RECEIVED
2010 NOV 16 AM 10: 15
IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE	)	
APPLICATION OF ROCKY	)	**CASE NO. PAC-E-10-07**
MOUNTAIN POWER FOR	)	
APPROVAL OF CHANGES TO ITS	)	**Rebuttal Testimony of Bruce N. Williams**
ELECTRIC SERVICE SCHEDULES	)	
AND A PRICE INCREASE OF $27.7	)	
MILLION, OR APPROXIMATELY	)	
13.7 PERCENT	)	

ROCKY MOUNTAIN POWER

CASE NO. PAC-E-10-07

November 2010

Introduction and Summary of Rebuttal Testimony

Q. Are you the same Bruce N. Williams that provided direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the capital structure recommendations offered by Monsanto Company ("Monsanto") witness Mr. Michael P. Gorman and the adjustment to pension expense proposed by Idaho Public Utilities Commission ("IPUC") Staff witness Mr. Donn English.

In my analysis, I demonstrate that Mr. Gorman's recommendations unreasonably propose the use of a hypothetical capital structure without a clear and compelling justification for disregarding PacifiCorp's actual capital structure. PacifiCorp's proposed 52.1 percent equity component remains well supported by the updated cost of capital summary presented in my testimony. Adoption of PacifiCorp's actual capital structure will allow the Company a fair opportunity to maintain its credit rating and attract capital on reasonable terms.

My rebuttal testimony also responds to Monsanto's overall rate of return recommendations and shows how this recommendation, if adopted, would negatively impact PacifiCorp's financial integrity.

Review of Staff and Monsanto Recommendations

Q. What are Monsanto's and IPUC's recommendations on cost of capital?

A. Mr. Gorman recommends a hypothetical capital structure that reduces the equity component from PacifiCorp's actual equity share of 52.1 percent to 49.7 percent.

IPUC witness Ms. Terri Carlock proposes slight changes to the Company's cost of long-term debt and preferred stock. Both Monsanto and IPUC propose reductions to the Company's proposed return on equity which Dr. Samuel C. Hadaway will discuss in his rebuttal testimony.

Q. Are there items concerning the cost of capital in your direct testimony with which the parties agreed?

A. Yes, Ms. Carlock accepts the Company's proposed capital structure and Mr. Gorman accepts the Company's proposed cost of long-term debt and preferred stock.

Company's Overall Cost of Capital

Q. Are you proposing a new overall cost of capital in this proceeding?

A. No. Although the Company accepts Ms. Carlock's proposed cost of debt and preferred stock, the resulting overall cost of capital remains at 8.34 percent. The table below shows the Company's cost of capital adjusted for Ms. Carlock's proposed changes:

Overall Cost of Capital

Component	Percent of Total	% Cost	Weighted Average
Long Term Debt	47.6%	5.88%	2.80%
Preferred Stock	0.3%	5.42%	0.02%
Common Stock Equity	52.1%	10.60%	5.52%
Total	100.0%		8.34%

Q. What is the Company's actual capital structure?

A. At September 30, 2010, the capital structure was:

Long Term Debt	47.0%
Preferred Stock	0.3%
Common Stock Equity	52.7%

As the table above shows, the Company's actual equity component at the end of September is in excess of the 52.1 percent in the proposed capital structure. In addition, the common equity component will increase through the end of the year as the Company continues to retain all earnings. Finally, it should be noted that since acquisition by MidAmerican Energy Holdings Company in 2006, PacifiCorp's common equity component has averaged 50.6 percent of total capitalization.

Q. Please explain the benefits of the Company's actual capital structure.

A. The Company's actual capital structure is intended to maintain current credit ratings. As I discussed in my direct testimony, maintenance of the Company's credit ratings benefits customers by reducing immediate and future borrowing costs. In addition, higher rated companies are more likely to have on going, uninterrupted access to capital and access at lower costs. Further, higher rated companies have greater access to the long-term markets for power purchases and sales which provides more alternatives to meet the current and future load requirements of customers. Also, higher rated companies can often avoid or reduce the amount of costly collateral requirements that are typically imposed on lower-rated companies when transacting in the wholesale energy markets.

