STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

IN THE MATTER OF MISSOURI GAS ENERGY'S TARIFFS TO IMPLEMENT A GENERAL RATE INCREASE FOR NATURAL GAS SERVICE

Case No. GR-2004-0209

DEPOSITION OF JOHN DUNN

May 6, 2004

STATE OF MISSOURI
PUBLIC SERVICE

In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate Increase for Natural Gas Serviced.) Case No. GR-2004-0209

DEPOSITION OF JOHN DUNN,

a witness, produced, sworn and examined on the 6th day of May, 2004, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law offices of the Missouri Public Service Commission, 200 Madison Street, Room 810, in the City of Jefferson, County of Cole, State of Missouri, before

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and Notary Public within and for the State of Missouri, commissioned in Cole County, Missouri, in the above-entitled cause, on the part of the Staff of the Missouri Public Service Commission, pursuant to Notice.

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Rick Marshall
Matt Barnes
Travis Allen
David Murray
John Kiebel
Michael Noack

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SIGNATURE INSTRUCTIONS:

Presentment waived; signature requested.

EXHIBIT INSTRUCTIONS:

Attached to original.

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DUNN EXHIBITS INDEX

JOHN DUNN, being sworn, testified as follows:

DIRECT EXAMINATION BY MR. BERLIN:

Q. Good morning, Mr. Dunn. I'm Bob Berlin. I am an attorney on staff of the general counsel of the Missouri Public Service Commission, and this morning I will be asking you a series of questions.

Would you please state your full name for the record.

A. It's John C. Dunn, D-u-n-n.

Q. How are you employed?

A. I am a consultant, and my employment is technically with the firm of John C. Dunn & Company.

Q. Have you ever been deposed before?

A. Yes, sir, I have.

Q. So you know that you are obligated to answer my questions truthfully?

A. Yes, sir.

Q. And if you don't understand my questions, will you tell me?

A. Yes, sir.

Q. Have you provided written testimony in this case?

A. Yes, sir, I have.

Q. On what issue have you provided testimony?

A. Rate of return and its components, capital structure, cost of debt, cost of preferred and cost of equity.

Q. I have here a copy of your direct testimony in this case. This is a complete copy with schedules. I'd like to mark this Dunn Exhibit No. 1.

(DUNN EXHIBIT NO. 1 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. BERLIN:

Q. Would you agree that the copy we've marked as Exhibit 1 is a copy of your direct testimony in this case?

A. I would certainly accept that, sir. I would note, however, at least in the bound copy that I've been supplied by the company, Appendix A is at the very end of the schedules, and in this particular case, Appendix A is prior to the schedules.

Q. Do you have any other corrections to make to your testimony at this time?

A. Yes, I do have a couple of corrections that I would like to make. On page 45, line 10 -- page 45, line 10, it currently reads at the end of the line Schedule JCD-5, and should read JCD-7. Should I make the change on the exhibit?

Q. That's fine with me, yes. And please initial where you made the change.

A. (Witness complied.)

And then in Appendix A, page 3, line 17, after the word "yes" and before the word "the," insert the words "I have been a member of."

On page 4, line 9 --

MR. SWEARENGEN: That's of Appendix A?

THE WITNESS: Again in Appendix A. After the word "a", the fourth word in line 9, insert the word "past." Those are the only changes I'm aware of at this time.

BY MR. BERLIN:

Q. And you initialled each one?

A. Yes, sir, I did.

Q. Thank you. Mr. Dunn, have you provided testimony on behalf of MGE in other cases?

A. Yes, sir, I have.

Q. Which cases?

A. In their last rate proceeding. I don't know the number, but it was their last rate proceeding before the Missouri Public Service Commission.

Q. Have you provided testimony on the issue of capital structure for other client companies?

A. I have.

Q. Which companies?

A. A great many companies. I'm not sure that

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I can be absolutely exhaustive.

One of my first capital structure cases was Kentucky, West Virginia Power Company before the Federal Power Commission many, many years ago, which became the precedent-setting case for their establishment of a policy. It's been subsequently modified a couple times. I have provided testimony for Aquila in their various jurisdictions, and I most recently provided some testimony for a company called West Texas Gas. That's within the past month or so.

And a number of years ago, I provided some substantial testimony for a company called Lavoca (ph. sp.), which was a gas transmission distribution company in Texas. It was a complex organization that had both distribution properties and transmission properties, and they had intra and interstate properties, and I provided testimony for their distribution properties in various Texas proceedings and for their interstate properties at FERC and at FPC.

I'm confident that I provided capital structure testimony for other cases. The others just don't come to mind at the moment.

Q. Mr. Dunn, did you attend the deposition of Staff Witness David Murray at the law office of Brydon Swearengen on Tuesday?

A. I did.
Q. Did you talk with anyone before this deposition today?
A. Yes.
Q. Who did you talk with?
A. I've spoken to Mr. Swearengen. I've spoken to Mr. Hack. I've spoken to Mr. Herschmann. I've spoken to Ms. Dodds. I've spoken to Dennis Morgan. I've spoken to Mr. Quain. Of course, a separate gentleman that I don't know that you know, his name is Mr. Fay.
Q. And who is Mr. Fay?
A. Mr. Fay is an attorney in Mr. Herschmann's office.
Q. With regard to MGE's current case before the Commission and for this deposition today, what materials did you review?
A. The majority of the materials that I reviewed were independent of Missouri Gas Energy. I reviewed documents from ValueLine Investment Service. I reviewed documents that were Internet sourced with respect to stock prices and earnings growth. I also reviewed documents in connection with the acquisition of Panhandle Pipeline by Southern Union Company that I also obtained from the Internet. And then I reviewed a number of documents relating to general economic conditions and to

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natural gas market conditions.

Q. Did you perform a study supporting your testimony in this case?

A. I did.

Q. For your study, what documents did you rely on?

A. The majority of the study relies on the documents which I just enumerated for you, but to a greater extent on the information in ValueLine, the information that I obtained in connection with financial analyst forecasted earnings and the information which I obtained in connection with dividend yields.

Q. In preparing your testimony, you have draft copies?

A. I don't believe I do.

Q. So you prepared the testimony without a draft or a need for a draft?

A. Oh, I prepare a draft, but I don't know that I've saved them all.

Q. What have you read about the Missouri Public Service Commission on the issues of return on equity, rate of return, long-term debt and capital structure?

A. Recently?

Q. Or at any time.

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A. Well, many years ago a number of organizations, agencies, investment bankers, ValueLine, as a matter of fact, ranked public service commissions in terms of their own individual ranking systems, which generally went from excellent to below average. Historically I've reviewed those kind of documents. Most recently I've not reviewed any document that I can remember about evaluating the Missouri Public Service Commission.

Q. Do you consider yourself an expert on the subject of return on equity, rate of return, long-term debt and capital structure?

A. I do.

Q. Do you have any personal opinions about MGE's capital structure?

A. I do.

Q. What are your personal opinions?

A. Well, I believe that MGE has a capital structure that's very close to a natural gas distribution capital structure, and that the capital structure is approximated in my direct testimony.

Q. Do you have any other personal opinions regarding MGE's capital structure?

A. I'm not sure what you mean by that question.

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Q. Have you formulated any opinion personally or professionally about MGE's capital structure?
A. There are other capital structures proposed in these proceedings in connection with MGE's capital structure. I have opinions about those.
Q. So you don't have any personal or professional opinions about MGE's capital structure?
A. I just gave you my opinion about MGE's capital structure. I have supplied in my testimony a capital structure which approximates the MGE capital structure at June 30th, with some pro forma adjustments. The capital structure today is somewhat different than that, and the capital structure at the true-up date will, again, be somewhat different from that, and it is my understanding that there will be some controversy over the capital structure in the coming months.
Q. Have you had an opportunity to review the testimony of Staff Witness David Murray?
A. I have.
Q. In your expert opinion, do you see any problems in Mr. Murray's study on capital structure?
A. Yes.
Q. What are they?
A. I guess the first problem is the easiest problem. He makes a calculation toward the end of his

testimony where he derives an MGE stand-alone capital structure. I think that's completely incorrect. And then for the main thrust of his testimony, which I believe he bounces back to the consolidated capital structure after having made this incorrect calculation, and concluding from that incorrect calculation that the capital structure was inappropriate for a distribution company, he bounces to the consolidated capital structure, even though MGE is a system -- or as a part of the system meets his criteria for using a stand-alone capital structure, at least what I understood.

And subsequently he concludes that the consolidated capital structure of MGE's parent company, Southern Union, is the appropriate capital structure. I believe that's absolutely incorrect.

Q. Any other problems that you see in Mr. Murray's study?

A. The study in its entirety or capital structure?

Q. In his study in the entirety.

A. I think, first of all, that his return on equity recommendation is extraordinarily low. On its face, I think it is so low as not only to cause problems for MGE, but to cause problems for the Missouri Public Service Commission. I think it's the kind of number that financial analysts, investment bankers, knowledgeable observers of stocks and utilities would say, this number is completely out of line.

In addition to that, I just mentioned the fact that I think he used absolutely, positively the wrong capital structure. There's no question about that. I think that, given the fact that he used the wrong capital structure, he was obligated, if he was to complete his analysis properly, to make an adjustment for the extreme leverage that he had in the capital structure which he chose. He chose a capital structure that had, I believe, 20-some percent equity in it, and he made no adjustment for leverage.

Now that, I think freshman accounting textbooks even suggest to you that you make such an adjustment, and that I don't think there is any dispute by anybody that all of the literature of finance that increased leverage increases the risk to the shareholder and consequently demands and deserves an upward adjustment in return on equity to compensate for that increased risk.

And then there -- there are some separate problems. I think that the data that Mr. Murray used is older. I'm sympathetic to the problem of -- that there's constantly evolving testimony and proceedings are moving along and there's deadlines, but he used 2002 data for his

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study and filed his direct testimony in 2004.

I've been given to understand by others who have reviewed that data that, in fact, there are significant changes, at least with respect to some of the companies, if 2003 data is substituted for 2002 data. The result of the studies would be substantially different. And although it would have been a time crunch, 2003 data was substantially available to Mr. Murray when he prepared his testimony, which was filed in April.

I think that because of the fact that -- and this is a different subject. Because of the fact that Mr. Murray did not make an adjustment for the high amount of financial leverage in the capital structure that he proposed, he has, in effect, turned the Panhandle stipulation that the company has with the Staff, which was subsequently approved by the Commission, basically on its head.

