

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

MoGas Pipeline LLC

Docket No. RP09 -____-000

**PREPARED DIRECT TESTIMONY OF
OF
FRANKLIN D. KNIGHT
ON BEHALF OF
MOGAS PIPELINE LLC**

June 30, 2009

1 **Q. Please state your name and address.**

2 A. My name is Franklin D. Knight. My business address is 1155 15th Street, NW,
3 Suite 400, Washington, D.C. 20005.

4 **Q. What is your position?**

5 A. I am a Rate of Return consultant with the firm of Brown, Williams, Moorhead,
6 and Quinn, Inc., located in Washington, D.C.

7 **Q. Please describe your education and professional experience.**

8 A. I retired from the Federal Energy Regulatory Commission (FERC) in September
9 2005, after 30 years analyzing and testifying concerning rate of return matters at
10 FERC and its predecessor the Federal Power Commission. After retirement I
11 joined the consulting firm of Brown, Williams, Moorhead, and Quinn, Inc. Since
12 then I have provided consulting services to company clients. My education and
13 experience are described in Appendix A to this testimony.

14 **Q. What is the purpose of your testimony in this proceeding?**

15 A. The purpose of my testimony is to recommend the appropriate return on equity to
16 be included in the overall return that is applied to the jurisdictional rate base of
17 MoGas Pipeline LLC (MoGas).

18 **Q. Are you sponsoring any exhibits?**

19 A. Yes, Exhibit No. MGP-58.

20 **Q. What return on equity (ROE) are you recommending?**

21 A. MoGas is a small, new pipeline facing high risks, and therefore should be
22 allowed a ROE at the upper end of the zone of reasonableness. However, I am

1 recommending an ROE of 14.34%, the median of the DCF range that I calculated.

2

3 **Q. Please describe MoGas and its operations.**

4 **A.** MoGas is a newly created pipeline created by the merger of three affiliated
5 pipelines, Missouri Interstate Gas LLC, Missouri Gas Company LLC, and
6 Missouri Pipeline Company, LLC. The merger was allowed by the Commission
7 in an order issued April 20, 2007. Missouri Interstate Gas, LLC, 119 FERC
8 ¶61,074 (2007). MoGas operates a small natural gas pipeline operating in the
9 area southwest of St. Louis, Mo. The primary customers are small distribution
10 companies.

11 **Q. What debt cost is appropriate for MoGas?**

12 **A.** The debt cost of MoGas is 7.24 percent. The debt cost is developed and
13 supported in the testimony of Mr. Alan Lovinger (Exhibit No. MGP-1).

14 **Q. What is the appropriate capital structure for the MoGas to use in this**
15 **proceeding?**

16 **A.** MoGas has an actual capital structure of 53.40 percent equity and 46.60 percent
17 debt. The capital structure is developed by and supported in the testimony of Mr.
18 Alan Lovinger. The recommended capital structure and the weighted capital
19 costs are shown on page 1 of Exhibit No. MGP-14, Statement F-2, and also
20 below:

21

1		Ratio	Cost	Weighted Cost
2	Long Term Debt	46.60%	7.24%	3.37%
3	Common Equity	<u>53.40%</u>	14.34	<u>7.66</u>
4	Total	100.00%		11.03%

5 **Q. What return on equity is appropriate for MoGas?**

6 A. As developed subsequently in my testimony, I used the currently approved
 7 Commission DCF methodology to determine a reasonable range of equity returns.
 8 I then made a risk assessment for MoGas, and arrive at a recommended return on
 9 equity of 14.34 percent.

10 **Q. Would you explain the criteria used in your determination of a reasonable**
 11 **rate of return on equity for MoGas?**

12 A. The criteria for a fair rate of return that I used follow from the landmark Hope and
 13 Bluefield decisions and are as follows:

14 (1) The return should be commensurate with the earnings
 15 of other business enterprises having corresponding risk.

16 (2) The return should be sufficient to maintain credit and
 17 assure the financial integrity of the company.

18 (3) The return should be sufficient to enable the company to
 19 attract capital.