Reply to Monsanto Witness Mr. Gorman

Hypothetical Capital Structure

Q. What is your general response to Mr. Gorman's capital structure recommendations?

A. Mr. Gorman proposes a series of adjustments to PacifiCorp's actual capital structure to produce a hypothetical capital structure with a common equity component of 49.7 percent. Mr. Gorman has failed to provide a clear and compelling justification for his hypothetical capital structure. Mr. Gorman's adjustments are arbitrary and without a financial basis. Further, he uses a time period for his common equity analysis which is inconsistent with the rate case test period and his attempts to prove the recommended equity structure is supportive of the Company's credit rating are in error.

Q Please explain Mr. Gorman's adjustments to the Company's actual common equity component.

A. Mr. Gorman proposes to remove special deposits, short-term investments, and the difference in affiliate notes receivable and payable. The most significant of these is the adjustment for short term investments of $196 million. Mr. Gorman believes his capital structure "is more reasonable for setting rates because it reflects the actual common equity capital RMP relied on to invest in utility plant."[1]

Q. Please identify the fundamental problems in Mr. Gorman's analysis.

A. First, as of September 30, 2010, the Company had exhausted its temporary cash

---

[1] Gorman Direct Testimony page 14 lines 4 and 5.

investments, effectively eliminating this aspect of Mr. Gorman's adjustments.

Additionally, in general financial treatment, short term investments are often netted against long term debt to determine what is known as "net debt". Net debt is used as a financial metric to reflect the company's net obligation to its bondholders. Nowhere in general finance is there support for Mr. Gorman's novel proposal to net common equity with cash to derive net common equity.

Q. Mr. Gorman states that it is reasonable to believe that these short-term cash investments simply represent a placeholder for all the earnings RMP is retaining until needed to fund utility plant investment.[2] Do you agree with him?

A. No. All of the Company's net cash from operations since acquisition by MEHC has been re-invested in the business. The fact is that PacifiCorp is investing more into its business than the amount of cash flow generated by operations. For example during the first six months of 2010, the Company has invested $876 million into capital expenditures while generating only $779 million of net cash flow from operations. These facts show that Mr. Gorman's position is unfounded.

Q. Did Mr. Gorman use the same period of time as the Company to determine his hypothetical capital structure?

A. No, based on Exhibit No. 202 (MPG-1) Mr. Gorman is using a period of time from June 30, 2009, through June 30, 2010. However, the Company's capital structure was determined as the average during the twelve months ending December 31, 2010. Therefore, as the Company expects to retain all earnings

---

[2] Gorman Direct Testimony page 14 line 24 through page 15 line 2.

during 2010 to finance necessary capital expenditures to serve its customers, Mr. Gorman would naturally have a lower common equity percentage than what the Company calculated.

Q. Do you agree with Mr. Gorman's statement that the Company's capital structure at June 30, 2010, is 52.2 percent and is very close to that projected by the Company for year-end 2010 of 52.1 percent?[3]

A. Yes, Mr. Gorman has correctly stated the Company's actual common equity level of 52.2 percent at June 30, 2010. However, the 52.1 percent he cites is the expected average during the calendar year and the common equity component will be higher at year end 2010. This higher ratio will permit maintenance of the Company's credit rating and allow the Company to attract additional capital to meet construction needs.

Credit Metric Analysis

Q. Please comment on Mr. Gorman's discussion concerning financial integrity and his credit metric analysis.

A. I disagree with Mr. Gorman's analysis and conclusions for four reasons:

- First, Mr. Gorman's calculations did not properly reflect the adjustments that rating agencies make when calculating their credit metrics. For instance, my direct testimony stated that S&P adds nearly $1 billion of additional debt and $73 million of interest to PacifiCorp's reported results.[4] While Mr. Gorman did attempt to include the adjustments, he unfortunately only included a

---

[3] Gorman Direct Testimony page 13 lines 20 through 21.