What's happened is that I believe that he has made a proposal which creates a windfall for customers, and I guess there's two ways of viewing this; you can view it as a mistake or you can view it as an effort to create a windfall for customers which flows from the acquisition of Panhandle by Southern Union, which has nothing to do with MGE. I think that's a serious problem.

The capital structure is in two parts, as I

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explained. The first part is the actual capital structure used, and then the second part is just the erroneous calculation he made, which I assume caused him to use the capital structure he did.

Then he did other work. He did a discounted cash flow analysis, but then he also did a risk premium analysis, and he did a Cap-M analysis. The difference in results between his base analysis, which was a discounted cash flow analysis, and one that he had placed most of his emphasis on, was significantly 20 to 40 percent different. He had before him a discounted cash flow result, and separately two other results; one from his Cap-M analysis and one from his risk premium analysis. They did not match up.

And I believe the appropriate methodology at that point would have been to either examine why, determine why, establish why such a disparity and discrepancy in results occurred, or to take a second look at everything. He simply ignored the other two analyses and adopted the discounted cash flow result.

There's a separate and sort of related problem. There was a great deal of time spent in the front of his testimony discussing the economic environment. And he moves through the testimony, does his DCF analysis and gets to the end of the DCF analysis and

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comes up with a conclusion. Now, it seems to me that, given the fact that he understands the environment in which all of this is taking place, it would be appropriate to place -- in fact, beyond appropriate -- I think required to place his recommendation into the economic environment that we're in.

Now, that economic environment is clearly a matter that we are at a turnoff as far as capital costs are concerned today. We're moving out of the turnoff rather rapidly, I think. Everybody sees the paper every day that says interest rates on home mortgages have gone up weekly for the last five or six weeks. The Federal Reserve has changed their policy. They forecasted increases in interest rates. They've dropped the word "patience," they're proposing that there will be increases in interest rates.

Those are things that he should have rolled into his final decision, should have taken his DCF result after he had appropriately handled all of these discrepancies that relate to the Cap-M and the risk premium, should have taken that result and then said, we are in this environment today, here's where we stand on the curb, so to speak.

And he should have looked ahead, and looking ahead would say that interest rates are going to go up, costs of capital in general are going to go up, and the rates that are being set forth today or will be decided as a consequence of this case are going to be for some period of time subsequent to today. They're not going to go into effect until perhaps the end of the summer. I'm not sure when, but they will be in effect late 2004 through 2005, maybe longer.

To ignore the fact that the economics or the reality in which the company finds itself is changing and will change significantly through the years -- or through the period the rates are in effect is, I believe, something that is just entirely inappropriate and it goes beyond oversight. I think it's an integral part of what he should have done.

Q. Mr. Dunn --

A. There are a couple of other points. The reality of what's going on here is that there's some changes in the industry, one of which is very substantial, and that's the dividend payout policies of utilities in general and gas distribution companies in particular.

And I believe that Mr. Murray used a pretty mechanistic approach. He ground his way through a process in his exhibit, and in so doing ground his way to an end result that did not take into consideration the fact that the dividend growth in the past and probably for the future will be abnormally low as compared to growth in earnings.

In fact, I believe that adding the dividend growth into his calculation repeatedly in the way he's done it, averaging averages repeatedly is a matter that goes beyond inappropriateness. We can get more detailed about numbers. I have lots of number questions, but I think those are the conceptual problems I have with his testimony.

Q. You indicated that -- you indicated that Mr. Murray's study could possibly have used more recent 2003 numbers. Are you aware of any studies that were made on Mr. Murray's testimony with more recent 2003 numbers?

A. I told you that I have been advised of some calculations which have been made substituting 2003 numbers, and I don't know how complete those studies are. I know they do not -- they're not comprehensive, in that they have not covered all of this company's -- at least I've not been advised of such. I've only been advised that some of the companies, the results change substantially when you move from 2002 data to 2003 data, and the company that I was told is the most extreme example is Washington Gas & Light, or WGL.

Q. Mr. Dunn, who performed those studies?

A. I don't know that you can say they're studies. They are more like calculations, and they were done by a gentleman by the name of Mr. Fay, or at least Mr. Fay told me about it.

Q. When were they done?

A. As far as I had heard about one of them yesterday. And they're not studies, they're calculations. These are not an attempt to replicate the exhibit using 2003 data. At least I don't know if they are. I haven't been advised that they are.

Q. Mr. Dunn, when the credit rating agencies go to determine the creditworthiness of Southern Union, how do the credit rating agencies evaluate the capital structure of Southern Union?

A. I can't tell you with specificity. I can tell you that they look at Panhandle Eastern by itself. It's separately rated, and they look at Southern Union, and then they make a number of adjustments. They state generally in the manuals that appear in the -- that are available on the Internet for their procedures how they can convert certain types of liabilities into debt and then make their calculations.

Q. Do the credit rating agencies evaluate the consolidated capital structure of Southern Union?

A. Secondly. They look at the parts, and then they look at the total, as does virtually everyone.

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There's a recent study in, I believe it's the Financial Management Journal or the Journal of Financial Management and Practice, I'm not sure which, that this actually is a survey study where they surveyed 25 companies which they selected that they believed to be the 25 most sophisticated companies in the United States.

They selected a group of investment bankers and also a group of textbooks, and they designed their selection process so as to, at least in their view, to obtain the cream of the crop not only in terms of companies, but in terms of textbooks and investment bankers.

One of the questions was, to the investment bankers and to the textbooks, was how do you evaluate capital structure in the evaluation of the company? And 100 percent of both groups indicated that they broke the company into parts and pieces to evaluate the capital structure.

It's only common sense, and I'm sure that you're aware of the fact that if you have two companies that are separate but happen to be owned by the same company and they're radically different in operations and consequently radically different in their need for capital and their capital structures, they would have radically different capital structure. You put them together and you end up with a consolidated capital structure which bears absolutely no resemblance whatsoever to either of two companies.

And that's the problem with the capital structure. Everybody that reads a basic introductory finance text knows that. In a simple day, companies many years ago were relatively simple, single lines of business and have maybe a tiny little subsidiary. Water company has a water testing subsidiary, no problem. Or even somebody like American Waterworks, which has a number of water company subsidiaries, consolidated might work simply because they're comprised of 15 companies that are virtually identical and all probably capitalized at least similarly. The same for AT&T when it was the dominant telephone company.

When you have companies that have completely unique, different and separate kinds of subsidiaries, those companies don't have anything to do in terms of their capitalization with the consolidated capital structure, other than the fact they are a part of the process of adding up to a consolidated structure.

Q. So the credit rating agencies, if I understand you correctly, would not include the Panhandle operations in their evaluation of Southern Union?

A. They would do both. They would be more comprehensive. They would look at Panhandle. They would look at Southern Union. They would look to see if the total capital structure, given the two parts which comprise it, is a reasonable capital structure.

Q. Did you make a capital structure recommendation in your testimony?

A. I did.

Q. And what recommendations did you make?

A. The recommendation at June 30 was for the June 30th book capital structure of the Southern Union Company, less the Panhandle Eastern Pipeline debt. Plus I made some adjustments with respect to the new issuance of preferred. The TOPrS were retired and replaced with a new issue of preferred, part of which went to retire the TOPrS and part of which went to retire a portion of the term.

Q. Mr. Dunn, did you exclude any Panhandle capital from your recommendation?

A. As I just indicated, I excluded the Panhandle long-term debt from my recommendation. The Panhandle long-term debt is debt which was raised by Panhandle Eastern Company many years ago. It is obligated to the Panhandle Eastern Corporation, and it is nonrecourse to Southern Union Company. That debt was excluded.

Q. With regard to Panhandle equity, did you

exclude Panhandle equity?
A. I did not. This particular process that we go through in the ratemaking process will automatically exclude that equity.
Q. Is there interest equity that supports the Panhandle operations?
A. There is equity, yes. And I might explain, just like the equity which supports other operations of Southern Union, such as their Pennsylvania operations or their New England operations, this process in Missouri will not permit the New England equity nor the Pennsylvania equity nor the Panhandle equity to get into the Missouri rate case decision.
Q. On what authority do you rely to justify your decision of including the Panhandle equity in the Southern Union capital structure for the purpose of making your recommendation?
A. It's not a matter of authority. It's a matter of -- and when you say authority, I assume that you mean some sort of judicial or legal authority. Am I correct in that assumption?
Q. I'd like to know any authority that you used to make that decision.
MR. SWEARENGEN: Excuse me. Can you restate what this is?

BY MR. BERLIN:

Q. My question is, what authority do you rely on to justify your decision of including the Panhandle equity in the Southern Union capital structure for the purpose of making your recommendation?

A. It is a consequence of the practice that's followed -- I shouldn't say a consequence. The practice which is followed in Missouri will exclude that equity from consideration in the final analysis that's derived either by the Commission or by an agreement between the Staff and the company. The Panhandle equity is no different than the equity which is involved in supporting the operations of Pennsylvania. It's no different than the operations or the equity involved in supporting the operations in New England.

That equity will be excluded from the capital structure from the decision and will in no way impact the results of this proceeding after the final determination is made, because of the fact everything works off of the rate base, not the capital structure. The capital structure is simply ingredients which works its way through the process of numbers derived from the capital structure, but in the final analysis, the shape of the rates, the magnitude of increase, the revenue requirement, the net operating income and income taxes of

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the company more specifically will be determined by the size of the rate base, which is exclusively existent here in Missouri, which is -- I'm sure it's a part of this process -- exhaustively audited and carefully established.

Q. So for the purpose of your prepared testimony and your MGE capital structure recommendation, you did exclude the Panhandle debt from Southern Union?

A. I did.

Q. And again, so I can understand, how does your methodology support using the Panhandle equity to make a capital structure recommendation regarding MGE in this rate case?

A. I believe the fault is mine. I'm obviously not being clear on what I understand this process is. But if you think of the company, think of a rectangle, and consider that rectangle to be the capital of the company. In this particular case, this is Southern Union, after my adjustments, after I have eliminated Panhandle Eastern debt.

A piece of that capital from top to bottom, some of its debt, some of it's preferred, some of it's equity, goes off to Pennsylvania. A piece of that goes off to New England, a piece of it goes off to Panhandle. This piece that's left is MGE, and it's not what's left ordinarily. I'm just using that as an example. A piece of the capital appropriately belongs to MGE or is used by MGE to support its facilities here in Missouri. That piece of capital consists of debt, preferred and equity.