20 **Q. One of the criteria referred to states that the return should be commensurate**
 21 **with the earnings of other business enterprises having corresponding risk.**

22 **How does risk relate to return?**

23 A. A positive relationship exists between expected risk and expected return. An

investment perceived by investors as being of higher risk requires a higher return in order to attract investors to commit their capital. This capital attraction requirement suggests that risk must be considered in the framework of a market, where alternative investments compete for capital and, accordingly, supply and demand forces determine the costs of capital. Both regulated and unregulated firms must compete for investor capital in the debt and equity capital markets. Consequently, any estimate of a regulated firm's cost of capital should take into consideration conditions in the capital markets. A market based methodology is preferable because it uses market data in an effort to estimate the level of returns that investors expect to receive from their investments.

Q. How is a level of risk determined?

A. It is a difficult task to define and measure risk. In textbooks, most academicians equate risk with some measure of volatility. Fundamentally, it is a question of how reliably one can predict a given outcome. When examining the past, a history of wide fluctuations and volatility in results is evidence, in hindsight, of high risk. When attempting to examine the future, a situation exhibits high risk if it is characterized by a great deal of expected variability or volatility and a wide range of possible outcomes rather than a narrow, limited range of results. Conversely, when little volatility or variability is expected to occur in the future, the situation exhibits low risk. Total risk to a company is comprised primarily of business risk and financial risk.

Q. What is business risk?

A. Business risk is the fundamental risk inherent in a company's operations. The

1 term business risk refers to the variability or volatility of operating income of the
2 firm. The degree of business risk is determined largely by the effect that
3 economic conditions, competition, and supply and demand for the product or
4 service have on the firm's revenue stream.

5 **Q. What is financial risk?**

6 A. Financial risk represents a second form of risk, which results from the financing
7 decisions of the individual company. A company with no debt has no financial
8 risk. Companies finance with debt for two principal reasons: (1) The cost of debt
9 is lower than the cost of equity, and (2) debt has tax advantages, which reduce its
10 after-tax cost. A company policy of using debt to finance the purchase of assets
11 imposes financial risk on the company. The requirements to pay interest and
12 repay the principal are fixed costs, and higher fixed costs increase the variability
13 of net income available to the common stockholders. A common technique the
14 Commission has used to estimate the degree of financial risk is to look at the level
15 of the equity ratio. A high or "thick" equity ratio indicates that the company has a
16 strong balance sheet or cushion of financial resources to carry it through
17 unfavorable economic conditions without falling into default on its interest
18 obligations. A low or "thin" equity ratio indicates that the company's ability to
19 pay interest on its debt obligations may deteriorate in periods of poor economic
20 conditions due to the lack of a cushion of financial resources. Unlike preferred
21 and common dividends, which can be suspended in the absence of sufficient
22 earnings, a company is continually required to make interest payments to
23 bondholders regardless of the level of its earnings. Conventional financial theory

1 holds that a company can reduce its overall cost of capital by maintaining a
2 certain percentage of debt in its capital structure. However, if the level of debt
3 becomes too high, the cost of both debt and equity capital will increase because
4 too much financial risk is being added, thereby increasing the overall cost of
5 capital. Ideally, a company will attempt to maximize profits by assuming an
6 optimal amount of financial risk. When a company does this, it will have an
7 efficient capital structure, which is also appropriate for the risks that it faces.

8 **Q. What approach did you use to estimate the cost of equity for MoGas?**

9 A. I employed a market-based approach, the Discounted Cash Flow (DCF)
10 methodology, to estimate the equity investors' expected rate of return for MoGas
11 operations. This is the methodology that the Commission has used to determine
12 equity returns for many years.

13 **Q. How is the DCF methodology used to estimate the equity investors' expected**
14 **return?**

15 A. The DCF methodology (sometimes called the Dividend Discount Model) assumes
16 that today's price (the Present Value) of an asset is determined by investors'
17 expectations of the future stream of cash flow or income (i.e., dividends)
18 generated by the asset. Investors discount the future stream of income at some
19 required rate of return that reflects both the risk of the investment and the fact that
20 the income will be received over time. Central to the DCF methodology is the
21 assumption that markets are efficient, that is, the current price accurately reflects
22 investors' knowledge of and expectations of growth of the future income stream.
23 The DCF formula (which was designed to solve for price, when dividend,

discount rate, and growth rate are known) can be rearranged to solve for the discount rate (cost of capital) when dividend, price, and growth rate are known.

