foregoing deposition was duly sworn by me; that the testimony of said witness was taken by me to the best of my ability and thereafter reduced to typewriting under my direction; that I am neither counsel for, related to, nor employed by any of the parties to the action to which this deposition was taken, and further that I am not a relative or employee of any attorney or counsel employed by the parties thereto, nor financially or otherwise interested in the outcome of the action.

____

KELLENE K. FEDDERSEN, RPR, CCR
Notary Public, State of Missouri
(Commissioned in Cole County)
My commission expires 3/28/05.

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SIGNATURE PAGE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, John Dunn, do hereby certify:

That I have read the foregoing deposition;

That I have made such changes in form and/or substance to the deposition as might be necessary to render the same true and correct;

That having made such changes thereon, I hereby subscribe my name to the deposition.

I declare under penalty of perjury that the foregoing is true and correct.

Executed the ____ day of__________, 2004, at
____.

____
JOHN DUNN

Notary Public:
____
My commission expires:
____

KF/John Dunn
Re: MGE/Tariffs - GR-2004-0209

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ERRATA SHEET

Witness: John Dunn
In Re: MGE - GR-2004-0209

Upon reading the deposition and before subscribing thereto, the deponent indicated the following changes should be made:

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Reporter: Kellene K. Feddersen, RPR, CSR, CCR

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May 7, 2004

James Swearengen
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312 East Capitol Avenue
P.O. Box 456
Jefferson City, MO 65102-0456

In Re: MGE - GR-2004-0209

Dear Mr. Swearengen:

Please find enclosed your copy of the deposition of John Dunn taken on May 6, 2004, in the above-referenced case. Also enclosed is the original signature page and errata sheet.
Please have the witness read your copy of the transcript, indicate any changes and/or corrections desired on the errata sheet and sign the signature page before a notary public.

Please return the errata sheet and notarized signature page to Mr. Berlin for filing prior to trial date.
Thank you for your attention to this matter.
Sincerely,

Kellene K. Feddersen, RPR, CSR, CCR
Enclosure
cc: Robert Berlin
Douglas Micheel

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