Panhandle is in the total capital structure. This is, in many respects, very similar to the consolidated capital structure, except that I have not included the nonrecourse Panhandle debt which, by no stretch of the imagination, can conceivably be involved in the Missouri operations of the company. Some of it was raised in the early 1990s. That money has been spent. It's involved in trunkline, it's involved in pipeline companies that are running across the country. It has nothing to do with the Missouri properties of the company, and then there's no way it could be involved. And on top of that, there's a stipulation which basically says that the Panhandle Eastern is supposed to be kept separate, you know.

Maybe we could do this from another perspective. Mr. Murray from time to time uses the term "ring fenced," which is a term, I think, that probably the investment or at least the bond rating agencies are acquainters of, if there is such a word. They have coined the term "ring fence" to describe the situation whereby a company, a consolidated company or a complex company, as those folks refer to them, where a complex company

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isolates from the rest of its operations an activity.

Panhandle has been isolated in the most stringent ways possible from Southern Union Company. It is a separate corporation. It is a subsidiary. Its debt is nonrecourse. Southern Union Company has entered into an agreement with the Missouri Public Service Commission Staff, which was subsequently ratified and adopted by the Missouri Commission, which says that there is to be no flow from Southern Union into Panhandle. It's to be effectively ring fenced.

I, in many respects, construed that stipulation to be a ring fencing document. So if you ring fence a piece, it doesn't leak over into the other. Now, we still have the fact of the matter that the equity of Panhandle is owned by Southern Union Company.

Southern Union Company uses a bit of its capital from top to bottom to own that company. Some of Southern Union's debts, some of its equity, some of its preferred is involved in the ownership of Panhandle equity, but none of that debt, equity or preferred is in any way involved in the operations here in Missouri. It's involved in the Panhandle operations.

Q. Mr. Dunn, you used the term "nonrecourse debt." What is the definition of nonrecourse debt?

A. Nonrecourse debt is debt that's issued by a corporation, in this particular case, and which is not guaranteed or for which payment is not promised by the corporation's owners; in this particular case, another corporation.

Q. So are you saying that in the event of a Panhandle default, that this nonrecourse debt is not collectable from Southern Union?

A. Well, that is the current situation. There are circumstances which don't come up every day but they do come up, and they fall under the general heading of reconsolidation. When companies commingle the activities of a parent and subsidiary, and the subsidiary, assuming it has nonrecourse debt, the courts often construe that as a reconsolidation of the two entities and conclude that as a shifting of the nonrecourse away from the parent, such that the parent becomes obligated for the debt.

Now, in certain respects I interpret use of a consolidated capital structure in this case as not an attempt, but as an unintended consequence of the Staff proposal to use the consolidated capital structure. The Staff is proposing that the capital of the company be commingled and regulated around the country, including the Panhandle, in particular the nonrecourse debt.

The courts have interpreted that type of behavior in the past as a commingling of company liabilities in such a fashion as to invalidate the nonrecourse provisions of debt. That's something that Moody's spends -- or Standard & Poors spends some considerable time talking about it in their ratings manual and considers it a genuine risk.

Q. Of all of the Panhandle debt that is nonrecourse to Southern Union, is it your belief that this debt is not secured by any Panhandle equity or assets?

A. It's secured by Panhandle equity and assets.

Q. So you --

A. But mostly it's concerned by Panhandle assets. The equity is essentially nonexistent. We sit around and we talk about equity and we talk about debt. When debt flows into a corporation, it disappears. It's a piece of paper, and the debt goes out the door and is used to build facilities. Companies don't accumulate debt just for the sake of accumulating debt. They take that debt and they build plant.

And the Panhandle equity is in the ground somewhere. It's in the ground in trunkline, pipeline that runs from somewhere in Louisiana to the northeast. It's in the ground in the Panhandle pipeline that runs from out in central Kansas up through to Detroit. That equity is long gone. The dollars are not there. The only thing that's really there, the only tangible residual of that balance sheet is the physical property. That's what's there. There isn't any real equity there.

Q. Is --

A. So a claim by a lender would be a claim against the assets.

Q. So then I understand that Panhandle's debt is recourse debt to Panhandle; is that right?

A. It's a Panhandle obligation, yes.

Q. When did Southern Union last issue common shares?

A. I don't know the date. I know that they have current plans to issue shares.

Q. Are you aware of any common share issue of Southern Union?

A. That's scheduled? I'm aware of --

Q. Recent.

A. Oh, I don't know about a recent issue. There were shares issued in connection with the acquisition of Panhandle. There was a hybrid security issued in connection with the acquisition of Panhandle that currently resides on the books of Southern Union as a debt obligation of Southern Union, which converts to equity in 2006, which is only a couple years from now. Though both of those are equity, the 3 million shares is a part of the transaction. And then this equity hybrid issue, those are the two most recent issues that's occurred this year. Immediately prior to that -- this year is 2004 -- they would have occurred last year.

Q. And why did Southern Union issue additional shares?

A. Because they're part of the acquisition of Panhandle.

Q. Mr. Dunn, what are floatation costs?

A. When the company issues shares in the public market, there tends to be pressure because of an imbalance in supply and demand on the price of their stock. And in many cases, the prices of stock which exist prior to the issue is not realized in the issue itself.

Secondly, floatation costs are the costs and expenses associated with the actual offering itself; and third, the payments made to various organizations to sell the issue or raise the capital.

Q. Who bears the costs that are associated with the issuance of new Southern Union stock shares?

A. The company.

Q. Are you aware of any other capital other than common equity at the Southern Union level that may have been used to finance, whether directly or indirectly, the acquisition of Panhandle?

A. Yes.
Q. What is that?
A. Panhandle was acquired in part with proceeds from the sale of Southern Union Texas properties.
Q. What debt issuance did you use to calculate the embedded cost of debt?
A. The debt issuances of Southern Union Company.
Q. And what is your embedded cost of long-term debt?
A. 7.348 percent.
Q. Could you say that number again for me, please?
A. 7.348 percent.
Q. What is your embedded cost of preferred stock?
A. As I told you earlier, I made a pro forma adjustment and replaced the older 9-something TOPrS with the new preferred issuance, and the cost of the new preferred is 7.863 percent.
Q. Mr. Dunn, previously you stated that you attended David Murray's deposition on Tuesday; is that correct?
A. Yes, sir.
Q. Are you familiar with Murray Exhibit No. 2

from that deposition?

A. I'm not sure that I am.

Q. I'm going to pass out a copy of Murray Exhibit 2 from Staff Witness David Murray's deposition. We'll call this Exhibit No. 2, please.

(DUNN EXHIBIT NO. 2 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. BERLIN:

Q. Mr. Dunn, after you've had an opportunity to look at what I call Murray Exhibit No. 2 from Mr. Murray's deposition, this is now Dunn Exhibit No. 2, are you familiar with this exhibit?

A. I don't know if familiar is the proper word. I think perhaps only his mother knows all of this about him, but I know what it is.

Q. For the purpose of today, would you please read the first paragraph?

A. Dr. Morin is professor of finance at the College of Business Administration, Georgia State University, and professor of finance for regulated industry at the Center for the Study of Regulated Industry also at Georgia State University.

Q. Thank you. Do you know Dr. Morin?

A. Only sort of in passing. We both have a -- we share a common client.

Q. Have you ever met Dr. Morin?
A. Yes.
Q. When did you meet Dr. Morin?
A. He represents OG&E, and I represent the OG&E shareholder group, and we have seen each other in passing and met at the rate proceeding.
Q. Has Dr. Morin been retained by MGE for this rate case?
A. I don't know at this point in time.
Q. Have you consulted Dr. Morin on this rate case?
A. I haven't.
Q. Has anyone that you know of consulted Dr. Morin?
A. At this point in time, I don't know if Dr. Morin has actually been contacted with respect to this case.
Q. Do you know if anybody in MGE has contacted Dr. Morin?
A. Again, I don't know if Dr. Morin has been contacted at this point in time with respect to this case.
Q. Mr. Dunn, what is the current yield on Southern Union's preferred stock that it issued in October of 2003?
A. I don't know.

Q. What did Southern Union use the term loan of $130 million for that was reduced by the issuance of preferred stock?

A. I don't know that either.

Q. What was the long-term credit facility used for that the preferred stock was used to pay down?

A. Again, I don't know.

Q. For the purposes of your study, did you evaluate other companies?

A. I did.

Q. What companies did you evaluate?

A. All of the companies in the ValueLine investment service are included in their category of natural gas distribution companies.

Q. Can you name them?

A. I can read them for you from my exhibit.

Q. That's fine.

A. AGL Resources, Inc., Atmos Energy Corp, Cascade Natural Gas, Keyspan Corp, Laclede Gas Company, New Jersey Resources, Nicor, Inc., Northwest Natural Gas, NUI Corp, Peoples Energy Corp, Piedmont Natural Gas, South Jersey Industries, Southwest Gas Corp, UGI Corp, WGL Holdings, Inc. Now, those are the companies included in my proxy group. In addition, I reviewed Semco, S-E-M-C-O, Energen, and Southern Union Company, which were also

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members of the ValueLine Investment Company natural gas distribution group, and which I excluded from my analysis for various reasons.

Q. With regard to your proxy group, why did you pick those companies?

A. I picked them because -- with the intention of picking all of the companies from the ValueLine distribution group to have as large a group as I possibly could, and I eliminated three from that group and ended up with my group of proxy companies.

Q. You said that you eliminated some companies. Which companies did you eliminate?

A. Southern Union Company, Semco, S-e-m-c-o, and Energen, E-n-e-r-g-e-n.

Q. Why did you eliminate Semco?

A. Semco was having some dividend problems when I was looking at the company, and as I recollect at this point, the dividend was quite high, which is indicative of a probable down rating or change in the dividend payment. And I believe even one of the ValueLine's that I looked at suggested a change was imminent, and I decided to drop it.

The Southern Union was dropped for obvious reasons. And Energen was dropped because Energen has what I guess are considered to be pretty fantastic prospects.

I considered them very fantastic prospects, mainly from their very, very successful oil and gas exploration and production business, and I thought that would distort my results upward.

Q. So if I understand correctly -- and you may refer to page 26, lines 8 through 11 of your testimony -- you eliminated Energen from your study because of its natural gas production business; is that correct?

A. Because of its prospects more than its business. The business would not have bothered me. Every one of these companies has activities other than natural gas distribution. It's virtually impossible to find a company or group of companies that's large enough to be meaningful that don't have some element of diversification. It's just that Energen has been so successful.

I think that Energen's earnings growth is perhaps in the 15 percent range. They have been tremendously successful over the years in a coal and natural gas production and exploration business. It's likely to continue for many years.

Q. Are any of the companies on your list, that is the companies you've cited, considered by industry analysts to be diversified companies?