Q. Would you explain how the DCF methodology was developed?

A. The premise of the DCF methodology is that the value of an asset can be expressed as the present value of the future cash flows that investors expect to receive from that asset. Expressed algebraically, the formula is:

$$P = \frac{D_0(1+g)^1}{(1+k)^1} + \frac{D_0(1+g)^2}{(1+k)^2} + \frac{D_0(1+g)^3}{(1+k)^3} + \dots$$

If g is a constant, this simplifies to:

$$P = \frac{D_0}{k - g}$$

Where,

D_0 = Dividend at time 0

g = Estimated growth rate

k = Discount rate, or investors' expected/required rate of return

When this expression is rearranged to solve for k, the total return that investors expect from their investment in a firm's common stock, the formula becomes:

$$k = \frac{D_0}{P} + g$$

This is the simple DCF equation, which can be found in most financial textbooks and which has been used by the Commission for many years for determining the cost of common equity. Because this formula assumes that dividends are paid

continuously when dividends are in fact paid quarterly, the Commission's practice has been to make a modification to this equation to recognize the quarterly compounding of dividends paid out to stockholders. This modification results in the formula,

$$k = \frac{D(1+.5g)}{P} + g$$

DCF METHODOLOGY

Q. Would you describe the Commission DCF methodology you used to estimate the cost of equity?

A. The most recent revisions to the Commission approved methodology were made in Opinion No. 414-A, a proceeding involving Transcontinental Gas Pipe Line Corporation. In that Opinion, Transcontinental Gas Pipe Line Corporation, 84 FERC ¶ 61,084 (1998), the Commission approved a DCF derived cost of capital methodology in which a two stage growth rate was established by calculating a weighted average of a short-term five year forecast and a long-term forecast. The Commission decided to adopt a two-thirds weighting for the short-term estimate and a one-third weighting for the long-term estimate. In that decision, the Commission used the estimated five year short-term growth rate from the Institutional Brokers Estimate System (IBES) as the first stage, and an estimated long-term growth rate of the economy as a whole as the second stage in a DCF calculation. I have followed that methodology. This methodology was further modified by the Commission in its recently issued Policy Statement, 123 FERC

¶61,048 (April 17, 2008), wherein, the Commission decided to allow the inclusion of master limited partnerships (MLPs) in the proxy groups used to determine the zone of reasonableness for a company's ROE. In the Policy Statement, the Commission also modified the calculation of the long-term growth estimate for MLPs that were to be used as proxy companies. The Commission decided that the long-term GDP growth estimate should be reduced by 50 percent when calculating the growth component for an MLP included in the proxy group.

Q. Is it possible to calculate a DCF return directly for MoGas?

A. Like most FERC jurisdictional gas pipelines, MoGas is a subsidiary, and it has no publicly traded stock which can be used in estimating a market determined rate of return. Given these circumstances, the procedure has been to select a group of comparable companies to serve as a proxy for the natural gas pipeline industry, calculate a return on equity for each company, and place MoGas' allowed return somewhere within the resulting range of returns, historically called the "zone of reasonableness". I selected nine publicly traded companies, both corporations and MLPs, involved in natural gas transmission as a comparison group.

Q. What companies did you select to include in the proxy group?

A. I selected the following nine companies. Eight of the companies are MLPs and one of them is a corporation.

1. Boardwalk Pipeline Partners, L.P. (Boardwalk);
2. El Paso Pipeline Partners (EPP);
3. Enbridge Energy Partners, L.P (Enbridge);
4. Energy Transfer Partners, L.P. (ETP);
5. Enterprise Products Partners, L.P. (Enterprise);

- 1 6. Southern Union Company (Southern Union);
- 2 7. Spectra Energy Partners (Spectra Partners);
- 3 8. TC Pipelines, L.P. (TC);
- 4 9. Williams Pipeline Partners (Williams).
- 5

6 **Q. What percentage of these companies' operations are natural gas pipeline**
7 **operations?**

8 A. They all derive a significant portion of their operating income from natural gas
9 pipeline business as shown on Page 2 of Exhibit No. MGP-58.