A. Not insofar as ValueLine is concerned. I'm certain that there may be some analyst somewhere that considers them diversified, and there may be some analysts elsewhere who consider them something else. I use the ValueLine service and their classification.

Q. What is your definition of a diversified company?

A. I don't really have a definition. If you mean a definition like 7 percent pipeline and 15 percent production, I believe the AGA has a definition which is such and such a percent of pipeline, such and such a percent of exploration and production, and such and such a percent of distribution, which in total encompasses virtually the entire natural gas business from wellhead to burner tip as a diversified company.

I don't have a definition like that. I simply selected these companies because they were classified by ValueLine as natural gas distribution companies.

Q. What risks are faced by your proxy group of companies?

A. I think they all face natural gas distribution risks to a greater or lesser degree. One of the major risks that natural gas distribution companies face is the risk of weather, the risk of a very cold year as opposed to a very warm year. And now in some cases a very cold year is a serious risk because companies without appropriate adjustments end up carrying huge amounts of receivables, payments for gas that extend over some period of time. That's one of the major risks for the gas distribution company. I think there are other risks.

Depreciation is a substantial risk for a company. Facilities that natural gas distribution companies use are pretty long lived, 30 years, 20 years. Over that period of time, a lot of things can happen to an investment, some of them good, some of them bad. You've got a 30-year investment out there. Many, many things could happen to it over a 30-year period. It could go through depression, recession, boom times. We could find alternative fuels that would completely obsolete your facilities.

And I think that the depreciation of those facilities in some cases is a risk. Some companies have better depreciation rates than others. To the extent that your depreciation rates are inadequate -- or perhaps that's an overly harsh term.

To the extent that your depreciation rates are longer than average means that you're collecting back your capital over a longer period of time, and consequently you're exposed to more long-range problems. Every company, to a greater or lesser degree, has that kind of problem. Some of the companies may not have a gas adjustment clause. Some of them do. Some of the companies have different kinds of ratemaking procedures. Some of them have diversification, which tends to offset some of the problems associated with the distribution business.

Some of them are integrated backwards and enjoy greater profits on some of their facilities, rather than -- other than the distribution. And I think one of the other major problems is the fact that gas distribution companies can't move their business. You make a commitment to serve, for example, and you're stuck there for 30, 40 years. You can want to move it, but you can't.

And one of their competitors, the propane industry, is in a position where it can move its facilities in and out. They can drop a tank at your house, drive a tank up, fill it with propane, and they are a competitor at the moment.

There's also, given the climate that we're in, a significant risk of competition from electricity. It used to be, many years ago, that heat pumps were not a competitive or viable alternative. They're becoming more so as time moves on.

Many of the new houses in the Kansas City area, or at least that I'm -- at least the way they're

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advertized, are advertised as having new highly efficient heat pumps, rather than natural gas heat, which when I was younger was the absolute standard quality as far as heating was concerned. So that's an area of competition which has occurred over -- it's taken 30 years to develop, 20 years to develop.

Q. Does MGE face the same identical risks?

A. They face similar risk. All of the risks are to a greater or lesser degree. And MGE is absolutely a pure distribution company. There's no other activities in MGE other than distribution. MGE has 100 percent of its assets regulated by the Missouri Public Service Commission. I think regulation's a risk.

Q. You stated that regulation is a risk that MGE faces?

A. Yes.

Q. What specific risks, in your expert opinion, does MGE face?

A. Well, I think it's no secret that MGE has not experienced results from its previous rate proceeding which has been commensurate with the expectations when the proceedings were started or when they were complete.

Q. Mr. Dunn, with regard to your comparable companies or proxy group, what is the average equity ratio of the BBB rated comparable companies?

A. I don't know. I haven't made that analysis. The average equity ratio of the group is about 46 percent.

Q. Is that somewhere in your testimony?

A. I believe it is. You'll find it on Schedule 2, my exhibit, Column E, that the equity ratio of the proxy group is 46.6 percent, and you'll also find that number discussed at, I believe, three places in my direct testimony. Do you want me to look for those?

Q. No. That's fine. Mr. Dunn, I'm going to refer to your testimony, page 34, line 13 through line 23.

A. I'm sorry. Give me a moment just to catch up with you.

MR. SWEARENGEN: What page was that?

MR. BERLIN: It's page 34, starting on line 13 through line 23.

THE WITNESS: There's one word on line 23, is that correct, the word earnings?

BY MR. BERLIN:

Q. That's correct.

A. Okay.

Q. Would you please read starting at line 13 through the end of line 23?

A. Question: Will dividends play their prior prominent role in the DCF model as the natural gas

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distribution industry changes?

Answer: No. Dividends are used in the formula to capture and measure a part of the return received by investors for utilities. This has historically been a very large part of the total return. Now and in the future, however, dividends are becoming less important, and as dividends become less important, growth in dividends and particularly regular increases in dividends will be replaced by overall growth in earnings as a significant component of the DCF calculation. This means that the best measure of future growth is not pure growth in dividends, but rather the growth in the company overall, particularly earnings.

Q. Thank you. Do you believe that dividends are increasing in 2004?

A. They are increasing, less so than they have in the past. I think we can verify that or confirm that fact simply by looking at another page in my direct testimony, and that would be page 38, where the earnings per share, dividends per share and book value per share for 5 years and 10 years are laid out in tabular form.

You'll note that the earnings per share for 10 years grew at a rate of 4.37 percent, and for the 5-year period grew at the rate of 7.18 percent, substantially faster. Dividends per share, however, for

the 10-year period grew at only 2.23 percent and for the 5-year period
2.46 percent.

Now, the DCF formula, DCF model assumes that these three elements, book value, dividends and earnings, will march along in tandem, and clearly that's not true. We can refer to Mr. Murray's testimony. You'll see the same relationship. And we can refer to Mr. Allen's testimony, and we can see again the same relationship where the dividend growth which they used in their calculation is substantially less than the earnings growth.

MR. BERLIN: Thank you, Mr. Dunn. I've reached a point in the questioning that I think would be a good time to take a break. So I would suggest about a 10-minute break.

(A BREAK WAS TAKEN.)

BY MR. BERLIN:

Q. Mr. Dunn, I have some additional questions, and I think that for most of the questions that I have, I will be referring to the schedules of your direct testimony.

Is it appropriate to eliminate negatives and zeros when calculating averages for the purposes of estimating a reasonable growth rate?

A. I believe it is.
Q. Why is that?
A. We're working to develop an investor expectation. I think you have to think how the DCF model works. We know what the dividend yield is, and we're trying to estimate what the investor wants for a return on equity. That's the objective of the exercise. We know the dividend yield. We know the value. We know the value of the stock. What we don't know is the growth expectation, and we don't know for sure what the investor wants.

Now, we can figure out the growth expectation by trying to do what the investor does. The investor looks at some data, some historic data, some projected data. He looks at data from publications such as ValueLine. He looks at data from analysts, brokerage houses. I'm sure he gets information and data off of shows like the Noon Show on CNBC. He's trying to find something that grows.

Now, there's no reason to believe that an investor would suppress his growth expectation by including a negative. In fact, a smart investor, and we believe most of them are reasonably smart, would exclude those companies entirely. He just would not even consider buying a company with negative growth prospects. That's silly. This is the term of art there. And that's the main reason they are excluded.

No wise, reasonably intelligent investor would consider including in his analysis a negative, because he has no interest in a company that doesn't grow its earnings. He's only interested in companies that have future prospects, and including the negatives does nothing more than suppress the growth rate when you make these calculations. And when you run these negatives and low numbers through calculations repeatedly, you end up suppressing the number even more which, because of the mechanics of the discounted cash flow calculation, ends up producing an artificially low investor expectation.

Q. Do you think that investors exclude the possibility of negative growth rates when estimating future growth?

A. No. There is always the possibility that things will be different in the future than what you expect them to be. In fact, I would say it's more likely a probability that the future will be different than what you expect. But you try and develop a future which you think is reasonable, and no investor is going to develop a future and make an investment in a company that he believes has negative earnings growth.

Q. Do you believe that investors ignore

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negative returns when they evaluate the performance of their investment?

A. I think they see a negative return, that it's a consequence of an individual security, they would wisely, I would assume, exclude that security from their portfolio. If it's part of the evaluation process, where they see a company that's underperforming or producing negative returns, they would exclude it from their consideration.

Q. If a fund manager experiences negative growth, do you think the investor would consider such a negative growth when evaluating whether to keep the position in the investment?

A. I'm sorry. I don't think I understand.

Q. Well, if --

A. Which investor are you talking about? The fund manager is an investor, and then you're talking about the investor who buys the mutual fund that's managed by the -- I'm sorry. I'm just confused here.

Q. What I'm referring to is an investor in a fund, and the fund has a manager. If that fund would experience a negative growth, do you believe that investors would consider that fund's negative growth when evaluating their own position on whether to keep the investment?

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A. You're talking about the mutual fund investor, one step away. I believe that the fund manager would take care of that problem rather quickly by eliminating the negative growth company from his portfolio.

And the way in which mutual fund investments -- and this is an unfortunate part of our system. The way in which mutual fund investments are reported, an investor would have to go to some substantial amount of work to determine whether or not there was negative growth during the period of ownership. In fact, I don't think, absent having several reports in your possession, you would be able to figure out when the position was taken and whether or not there was negative growth.

Q. Do you have an authority that you rely upon for your opinion that supports the exclusion of negative growth rates?

A. I think it's a matter of common sense. We're trying to develop an average which we believe will be reflective of the future, and in the future it's reasonable to believe that companies which produce negative growth will not be on an investor's radar. They're simply not going to buy a company with negative growth, particularly if they expect that negative growth to continue.

Now, that's the assumption that's built into these calculations. When you make a calculation and include negative growth, you're assuming that that negative growth is going to continue in perpetuity. That's just wrong.

Would you -- you won't be an investor for long if you buy companies that have negative growth in perpetuity. That's just a fact of life. So it's pretty Darwinian, but those folks are all gone now. And the folks that survive are the folks that eliminate the negatives out of their prospects for the future.

Q. In referring to Schedule JCD-6 of your testimony, could you please explain to me why you exclude the negative 32.41 percent growth rate from your averages?

A. For the same reason that I explained earlier. The company produced negative growth over the period, and if it were to continue to produce negative growth, you would not purchase that company and you would not use that as a part of what you believe to be the future of the industry.

What we're doing here is sort of similar to selecting the companies that would go into a sector fund. And you wouldn't include companies in your sector fund that didn't produce reasonable results, particularly if you had some control over the constituents of the sector fund.

Q. In looking at Schedule 6, do you believe an investor would reasonably expect a growth rate of 49.14 percent when investing in a company?

A. I believe an investor might hope for that. I believe lots of investors believe that that would happen, particularly during the dot com boom, and I suspect that that number would attract an investor to look it over and determine whether or not it had a high probability or reasonable probability of continuing into the future.

Q. Did you include the positive growth rate of 49.14 percent when calculating the average?

A. I did, just like I included the growth rate of .47 percent.

Q. But you excluded the negative 32.41 percent?

A. That's correct.

Q. Would you agree that the negative 32.41 percent and 49.14 percent positive growth rates are outliers?

A. They are.

Q. Why would you not exclude both numbers?

A. The main reason is to avoid getting into the problem of, well, I'm going to exclude the outliers which are 7 percent different than the average -- well, no, I'll exclude the outlier that -- it's too difficult to reach a conclusion that would be agreeable to most folks and ultimately stand the test of review in this type of proceeding.

Q. Referring to Schedule JCD-4 of your testimony --

A. Yes, sir.

Q. -- why did you exclude the negative 5-year historical growth rate?

A. For the same reason that I excluded the others. A negative growth is not something that an investor or a successful investor would expect to continue and be the basis for an investment.

Q. Do you believe that the 13.5 percent growth rate for Cascade Natural Gas is sustainable in the future?

A. It could be.

Q. How so?

A. Simply could be. I don't know. I didn't look at it in any detail, but I would hope at least as an investor you would think that the 1.5 percent growth rate would be something that would be a short-run problem rather than a long-run problem.

Q. Referring to your testimony, page 48,

lines 15 through 17, how did you determine that a 2 percent growth in dividend was appropriate?
A. That's simply a number I selected that I thought was relatively small; it didn't have a big impact on the calculation. I think that there may well be something on the order of 2 percent growth.
Q. Do you have a source --
A. No.
Q. -- for that number?
A. No, sir.
Q. On page 46, lines 6 through 10 of your direct testimony, you indicate that the ValueLine dividend yield calculation has been adjusted for an estimated increase in the dividend to be paid. Why did you make another adjustment to this dividend yield if it already reflects an estimated increase?
A. The way ValueLine puts the increase is in by quarter, and this is an annualized number.
Q. So your adjustment is annualized?
A. My adjustment is for a full year. ValueLine's adjustment may only cover a quarter.
Q. On page 50, line 24 through page 51, line 5 --
A. I'm sorry. Can you say that again?
Q. Page 50.

A. Yes, sir.

Q. Line 24.

A. Yes, sir.

Q. Through page 51, line 5.

A. Yes, sir.

Q. You indicate that the cost of exit equity will be increasing from its current lower levels to higher levels during the period these rates will be in effect. Did you make this same speculation in the last MGE rate case?

A. I don't know.

Q. Did your research regarding what may be termed as the small company size effect involve the analysis of the divisions of larger companies?

A. No.

Q. On page 57 of your testimony, lines 14 through 16, are you saying that the propane industry is less risky than the natural gas industry?

A. I think what specifically is said there is that they have movable assets, which is an advantage, and they have price advantages from time to time, which is an advantage. I don't think there's an overall conclusion on risk. This has to do with a risk for MGE. There's no attempt in that paragraph to determine the relative risk of the two industries.

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Q. With regard to Panhandle, does Panhandle use any short-term debt?

A. I don't know.

Q. With regard to your group of comparable companies, do you think it is appropriate to use companies that are rated below investment grade when used in a comparable group analysis for MGE?

A. Given my selection criteria, if a company in that group was below investment grade, I don't believe that that's a problem.

Q. Do you believe that all of the comparable companies that you used in your testimony are pure play type natural gas distribution companies?

A. I think that all of the companies meet the criteria which I used in selecting the companies. I think under the circumstances, and the circumstances being the condition of the industry and the evolution of the industry, particularly over the past few years, they are as pure play as you can get. They are all, to a greater or lesser degree, diversified, but they all are still classified by ValueLine as natural gas distribution companies.

Q. Referring back to Schedule JCD-5 of your testimony.

A. Yes, sir, I have that.

Q. All right. Why are the ValueLine earnings growth rates for UGI and Southwest Gas the highest out of all of the comparable companies?
A. I don't know. This is the ValueLine estimates.
Q. Do you believe it may be because of UGI and Southwest Gas being diversified gas companies that have higher-growth nonregulated companies in them?
A. It may be, but Atmos Energy, which is much less diversified, has a very similar growth rate at 9 percent to the growth rate which you've mentioned with respect to Southwest Gas at 9.5 percent.
Q. Referring to page 44, line 9 of your direct testimony, you indicate that the analysis growth forecast for the industry is 6.4 percent.
A. Yes.
Q. What is your source for this?
A. That appears to be a typographical error. That is close to the ValueLine forecast of 6.9 percent which appears on Schedule 5.
Q. So that number is an error?
A. I can't tie that number just this minute. I can take a moment or two and try and figure it out, but it appears to me to be an error.
Q. Mr. Dunn, I would like you to do that, but

we will send you a DR on that.
A. All right.
Q. Please refer to Schedules JCD-4 and 5 of your testimony.
A. I have those.
Q. What is the highest average growth rate?
A. That appears on those schedules --
Q. Yes.
A. -- for anything?
Q. Yes. I'm referring to your schedules.
A. Schedule 5 appears to be 18.5 percent for Southwest Gas Corp for 5 year, and on Schedule 5, it appears to be 17 percent for UGI Corp.
Q. Is that the average?
A. No. That's the individual number.
Q. I believe I asked for average.
A. Oh, I'm sorry. I didn't understand.
Q. Let me restate the question. What is the highest average growth rate?
A. It appears to be the 7.18 percent for the 5-year earnings.
Q. And what growth rate range did you select?
A. 6 to 7 percent.
Q. Are you familiar with Standard & Poor's business profile system?

A. Generally.
Q. Do you know the business profile of your listed comparable companies?
A. No, I don't.
Q. Why do you pick ValueLine instead of Standard & Poor's?
A. For selecting the company?
Q. Yes.
A. Standard & Poor's, to my knowledge, does not have a publication which comprehensively covers individual industries in this fashion and provides this level of detail for this period of time. You can gather the information. It's available on the Internet, and it's available in certain publications, but not in this convenient form and probably not as widely used by individual investors.
ValueLine makes the claim that they're the most widely used service of their type. Now, I don't know if that claim is accurate or not, but they make the claim.
Q. So --
A. It's certainly one of the most long-lasting. When I was an employee of the Commission, the Commission subscribed to ValueLine 30 years ago, and I'm sure continues to do so.
Q. Do I understand correctly that you are not

aware of Standard & Poor's business profile system?

A. If you're talking about the bond rating agency, the bond rating classification system, yes. I'm not aware of how they do it precisely. I use it as a consumer service, not as -- I know, for example, that they rate companies from 1 to 10, and I see the individual ratings. I don't know all the machinations which go into rating the company 3 as opposed to rating the company 4.

I'm sorry. I'm having trouble making the connection between selecting the company and using ValueLine and then the Standard & Poor's.

Q. I'm interested in knowing whether or not you looked at S&P's business profile risk of your proxy group companies.

A. No.

Q. Do you believe that the Standard & Poor's business profile risk may offer some insight into the Missouri regulatory environment?

A. I think that's probably a stretch to say that. I didn't make any evaluation of anything in terms of whether or not I was developing an insight into the Missouri regulatory environment by reviewing the document.

MR. BERLIN: Mr. Dunn, I'm near finished with my questioning, but I would like to take about a five-minute very short break at this point.

(A BREAK WAS TAKEN.)

BY MR. BERLIN:

Q. Mr. Dunn, I have only a few questions more to ask before I turn my chair over to Public Counsel. Are you aware of whether or not Panhandle filed a 10K report with the SEC?

A. It did.

Q. Do you believe that 10K report that Panhandle filed to be accurate?

A. I do.

Q. Do you believe it to be reasonable for an analyst to rely on Panhandle's 10K report?

A. I do, which is not to say that the information in the 10K cannot be misused.

MR. BERLIN: I have no further questions.

CROSS-EXAMINATION BY MR. MICHEEL:

Q. All right. Mr. Dunn, I've got some questions based on some answers that you gave to Mr. Berlin.

You indicated in your response to Mr. Berlin that you looked at a lot of different materials, some sourced from the Internet, and I want to unpack that. I want to know specifically what documents did you look at regarding and respecting the general economy?

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A. I don't know if I can tell you specific documents with respect to the general economy. I read Wall Street Journal every day. I read Barron's every week. I read the business section usually of USA Today. I receive something from Vanguard usually weekly, sometimes more frequently. These are all general economic matters.

Q. And so it's from those publications, Wall Street Journal, Barron's, the business section of USA Today and Vanguard that you get your general economic information?

A. General economic information. I also read a number of slick paper magazines.

Q. And what slick paper magazines would those be?

MR. SWEARENGEN: Related to financial matters.

THE WITNESS: That would be Business Week, Forbes, Fortune.

BY MR. MICHEEL:

Q. And what are those publications indicating about the general economy?

A. That the general economy tends to be relatively robust, that the general economy is moving into an area where it becomes somewhat tighter than it has in the past, and perhaps inflation becomes a risk.

Q. When you say --

A. Certainly --

Q. When you say tighter in the past, why don't you explain that to me. I don't have an economics degree or anything like that.

A. I think all we're talking about there is that the supply and demand situation in the economy is shifting from a point where there was excess supply to where supply and demand are more closely aligned or in better balance. For example, in the past reports on manufacturing, manufacturing output is at its highest level in several years now.

Q. Are there any specific articles that you can recall from those items that you looked at, both the slick magazines related to the economy and the Wall Street Journal and other items that you reviewed?

A. Not offhand. If I think of one during the course of this, I'll mention it to you.

Q. You also indicated that you look at the conditions generally in the natural gas market. And how do you get your information regarding the conditions in the natural gas market, natural gas distribution companies?

A. I have an investment in a natural gas distribution company, and as a consequence, I read from a brokerage house a good bit of information and access to research, both investment bankers and other entities such as Standard & Poor's and Argus in connection with that investment.

Q. And what natural gas company is it that you've invested in?

A. I've invested in Southern Union. I've also invested in some other natural gas companies.

Q. Is your investment in Southern Union a current investment?

A. Yes.

Q. And how large is that investment?

A. It's approximately 1,000 shares.

Q. And what other natural gas companies have you invested in or are you currently an investor in?

A. K&M Pipeline. That's all I can think of at the moment.

Q. Do you think that K&M Pipeline Company is a natural gas distribution company?

A. It's not a distribution company, but it has natural gas interests. It originated as a pipeline company, shipping products, and it has subsequently, in order, I think, to take advantage of its status as a master limited partnership, added some distribution

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properties.