10 **Q. Has the Commission issued any additional rulings that contain guidelines for**
11 **selecting a proxy group?**

12 A. Yes the Commission recently issued Opinion No.486-B, Kern River Gas
13 Transmission Company, 126 FERC ¶ 61,034 (January 15, 2009). In that Opinion,
14 the Commission selected a proxy group consisting of five companies based upon
15 a 2004 test year. Those five companies are shown below:

- 16 1. Kinder Morgan Inc.
- 17 2. Kinder Morgan Energy Partners, LP
- 18 3. National Fuel Gas Company
- 19 4. Northern Border Partners, L.P.
- 20 5. TC Pipelines, L.P.
- 21

22 **Q. Can those five companies be used in a proxy group in this proceeding?**

23 A. TC Pipelines Partners can be currently used. Kinder Morgan Energy Pipeline is
24 involved with products transmission, CO₂ operations, terminal operations, and
25 other operations. According to its 2008 10-K, only about 27 percent of its income
26 came from natural gas transmission operations. Kinder Morgan Inc. has been

1 taken private, and no longer is publicly traded. Northern Border is also no longer
2 publicly traded as a separate company. National Fuel Gas is primarily a
3 distribution company.

4 **Q. In your opinion, should National Fuel gas be considered a proxy company**
5 **today?**

6 A. No, National Fuel Gas is primarily a distribution company with exploration and
7 development segments also. There are enough natural gas transmission
8 companies now, that it is unnecessary to include National Fuel Gas in the proxy
9 group.

10 **Q. Are there any companies that the Commission excluded that you believe**
11 **qualify now for inclusion?**

12 A. Yes. The Commission excluded Enterprise Products Partners because it had
13 recently gone through a merger, and its gas transmission operations at that time
14 were insignificant. The merger has been over for four years, and the gas
15 transmission business of Enterprise Products is now significant.

16 Another company that the Commission excluded was Southern Union Company,
17 primarily because it had not paid a cash dividend in 2004. Southern Union has
18 been paying cash dividends since 2006, and is primarily a gas transmission
19 company. Both Enterprise Products and Southern Union should now be included
20 in a proxy group.

21 **Q. Would you now explain why each of your selected companies is suitable for**
22 **inclusion in the proxy group?**

23 A. Yes, an explanation for each company follows. Information about the degree of

1 gas transmission operations of the proxy group companies is shown on page 2 of
2 Exhibit No. MGP-58.

3 **Q. Please explain why Boardwalk Pipeline Partners should be included as a**
4 **proxy group member.**

5 A. Boardwalk Pipeline Partners is a MLP engaged in the interstate natural gas storage
6 and transportation business. Boardwalk has two main subsidiaries: Gulf South
7 Pipeline is a pipeline system that gathers gas from supply areas between Texas and
8 Alabama and delivers it to markets in the Northeast and Southeast; and Texas Gas
9 Transmission, a pipeline that moves gas from Gulf Coast supply areas to the
10 Midwest. Boardwalk is included as one of the companies in Value Line's Oil/Gas
11 Distribution Industry. Boardwalk's subsidiaries are all interstate natural gas
12 pipelines.

13 **Q. Why should El Paso Pipeline Partners be included in the proxy group?**

14 A. El Paso Pipeline Partners is a pipeline MLP. It owns 100% of Wyoming Interstate
15 Company, a pipeline serving the Rocky Mountain region, and 40% of Colorado
16 Interstate Gas Company, also operating in the Rocky Mountain region and 25% of
17 Southern Natural Gas Company. El Paso Pipeline Partners is an MLP that is a
18 100% regulated interstate pipeline partnership. El Paso Pipeline Partners is
19 included as one of the companies in Value Line's Oil/Gas Distribution Industry.

20 **Q. Why should Enbridge Energy Partners be included in the proxy group?**

21 A. Enbridge Energy Partners is a MLP that provides natural gas transportation,
22 midstream natural gas gathering, processing and liquids, and crude oil
23 transportation. Enbridge operates 11,500 miles of natural gas gathering and

1 transmission pipelines. Enbridge owns the UTOS, AlaTenn and Midla pipelines.

2 **Q. Why should Energy Transfer Partners be included in the proxy group?**

3 A. Energy Transfer Partners owns Transwestern Pipeline, a major interstate natural
4 gas pipeline. Energy Transfer Partners has pipeline operations in Arizona,
5 Colorado, Louisiana, New Mexico, Utah, and Texas. Energy Transfer Partners is
6 included as one of the companies in Value Line's Oil/Gas Distribution Industry.
7 According to Value Line, the company's 2008 operating profits were 64%
8 intrastate transportation and storage, and 11% interstate gas transportation.