Q. And how many shares do you have?

A. Not distribution property. Excuse me. Natural gas properties.

Q. And how many shares do you have in K&M Pipeline?

A. I believe 3,000.

Q. And you said that you get information from investment bankers regarding those investments?

A. That's correct.

Q. What investment bankers do you get information from regarding Southern Union Company?

A. I have access through Charles Schwab to Goldman Sachs, Argus, Standard & Poor's, and occasional recommendations of investment banking houses that are not part of their regular lineup. Plus the Charles Schwab review.

Q. Why did you invest in Southern Union Company?

A. I thought that its acquisition of Panhandle would make a significant difference in the company.

Q. What is Goldman Sachs saying about Southern Union Company and their investment analysis?

A. I don't know at this point.

Q. You haven't reviewed it?

A. Not recently.
Q. In the past, what did they say?
A. I don't remember.
Q. What about Argus, what were they saying about it?
A. I think all of them have it rated as a buy.
Q. What's --
A. I don't remember the detailed reports.
Q. What's Standard & Poor's saying?
A. I think it's rated as a buy.
Q. And what other investment houses have you looked at or got information from regarding Southern Union?
A. Argus. Argus Research.
Q. Could you just spell Argus for us?
A. Capital A-r-g-u-s.
Q. What did Charles Schwab say about Southern Union Company?
A. I would suspect that Charles Schwab ranks it as a hold, but I don't know.
Q. And why would Goldman Sachs say it's a buy?
A. As I indicated, I don't remember the details of the report. I'm recounting to you some information from summaries which appear in the Charles Schwab report on Southern Union.

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Q. Other than looking at the reports on Southern Union, what other items, if any, did you look at regarding the natural gas distribution industry?

A. I look at the ValueLines when they come out every quarter, and I subscribe to the ValueLine small stock service, and I look at that, usually read most of the companies' information, if there appears to be some change to me.

Q. And what's included in the ValueLine small stock items?

A. Much smaller companies. I believe, for example, K&M might be in that particular group. It is -- it is not a group of companies similar to the group of companies which appear in the regular ValueLine edition.

Q. Are any of the companies that you utilized as comparable companies in your analysis in this case covered in that small stock information that you reviewed?

A. No.

Q. Are any of the comparable companies that are included as comparable companies in your testimony covered in the ValueLine information?

A. All of them are.

Q. And how in depth is the ValueLine information that you're receiving from those companies?

A. ValueLine provides a 10-year and sometimes longer history, a number of variables with respect to each of the companies. They provide a 5 and 10-year growth. They provide a forecasted growth for 5 years. They provide forecasted information for the next time period, which is 3 to 5 years, and they provide a discussion with respect to the company.

They also provide some details with respect to the balance sheet and some details with respect to the characteristics of the company, insofar as its customer size and stock ownership, officers, directors, that type of information.

Q. Do you speak -- have you spoken recently with any investment bankers regarding the natural gas distribution industry?

A. No.

Q. Have you spoken with any brokers regarding the natural gas industry?

A. No.

Q. Have you spoken with any other investors regarding the natural gas industry?

A. Yes.

Q. And who have you spoken with?

A. Individuals that I'm friends with that we spoke about stocks from time to time.

Q. And who are they?

A. The one that I can think of is a Dr. Hazuaka. He's a -- he's actually a radiologist who spends a good deal of time researching stocks. And from time to time I've spoken with Ken Matzdorff about them. That's all I can think of at the moment.

Q. And do you know if Dr. Hazuaka -- and why don't you give me a spelling of that or at least phonetically for Kellene here?

A. It's H-a-z-u-a-k-a.

Q. Is Dr. Hazuaka purchasing local distribution stocks?

A. I don't know.

Q. How about Mr. Matzdorff? And why don't you give me the spelling of Mr. Matzdorff also?

A. Matzdorff is M-a-t-z-d-o-r-f-f, and I would suspect he is not.

Q. You also --

A. And if I had to guess, I would guess that Hazuaka is not also.

Q. So those two investors that you're talking about, you're not discussing natural gas distribution companies?

A. No. We're discussing them. They have excluded them. They're aware of them and they're knowledgeable investors. They just like companies with better future prospects.

Q. And that's why they excluded them, that's what they told you?

A. I am suspecting that in the case of Hazuaka. I'm pretty confident of that in the case of Mr. Matzdorff.

Q. You indicated also in your response to Mr. Berlin that you reviewed Internet-sourced items in getting your whole, you know, for background materials. And I'd like to know what Internet-sourced items you reviewed.

A. The Standard & Poor's full reports, the information in the financial section of AOL, information in the financial section of Yahoo. This is with respect to the individual companies.

Q. Let me unpack that. When you say Standard & Poor's full report, are you indicating that you reviewed the Standard & Poor's full report on the Internet with respect to all of your comparable companies?

A. Yes.

Q. And when you say you reviewed the financial section of AOL, which is America Online, I'm assuming, you reviewed all the reports that AOL provided with respect to your comparable companies?

A. Not all of the reports on AOL. AOL

provides charting and a number of other things that I generally don't read. I reviewed the analyst's forecasts in AOL and would have used those, as opposed to Yahoo, except that it was too difficult to print them. And I assume that there would not be a substantial difference, since both of them are sourced with Thompson Financial.

Q. And the last one we talked about was Yahoo, and all you did was look at analyst reports on Yahoo?

A. Yahoo has analysts reports, growth forecasts, snapshot is what they call it, and yes.

Q. And so is it my understanding that some of the information that appears in your prefiled direct testimony was taken directly from the financial section of Yahoo?

A. That's correct.

Q. And specifically what information in your direct testimony was taken from the financial section of Yahoo?

A. I believe dividend yields, and I also believe the earnings forecasts.

Q. And when you say dividends yields and earnings forecasts, you're talking about both the dividend yields and the earnings forecasts for your comparable group of companies?

A. That's correct.

Q. Is there anything else that you sourced in your direct testimony from your Internet sites?
A. Not that I can think of right now. I did source some information on the Panhandle acquisition.
Q. And what information did you source on the Panhandle acquisition from the Internet?
A. Some of the SEC filings.
Q. And what SEC filings did you review with respect to the Panhandle acquisition?
A. I believe all of them are classified as S8s. I'm not absolutely positive. I believe that is simply a designation of an important event. In some cases, attached to the S8 is a prospectus or a statement of pro forma. Those are the things that I looked at.
Q. And why did you review those items?
A. I was interested in the acquisition.
Q. And why were you interested in the acquisition?
A. To determine the impact of it on the company.
Q. Did you also look at the acquisition to determine whether or not you were going to make your individual investor decision to invest in the Southern Union Company?
A. No. I believe the acquisition of the

Southern Union stock was made prior to that.

Q. When did you acquire your 1,000 shares in Southern Union?

A. I don't know. I believe sometime during 2000 -- either 2002 or 2003.

Q. And why at that time -- and I had understood your earlier testimony to me that the reason you purchased the Southern Union stocks was because you were pleased with the Panhandle acquisition?

A. That's correct.

Q. And explain that to me.

A. That would have been a 2003 event.

Q. So --

A. And I'm not sure when I became aware of the event.

Q. So after Southern Union publicly announced the fact that they were going to purchase Panhandle Eastern Pipeline Company, you decided to invest?

A. I don't think it's quite that simple. I've owned Southern Union financial instruments for perhaps 15 years. I own TOPrS. I own the common. I've owned different Southern Union securities for many years.

Q. Let's go through that and unpack that. Sitting there today, right now, other than the 1,000 shares that you own of Southern Union common, what other

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financial instruments do you own of Southern Union Company?

A. Common is the only thing at the moment.

Q. In the past, what have you owned?

A. I've owned the common, both purchased it and sold it, and I have owned the TOPrS.

Q. And when you say TOPrS, are you talking about the trust originated preferred securities?

A. I am.

Q. And that acronym is T-O-P-R-S?

A. That's correct.

Q. And could you tell me what TOPrS are?

A. TOPrS are preferred stocks which are issued by a trust, which takes the proceeds of the preferred stocks and loans it to an entity, and the interest rate on the loan is the same as the dividend rate on the stock.

Q. And when did you divest yourself of the Southern Union TOPrS?

A. When they were called.

Q. And when were they called?

A. I believe in 2003.

Q. So just recently they were called and replaced with the new financing?

A. That's correct.

Q. You spoke with Mr. Berlin about capital structures, and specifically about Mr. Murray's capital structure in this case, and I'd like to know what your opinion is regarding the capital structure presented by Mr. Allen in his direct testimony.

A. I don't have Mr. Allen's testimony in front of me. If you -- as I recollect it, Mr. Allen used a consolidated capital structure. I haven't spent the same amount of time looking at Mr. Allen's testimony and capital structure as I have Murray's.

It's my understanding of what Mr. Allen has done is used a consolidated capital structure which is the same as the capital structure used by Mr. Murray, except that in calculating the cost of long-term debt, he did not use the costs associated with the Panhandle Eastern long-term debt.

Q. And do you think that was appropriate treatment?

A. No.

Q. Why not?

A. First of all, I think if there's any other option, the consolidated capital structure simply is the wrong capital structure to use. And in this particular case, there is another option, and that is the capital structure of the distribution companies, and I think that was what would have been appropriate.

I also think that in that particular case, had that not been appropriate, given how historic the capital structure they represented, I believe they should have used a hypothetical capital structure.

Q. Now, when you talk about a capital structure of a distribution company, did you use the capital structure of Missouri Gas Energy?

A. I used the Southern Union capital structure. Missouri Gas Energy is a division of Southern Union.

Q. And the Southern Union capital structure that you utilized, did you utilize the consolidated order under consolidated capital structure?

A. I used the consolidated capital structure less the Panhandle Eastern long-term debt.

Q. And why did -- why did you exclude the Panhandle Eastern long-term debt?

A. In part to conform with the reality, the relationship between Panhandle Eastern and Southern Union, in part to recognize the fact that the debt is nonrecourse and Panhandle Eastern is an independent corporation which has raised that debt publicly by itself, which essentially conforms to the Staff rule of what would be the right way to handle this, and in part because that money is not available to do anything in Missouri.

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Q. And the capital structure that you utilized for performing your analysis, is that found on page 23 of your direct testimony, sir?
A. It is.
Q. And is it your testimony today that the percentage of long-term debt in Southern Union's capital structure is 43.13 percent?
A. Approximately, yes.
Q. And that the preferred equity is 10.53 percent?
A. Again, approximately, that's correct.
Q. And is it your testimony that Southern Union Company currently has 43.34 percent common equity?
A. Approximately, yes.
Q. And that's excluding the Panhandle Eastern; is that correct?
A. That's excluding the Panhandle Eastern debt.
Q. Are there any other things that you see with respect to Mr. Allen's capital structure that you disagree with?
A. As I indicated, I haven't spent the time reviewing Mr. Allen's testimony and exhibits that I had with respect to the testimony and exhibits of Mr. Murray. Consequently, I really can't provide you a full analysis

of capital structure, except to say that I believe that it is incorrect because it's consolidated capital structure and it's clearly abnormal, as either Mr. Murray or Mr. Allen -- I'm not sure which -- admits in their testimony.

Q. Let me ask you, I take it you're looking at Schedule TA-1 in Mr. Allen's testimony?

A. Yes.

Q. Do you know how Mr. Allen arrives at the fact that Southern Union Company has common equity of 25.98 percent?

A. I believe that's 946 million divided by 3.6 billion.

Q. And how does he determine that the -- that's the number of -- that's the amount of common equity that Southern Union Company has?

A. I believe that's the Southern Union consolidated equity for December 31st.

Q. And you're not using a consolidated?

A. I'm using the consolidated common equity number, yes.

Q. And how do you arrive at a different percentage if you're using the common equity consolidated number?

A. I have a smaller numerator, and I don't have short-term debt in my calculation.

Q. What is the genesis of your smaller numerator? How come your numerator is smaller?

A. Because I excluded short-term debt and the Panhandle Eastern long-term debt.

Q. And it's your testimony that that's the numerator, not the denominator?

A. Or denominator.

Q. Could you explain to me the denominator?

A. I took the number that we've divided by.

Q. And what's the numerator?

A. That's the number that's divided into.

Q. Okay. I took math as a form of impact on society to get my degree.

So you have a different denominator and the difference in your denominator is derived from the fact that you excluded Panhandle Eastern's debt and you excluded short-term debt?

A. That's correct.

Q. Are there any other things that are different?

A. I don't know if this includes or excludes current maturities.

Q. Did you include or exclude current maturities?

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A. Excluded was my intention.
Q. And why did you exclude current maturities?
A. Because they are a form of short-term debt. They'll be refinanced by something else later.
Q. Why haven't you spent a lot of time looking at Mr. Allen's capital structure?
A. Just been a matter of time. I haven't been able to get to it.
Q. Do you plan on reviewing it before you file rebuttal testimony?
A. I do.
Q. Do you know if you're going to be the only witness for Missouri Gas Energy filing rebuttal testimony on this issue --
A. No.
Q. -- the issues of rate of return and capital structure?
A. No, I don't.
Q. Do you know if the company is contemplating hiring other witnesses?
A. I know it's been discussed.
Q. And who has that been discussed -- who have you discussed that with?
A. I haven't discussed it with anybody.
Q. Well, how do you know that's been

discussed?

A. I've simply heard others talking about the possibility of hiring other witnesses.

Q. Okay. And who have you heard talking about that possibility?

A. Well, I take that back in terms of discussions. I have been involved in, not a decision-making, but a discussion which involves a manager of a Big 6 CPA firm to do the proper deconsolidation to demonstrate precisely how the deconsolidation is done and to do the two resulting capital structures.

Q. Let's unpack that. First of all, who were you involved with in this discussion, you and who else?

A. Well, when you say involved, I participated in a conference call, and that individual was on the other line and I was in the room with, I believe, Mr. Swearengen, Mr. Marshall, perhaps Mr. Hack.

Q. And who was on the other end of the line?

A. I don't remember his name, other than he was a senior partner, perhaps retired, for a major accounting firm that had done Southern Union's audit.

Q. Any other discussions other than that one?

A. With that gentleman? Yes.

Q. Any other discussions with anybody else regarding hiring somebody, somebody else to provide

testimony on these issues?
A. When you say discussions, you're suggesting that I participated in discussions. I have heard discussions, been in the room.
Q. Okay. Let me make my question more narrow. Have you either participated in or heard discussions?
A. I have heard others talk about the possibility of hiring others to address the issue of rate of return in either rebuttal or surrebuttal.
Q. And who have you heard talking about it?
A. A couple of names I don't remember offhand. One of the names I do.
Q. Well, let's start with the name you remember.
A. That would be Dr. Morin.
Q. Dr. Morin. And what did you hear when you were listening to the discussion with Dr. Morin?
A. I heard that there was some interest in possibly retaining him or contacting him and discussing it.
Q. Okay. And what issues did you hear that they were going to retain or -- Dr. Morin to deal with?
A. I don't know if that was discussed.
Q. Okay. And that's the one you remember. What about the discussion that you heard that you don't

remember? Tell me about that.

A. I just think that involved the possibility of doing something else with capital structure and the possibility of doing something else with rate of return.

Q. And what were those possibilities?

A. I don't know who they were and, frankly, I don't even know if names were mentioned.

Q. Any other discussions that you're forgetting?

A. I can't remember discussions that I've forgotten.

Q. You'll let me know. You'll think about that during the deposition, and if there's one that comes to mind, you'll let me know, will you not?

A. I certainly will.

MR. SWEARENGEN: What kind of discussions? Why don't you specify what kind of discussions you're talking about?

MR. MICHEEL: Discussions about hiring some other folks to provide rebuttal testimony in this case that are not attorney/client privilege. I certainly won't want to delve into that.

BY MR. MICHEEL:

Q. Do you know when the company is going to make a decision about whether or not to hire Dr. Morin or this Big 6 CPA fella?

A. I think that the Big 6 CPA has been retained, but I'm not sure of that. I don't know, positively. I know that he -- he's familiar with the problem, and it's not a great deal of work for him to do it properly; consequently, I don't know that it's a major decision.

Q. And when you say familiar with the problem, what problem is that?

A. I think the problem that he is addressing arises as a result of a calculation which appears toward the end of Mr. Murray's testimony, where he takes the 10K and subtracts it from the Southern Union consolidated capital structure and produces a pretty low return on equity.

Q. When you say he takes the 10K, whose 10K is he taking? Is it Panhandle Eastern's 10K, is it Southern Union's 10K? Can you give me more specifics?

A. I'm sorry. I thought you were familiar. He reduces Southern Union consolidated balance sheet, particularly its equity, debt and preferred, the liabilities side, by the Panhandle Eastern liabilities to derive a capital structure.

Q. And do you know why he does that?

A. I can guess.

Q. Well --
A. He states that he does it because he would like to use it, but it comes out so low that he can't.
Q. And how is this Big 6 accountant going to deal with that problem, if you know?
A. I think he's going to just simply show the proper way to make a calculation of that type.
Q. And do you know what the proper way is?
A. Without all the technical detail I'm aware of it, yes.
Q. Why don't you tell me in your view what the proper way to do that is?
A. Southern Union consolidated capital structure has excluded from it already the Panhandle Eastern equity, and there is no second deduction from the consolidated capital structure of the Panhandle Eastern stand-alone common equity. In the calculation made by Mr. Murray, the Panhandle Eastern stand-alone equity is subtracted from the consolidated equity, which ends up in effect deducting it twice.
Q. So the problem that you see is -- and if I say this wrong, let me know -- Mr. Murray has double deducted?
A. That's correct.
Q. And that there should only be, in your

view, one deduction?

A. That's correct.

Q. Do you know the company --

A. Excuse me. Don't misunderstand that, to believe that I'm suggesting that there should be some further deduction to the published numbers. The published numbers have already embodied a deduction. The single deduction has been made when you look at the published numbers.

Q. So when you say when I look at the published numbers the single deduction has been made, are you talking about -- the published numbers, are you talking about when I look at the numbers in Panhandle Eastern's 10K? Are those the published numbers you're talking about?

A. When you look at the published numbers for Southern Union consolidated, Panhandle Eastern common equity has been excluded.

Q. And where would I see the published numbers for Southern Union consolidated? Is that in Southern Union's 10K?

A. Yes.

Q. And do you know when the company is going to make a decision about retaining Dr. Morin?

A. No, I don't. I'm not involved in that process.

Q. Other than discussions with Dr. Morin, have there been discussions with any other possible witnesses on that issue that you're aware of?

A. No, and I don't know if discussions have actually taken place with Dr. Morin.

Q. In response to Mr. Berlin, you indicated that Mr. Murray had used old 2002 data?

A. That's correct.

Q. In your view, does Mr. Allen's testimony suffer from the same problem, or alleged problem, I guess I should say?

A. He appears to have taken most of his information from the 2004 Turner Utility Report, which would be a lesser problem, an effort to address the problem with dated information.

Q. And how did your direct testimony address this issue?

A. I used the 2002 data because my testimony was prepared in the summertime and filed in November. Had I been preparing the testimony that was filed in April of this year, I would have used the latest data that I had available to me.

Q. Do you plan on updating your schedules and your direct testimony with your rebuttal, sir?

A. It's my understanding that the practice at the Missouri Public Service Commission is not to update rate of return in that fashion, in the same fashion that all of the other material is updated to the year end, and I will no doubt update some of them.

Q. Which ones are you planning on updating?

A. I haven't made that decision yet.

Q. And how will you make that decision?

A. Well, I'll review the adequacy of the data I've supplied and if I think it's inadequate, I'll apply the newer information. If it's adequate, I won't bother to adjust it.

Q. And how will you go about determining that? Will you just go on the Internet and look at Yahoo again, Yahoo finance and say, oh, there's a change in Yahoo finance?

A. Probably begin with review of ValueLine and may follow that up with a review of Standard & Poor's or Yahoo or AOL.

Q. Now, you indicated in response to Mr. Berlin that others had updated some of the data related to Mr. Murray's testimony. Do you recall that?

A. Yes.

Q. And have they provided you copies of that update?

A. No.
Q. Other than the one company that you talked about, I believe it was Washington Gas Light, did they indicate updates to any other companies?
A. They indicated that such calculations had been made, yes.
Q. And who's made those calculations?
A. I heard that from Mr. Fay. I don't know if he's the one that made the calculations or somebody made them for him.
Q. And why did you have occasion to discuss that with Mr. Fay?
A. I was speaking to Mr. Fay about another matter, and that came up.
Q. What matter was that that you were discussing with Mr. Fay?
A. He was concerned that they had -- or that Mr. Murray had used the 2002 data and wanted to know why, in my opinion, he did not use 2003 data.
Q. And who is Mr. Fay?
A. It's my understanding Mr. Fay is an attorney who works for the law firm that Mr. Herschmann works for.
Q. And what law firm is that?
A. I don't know the name of the firm.