9 **Q. Why should Enterprise Products Partners be included in the proxy group?**

10 A. Enterprise Products Partners is a MLP that provides natural gas pipeline
11 transportation, offshore pipeline transportation, and natural gas liquids
12 transportation. Enterprise Products Partners is included as one of the companies
13 in Value Line's Natural gas (Diversified) Industry. Value Line describes it as
14 "one of the leading integrated providers of natural gas and natural gas liquids
15 processing, fractionation, transportation, and storage services."

16 **Q. Why should Southern Union Company be included in the proxy group?**

17 A. According to Value Line, Southern Union Company is a corporation primarily
18 engaged in the transportation, storage, and distribution of natural gas. Southern
19 Union's transportation and storage operations are conducted by its subsidiaries
20 Panhandle Eastern Pipe Line Company, Trunkline Gas Company, Sea Robin
21 Pipeline Company, and a 50 percent ownership share in Florida Gas Transmission
22 Company. Southern Union is included as one of the companies in Value Line's
23 Oil/Gas Distribution Industry.

1 **Q. Why should Spectra Energy Partners be included in the proxy group?**

2 A. Spectra Energy Partners owns and operate 100% of the 1,510-mile East
3 Tennessee interstate natural gas transportation system, which extends from central
4 Tennessee eastward into southwest Virginia and northern North Carolina, and
5 southward into northern Georgia. East Tennessee supports the energy demands of
6 the southeast and mid-Atlantic regions of the United States. They also own a
7 24.5% interest in the 745-mile Gulfstream interstate natural gas transportation
8 system which extends from Pascagoula, Mississippi and Mobile, Alabama across
9 the Gulf of Mexico and into Florida.

10 **Q. Why should TC Pipelines be included in the proxy group?**

11 A. TC Pipelines is a limited partnership that owns and operates a portion of the U.S.
12 pipeline assets of TransCanada, a company based in Canada. TC Pipelines is
13 substantially involved in natural gas pipeline operations. TC Pipeline's primary
14 business is providing natural gas pipeline transportation within the U.S. TC
15 Pipelines owns 100% of Tuscarora Gas Transmission, 46.45% of Great Lakes Gas
16 Transmission and 50% of Northern Border Pipeline Company.

17 **Q. Why should Williams Pipeline Partners be included in the proxy group?**

18 A. Williams Pipeline Partners is a limited partnership that owns a 35 percent interest
19 in Northwest Pipeline, which operates a large interstate natural gas pipeline
20 system that extends from New Mexico to the northwestern area of the United
21 States. Its operations are almost entirely natural gas pipeline.

22 **Q. Turning now to the DCF formula and the proxy group calculated returns on**
23 **equity, what period did you use to calculate the dividend yields of the group?**

1 A. I calculated the average dividend yields for the proxy companies for the six month
2 period from December 2008 through May 2009. The derivation of the dividend
3 yields for the nine companies in the comparison group is shown on pages 4
4 through 12 of Exhibit No. MGP-58.

5 **Q. Did you adjust the dividend yield to comply with the Commission's**
6 **methodology regarding quarterly dividend payments?**

7 A. Yes. In order to recognize the effect of the quarterly payment of dividends, the
8 continuous yield (D/P) was multiplied by $(1 + .5 \times \text{growth rate})$ to obtain the
9 adjusted yield. The results of the yield adjustment are shown on the column titled
10 "Adjusted Dividend Yield" on page 3 of Exhibit No. 58.

11 **Q. How did you estimate the growth rates, "g", for the comparison group using**
12 **the Commission's DCF methodology?**

13 A. To arrive at the growth estimate for each company, I averaged a long-term and a
14 short-term growth forecast. The first stage, or short-term growth forecast is the
15 five year earnings growth estimate from Thomson Reuters Corporation
16 (Thomson).

17 **Q. Doesn't the Commission prefer to use the long-term growth estimates from**
18 **IBES?**

19 A. Yes. The Commission has used IBES growth estimates for this purpose for many
20 years. IBES is a service which surveys Wall Street analysts each month for their
21 estimate of each company's short-term earnings and also an estimated five year
22 earnings growth rate. It is my understanding that the estimates from IBES are no
23 longer published, and that Commission Staff is now using estimates from

1 Thomson, since they can no longer use IBES. Thomson purchased IBES a few
2 years ago and publishes growth estimates which are similar if not identical to the
3 ones published by IBES. I believe that the growth estimates published by
4 Thomson are reasonable substitutes for the IBES estimates.