Q. Did you have a conference call with Mr. Fay?
A. Most recently when this came was exchanged, I simply had a telephone call with him.
Q. Other than that, what else did Mr. Fay tell you?
A. I think that's it.
Q. So you're not certain if they updated all of Mr. Murray's?
A. I -- I would only speculate. My speculation is that if they updated parts of it. They may have updated all of it, but I don't know.
Q. Did Mr. Fay at all in any way discuss Mr. Allen's testimony with you?
A. No.
Q. I'm sorry, no?
A. No.
Q. In response to Mr. Berlin talking about the economic environment, you indicated that interest rates will change. Do you recall that?
A. Yes.
Q. Do you know when the Federal Reserve is going to change interest rates?
A. They have strongly suggested that sometime this year.

Q. Have you spoken with Fed Chairman Greenspan?

A. No, sir, I haven't.

Q. Have you spoken with any member of the Federal Reserve Board?

A. No, sir.

Q. What will the interest rates be in 2005?

A. Higher than they are today.

Q. And you're certain of that?

A. Confident, not certain.

Q. Okay. Give me an idea of magnitude of how much higher they will be.

A. I can't provide that to you. I don't know.

Q. Well, what's your best educated opinion?

A. I don't have an opinion.

Q. You're an expert witness, right?

A. I don't have an opinion as to interest rates in 2005.

Q. Okay. Well, you've indicated that interest rates are going to increase, did you not?

A. I did.

Q. And how much are those interest rates going to increase?

MR. SWEARENGEN: Objection, asked and answered.

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THE WITNESS: As I indicated, I don't know how much they will increase. I am confident they will be higher.

BY MR. MICHEEL:

Q. When will they increase?

A. As I indicated to you, I believe the Federal Reserve has clearly indicated they're going to raise interest rates during the second half of this year.

Q. And has the Fed indicated how much they're going to increase those interest rates?

A. They have not.

Q. Would you expect that interest rate increase would be greater than a quarter percent?

A. Over time, yes.

Q. Let's talk about, when you say they're going to increase them, do you think it will be a quarter percent?

A. I think that would be sheer speculation. The speculation of most everybody is somewhere between a quarter and a half percent and more than one increase.

Q. And what are the current interest rates the Fed has set?

A. I believe it's 1 percent.

Q. And historically that 1 percent interest rate that the Fed has set, how does that compare? Is that

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a historically high interest rate; is that a historically low interest rate?

A. It's 46-year low.

Q. And what news source did you acquire your belief that the Fed is going to increase interest rates next quarter?

A. I didn't say next quarter. Mr. Greenspan just testified for Congress and strongly suggested that interest rates would be raising during the last half of the year.

Q. And when would that be?

A. I don't know.

Q. Well, what's the last half of the year?

A. Sometime during the next six months.

Q. Did you read the transcript of Mr. Greenspan's testimony before Congress?

A. I did not.

Q. How did you acquire that knowledge that that's what Mr. Greenspan indicated?

A. I suspect from the Wall Street Journal.

Q. But you don't know?

A. I don't know the precise source of the first time I heard that information, no.

Q. In response to some of the questions posed by Mr. Berlin, you indicated that credit rating agencies

will look at Southern Union Company and Panhandle separately. Do you recall those answers?
A. Yes, sir.
Q. Who did you speak at -- speak to at the credit rating agencies that indicated that to you?
A. That's in their credit rating manual.
Q. And when you say in their credit rating manual, who are you referring to specifically?
A. Standard & Poor's has a credit rating manual which indicates that they tend to desire to evaluate subsidiaries independently.
Q. And that's as a general proposition, is that --
A. That's correct.
Q. Okay. Where did you see specifically that Standard & Poor's rates Southern Union Company in the way you say they do in their general manual?
A. I believe that was in a discussion with a company employee who indicated to me that there was separate evaluations, although not separate ratings.
Q. What company employee was that, sir?
A. That I don't know. I believe he's the chief financial officer. I don't remember his name.
Q. Would that be David Quapple (ph.sp.)?
A. No, not that I remember. He was simply on

a conference call.

Q. And what did that individual, Mr. X, tell you?

A. He indicated that it was his recollection that, in fact, Standard & Poor's evaluated the two entities separately and then provided a bond rating.

Q. Now, other than Standard & Poor's did the other credit rating agencies evaluate Southern Union Company and Panhandle Eastern separately?

A. I don't know. I would assume so. That's --

Q. Did you undertake any -- did you look to see if other credit rating agencies do that, other than Standard & Poor's?

A. The other credit agency is Moody's, who does not provide as much information of their methodology as Standard & Poor's.

Q. Does Moody's provide a separate rating for Southern Union and Panhandle Eastern?

A. It's entirely possible that they could, and it is a service that they offer. I don't know if they did.

Q. You didn't look?

A. That's correct.

Q. So you failed to look at Moody's to see

what Moody's has done?
A. I didn't look at Moody's.
Q. And did you look specifically at Standard & Poor's with respect to how they've rated Southern Union Company, or did you rely on the representation of Mr. X from Southern Union Company?
A. On their process?
Q. No. I'm not talking about on their process now. I'm talking about how specifically they rate Southern Union.
A. On the process that they employed in the rating?
Q. Yes.
A. Is that what you're talking about?
Q. Sure.
A. I relied on the company employee.
Q. Let me ask you this: If you know, does Southern Union Company and Panhandle Eastern have separate bond ratings?
A. I don't know.
Q. Did you --
A. I believe not.
Q. You believe not?
A. That's correct.
Q. And why -- what's the basis of that belief?

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A. I recollect having seen the two ratings side by side, and they were the same.

Q. And what does it mean if they don't have separate ratings?

A. Certainly means that they've been rated separately.

Q. If they don't have separate ratings?

A. Oh, no. I thought you said if they do have separate ratings.

Q. Let me go back.

A. Do.

Q. Does Southern Union Company and Panhandle Eastern have separate bond ratings?

A. That's my recollection that they do -- or excuse me. They have the same rating. I'm sorry. Maybe I misspoke early on. It's my recollection that they have the same rating.

Q. So the bonds -- because this is getting confusing and I want to make sure that you and I get it right here. It's your understanding that Standard & Poor's separately rates Southern Union Company's bonds?

A. Up 'til now we've been talking about the process, the process being they look at the two entities separately. Now we're talking about the bond rating. It's my understanding that both companies are BBB rated.

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Q. And that wasn't my question. When I go to look at Standard & Poor's, am I going to find a separate bond rating for Southern Union Company and a separate bond rating for Panhandle Eastern Company?

A. I don't know.

Q. You have not looked?

A. That's correct.

Q. Let's assume that there's only one bond rating and that Standard & Poor's does not rate Panhandle Eastern. What does that mean to you, if anything?

A. Nothing in particular.

Q. Okay. So you haven't -- you don't know whether or not Standard & Poor's separately rates Panhandle Eastern's bonds, separately rates Southern Union Company's bonds?

A. That's correct.

Q. Other than Panhandle Eastern, are you aware of whether or not Southern Union Company has any other separate subs? Not divisions. I'm talking about subsidiaries. You know the difference?

A. Yes, I know the difference. I think they have some small special purpose subsidiaries, but I don't think anything significant.

Q. And what are those small special purpose subsidiaries?

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A. I don't know offhand.

Q. And when you say small, what do you mean small?

A. Things that are not significant in terms of the overall company operation.

Q. Do you think that Panhandle Eastern's line of business is substantially different than Southern Union Company's line of business?

A. The physical aspects of the business are substantially different. The business and the requirements of the business are probably pretty similar.

Q. Let me ask you, you attached the ValueLine for your comparable companies. Would your comparable companies -- do any of your comparable companies have both innervate pipelines like Panhandle Eastern and gas distribution assets like our good friends at Southern Union Company?

A. I think many of them do.

Q. So in that sense, they're similar; is that correct?

A. That's correct.

MR. MICHEEL: We're about at lunch time. Why don't we take a lunch break and come back at one, if that's okay with everybody.

(A BREAK WAS TAKEN.)

BY MR. MICHEEL:
Q. Mr. Dunn, before the break we were talking about the Fed possibly raising the interest rates. Do you recall those questions?
A. Yes, sir, I do.
Q. And you indicated you believe that the Fed was going to do that?
A. I did.
Q. Do you think that the market is aware that the Fed is going to raise interest rates?
A. I believe it is anticipating an increase.
Q. And so in anticipation of that increase, do you think the market's making decisions right now?
A. I do.
Q. Do you think that those increases are reflected in the market right now, those proposed increases?
A. Not entirely.
Q. But partially at least?
A. Certainly.
Q. And they'd be reflected in both the equities and the bond markets?
A. Yes.
Q. Mr. Berlin asked you some questions about the nonrecourse nature of the Panhandle Eastern debt. Do

you recall those?
A. Yes, I do.
Q. And you indicated that there were some court decisions that had interpreted commingling the nonrecourse with the consolidated as somehow vitiating or obviating the nonrecourse nature of the debt. And my question is simply, what court decision is that -- decision or decisions are you referring to?
A. I indicated courts, not court decisions, and my primary reference in that, as I believe I indicated in response to his question, was the Standard & Poor's credit manual, which indicates that courts in the event of commingling do sometimes deconsolidate a company.
Q. Okay. And the S&P credit manual didn't list any cases or decisions that you're aware of --
a. Not that I can think of, no.
Q. -- it just said courts?
Okay. And when was this credit manual that you're talking about published?
A. The credit manual's been published for a number of years. At the front of the credit manual they say they simply update it every time that something happens.
Q. And when was the last update that you received?

A. I don't believe it's dated. It's on the Internet and available at their website.

Q. And what would I look for if I wanted to do that on the website? How would I do that, just look for their credit manual?

A. I believe so.

Q. You spoke with Mr. Berlin about floatation costs. Do you recall those questions?

A. Yes, sir.

Q. Have you testified before the Missouri Public Service Commission before?

A. I have.

Q. Are you aware of any decisions before the Missouri Public Service Commission that have allowed floatation costs in rates?

A. I'm not aware of any decisions, but I'm not a regular reader of the decisions of the Commission.

Q. Are you aware of any decisions that allowed floatation costs in rates?

A. Yes.

Q. What decisions are those?

A. I believe there have been decisions at FERC which have allowed them.

Q. I was at Missouri, sir.

A. Oh.

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