5 **Q. What is the basis for the long-term growth estimates?**

6 A. The second, or long-term sustainable stage growth forecast that is averaged with
7 the short-term Wall Street analysts forecasts was long-term growth estimates of
8 the total economy as represented by the Gross Domestic Product (GDP). I used
9 an average of the long-term growth rates of GDP, as estimated by two economic
10 reporting services. Those two services, both of which have been used by the
11 Commission in the past, are:

12 (1) The Energy Information Administration (EIA), and

13 (2) The Social Security Administration's Federal Old Age and Survivors
14 Insurance and Disability Insurance Trust Fund (SSA).

15 **Q. Why did you not include an estimate from Global Insight, Inc., the third**
16 **source of GDP growth estimates used by the Commission?**

17 A. The Commission usually includes a third estimate of long-term growth from
18 Global Insight, Inc., but Global Insight is a subscription service that I do not have
19 access to. I do not believe that including an estimate from Global Insight, Inc.
20 would change the results significantly.

21 **Q. What is the estimated long-term growth rate that you determined using data**
22 **from the two sources you used?**

23 A. The EIA data that I used was published in Annual Energy Outlook with

1 projections to 2030, issued in April 2009. The SSA data that I used were
2 published in The 2008 Annual Report of The Board of Trustees of the Federal
3 Old Age and Survivor Insurance and Disability Insurance Trust Funds. The
4 second stage period will begin in the year 2013. The calculations based on data
5 from the two services are shown on page 13 of Exhibit No. MGP-58. EIA
6 estimates that in the period between 2013 and 2030, the average growth of GDP
7 will be at an annual compounded rate of 4.93 percent. SSA estimates that in the
8 period between 2013 and 2065, the average growth of GDP will be at an annual
9 compounded rate of 4.61 percent. A simple average of the two estimates of GDP
10 growth results in a 4.77 percent growth rate for the GDP, which I used as the
11 second stage growth rate in calculating the cost of equity for the corporate proxy
12 companies. I reduced the long-term growth rate by 50 percent, to 2.38 percent for
13 the MLP companies in the proxy group according to Commission directive.

14 **Q. Would you summarize the range of returns that you arrived at after**
15 **applying the DCF methodology?**

16 A. Using current Commission DCF methodology produces a range of returns on
17 equity for the pipeline industry, as shown on page 3 of Exhibit No. MGP-58, of
18 10.85 percent to 15.63 percent. The midpoint of the range is 13.24 percent. The
19 average of the range is 13.73 percent. The median of the range is 14.34 percent.

20 **Q. How do you assess the overall risk of MoGas?**

21 A. The overall risk of Mogas is a result of combining the financial risk and the
22 business risk.

23 **Q. How do you assess the financial risk of MoGas?**

1 A. The 53.40 percent equity ratio of MoGas is similar to most natural gas pipelines.
2 Accordingly, in my opinion, MoGas has financial risk which is about the same as
3 the financial risk of the proxy companies.

4 **Q. What is the recent history of MoGas's financial performance?**

5 A. Since MoGas is a newly created company, it does not have a long history of
6 operations. In 2008, MoGas' first full year of operations, the company earned
7 \$2.413 million, and had common equity of \$35.682 million. These figures
8 translate into an earned return on equity of 6.7 percent, a very low level for an
9 earned return, and an indication of the risks inherent in the start-up of a new
10 operation, such as MoGas.

11 **Q. Based on the forgoing analysis, how do you assess MoGas's business risk?**

12 A. MoGas is a small pipeline. It doesn't have the size to weather the volatility of
13 economic conditions and cushion variability of throughput demand. On the
14 demand side, it depends heavily on one customer that ships the bulk of its
15 throughput. MoGas is also a new pipeline, operating without a stable history of
16 operating results. It is difficult to predict future results without a stable history of
17 operations. Furthermore, MoGas' business is highly dependent on the economy of
18 the St. Louis, Mo. region. I conclude that MoGas' business risk is very high when
19 compared with other pipelines.

20 **Q. How do you assess the total risk of MoGas?**

21 A. Overall, combining the high business risk and the average financial risk, I
22 conclude that MoGas is high in total risk compared to the comparison group, and
23 that its return on equity should be at the upper end of the zone of reasonableness.

1 **Q. Given the zone of reasonableness that you determined, what return on equity**
2 **is appropriate for MoGas?**

3 A. Because in my view MoGas is higher in total risk relative to the comparison
4 group of pipelines, MoGas' cost of equity capital should be at or near the upper
5 end of the DCF range. However, I am recommending for MoGas a very
6 conservative allowed return on equity of 14.34 percent, which is the median of the
7 zone of reasonableness produced by the DCF methodology

8 **Q. Does that conclude your testimony?**

9 A. Yes, it does.

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I received a Bachelor of Science degree from the U.S. Military Academy, West Point, New York in June, 1964. I served in the U.S. Air Force from 1964 to 1969 as a Management Analysis Officer. During that period I participated in studies of Air Force communications and radar facilities, and conducted studies of criminal and counter-intelligence investigations for the Air Force's Office of Special Investigations. After completing my military commitment in the Air Force, I became a registered representative for Bronwen Corporation, a Washington D.C. investment brokerage firm. While a registered representative, I recommended investments in stocks and bonds and analyzed industries and firms for investment value.

In January 1973, I joined the Equitable Life Insurance Company. My position there was Securities Analyst in the investment department. My duties consisted of evaluating economic conditions and financial statements of companies to determine their potential value as investments and recommending purchase or sale of securities to the investment committee. I also analyzed the financial statements of other insurance companies that were candidates for merger or acquisition. In 1975, I joined the Federal Power Commission as a Financial Analyst analyzing financial data and testifying in rate of return matters, and I continued in that position with the Federal Energy Regulatory Commission after its establishment in 1977 until September 2005. After retiring in September, 2005 I joined the consulting firm of Brown, Williams, Moorhead, and Quinn.

1 I have testified in hearings at the Federal Power Commission and its successor,
2 the Federal Energy Regulatory Commission in the following cases:
3 Lockhart Power Company, Docket No. E-9969
4 Arizona Public Service Co., Docket No. ER76-530
5 Idaho Power Company, Docket No. ER76-508
6 Nantahala Power and Light Company, Docket No. ER76-828
7 National Gas Storage Corporation, Docket No. CP76-492
8 Kentucky West Virginia Gas Company, Docket No. RP76-93
9 Arkansas Louisiana Gas Company, Docket No. RP77-59
10 Alabama-Tennessee Natural Gas Co., Docket No. RP78-49
11 Grand Bay Company Docket No. CP77-352
12 Alabama Tennessee Natural Gas Co., Docket No. RP80-2
13 Tennessee Gas Pipeline Co., Docket Nos. RP80-97 & RP81-54
14 Midwestern Gas Transmission Co. Docket Nos. RP81-17 & RP81-57
15 Williston Basin Interstate Pipeline Co., Docket No. CP82- 487
16 KN Energy, Inc., Docket No. RP86-11
17 National Fuel Gas Supply Corporation, Docket No. RP86-136
18 Colorado Interstate Gas Company, Docket No. RP87-30
19 Arco Pipeline Co., Docket No. IS86-3
20 Endicott Pipeline Company, Docket No. IS87-36
21 Kern River Gas Transmission Co. Docket No. RP92-226
22 Pacific Gas Transmission Company, Docket No. RP94-149
23 Williston Basin Interstate Pipeline Co. Docket No. RP95-364
24 Michigan Gas Storage Company Docket No. RP96-290
25 Transcontinental Gas Pipeline Corp. Docket No. RP97-71
26 Stingray Pipeline Company Docket No. RP99-166
27 Allegheny Power Docket No. ER02-13

IN THE DISTRICT

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OF COLUMBIA

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Before me, the undersigned Notary Public, in and for the District of Columbia, personally appeared Franklin D. Knight, who being by me first duly sworn, deposes and says that he is the individual identified and responding to the questions in the attached direct testimony and that the same is true and correct to the best of his knowledge, information and belief.


Franklin D. Knight

Sworn to and subscribed before me on this 25th day of June 2009.



Notary Public

My Commission expires:

Chrys D. Lemon
Notary Public, District of Columbia
My Commission Expires ~~08-14-2008~~

8-15-2013 (CDL)