[4] Beginning with their April 30, 2010 report S&P now imputes $78.2 million of interest while the debt amount is approximately the same. This increase, while not material to the discussion above, would further weaken Mr. Gorman's credit metrics had he included the updated adjustments.

portion of the total adjustments and not the entire amounts. He includes less than half of the total debt adjustments ($432 million vs. $998.2 million) and only $28.1 million of the $73 million of additional interest.[5]

- Second, even the portion of the adjustments he included is incorrectly stated as Mr. Gorman further reduces the amount by mis-matching an Idaho allocation percentage to a total company capital structure. This further reduces the impact of the already too low adjustments.
- Third, Mr. Gorman's model also excludes a significant amount of interest expense that the Company reports on its financial statements such as interest expense on customer deposits, interest on capital leases, regulatory liabilities and others.
- Fourth, Mr. Gorman ignores the rating agencies published expectations for PacifiCorp and instead measures the flawed results of his model against the general utility industry. Had Mr. Gorman used the Company specific targets from the rating agencies, his already over-stated results still would not have supported the Company's current ratings.

Q. Was Mr. Gorman aware of these rating agency published expectations for the Company?

A. Yes, Mr. Gorman cites them in his testimony on page 10 for Standard & Poor's and page 11 for Moody's. It is not clear why he ignored them for purposes of his credit metrics.

---

[5] Monsanto Company Exhibit No. 218 (MPG-17) lines 6 and 9.

Q. Should the Commission disregard Mr. Gorman's statements that his recommended return on equity and proposed capital structure are supportive of the Company's current bond rating?

A. Yes, for reasons outlined above, the Commission should disregard Mr. Gorman's statements that his recommended return on equity and proposed capital structure are supportive of the Company's current bond rating.

Q. Are there other inaccuracies in Mr. Gorman's testimony?

A. Yes. There are certain errors in Mr. Gorman's testimony that, while not essential to determining the cost of capital, should be corrected for the record in this case. For example on page nine of his testimony, Mr. Gorman states that RMP is a subsidiary of PacifiCorp and that PacifiCorp issues debt and equity on behalf of RMP. The fact is that RMP is not a subsidiary of PacifiCorp. RMP is a division of PacifiCorp and is the trade name under which PacifiCorp delivers electricity to customers in Idaho, Utah and Wyoming. Further, PacifiCorp is the financing entity and issues debt and equity to fund its overall needs including those of the operating divisions such as RMP and its other sister operating divisions.

Reply to IPUC Witness Mr. English

Q. Please describe the adjustment that Mr. English is proposing to the Company's pension expense.

A. Mr. English is proposing to average the projected contributions to the pension plan for the period of 2010 through 2014. This averaging results in a proposed reduction to pension expense of $20.9 million.

Q. Do you agree with Mr. English's proposed reduction to pension expense?

A. No. It is my understanding that historically this Commission has used cash contributions for the test period to set rates. The Company continues to believe that recovery of 2010 cash contributions is the most appropriate outcome. As discussed in Mr. Steven R. McDougal's testimony, the Company does not believe it is appropriate for parties to flip back and forth between approaches depending on what will give the lowest result. The Company's filing included expected cash contributions of $104.8 million during 2010 and this is the level that the Commission should include in determining revenue requirement.

Q. What was the actual level of cash contributions during 2010?

A. The Company's cash contribution to fund its pension plan in 2010 was $112.8 million.

Q. Why did the Company contribute $112.8 million in 2010 to its pension plan?

A. The Company made an additional $8 million contribution during 2010 in order to help improve the funded status of the pension plan. While the Company was scheduled to contribute $104.8 million to the pension plan during 2010 to meet minimum funding requirements, the resulting funded ratio would have been 79.45 percent. Plans with funded ratios below 80 percent are subject to restrictions including limits on lump sum distribution of benefits and plan amendments that would increase benefits. In addition, the plan would be put in "at risk" status as of January 1, 2011, causing a significant increase in the 2011 minimum funding requirements. By making an additional $8 million contribution (for a total of $112.8 million) the plan increased its expected funded status to 80.14 percent thereby avoiding benefit restrictions and "at risk" status, including the required notifications to plan participants, the Pension Benefit Guaranty Corporation, and any labor organizations representing plan participants.

Q. Has any party proposed that the Company should not be allowed to recover the contributions to the pension plan?

A. Indirectly, yes. If the Commission adopted Mr. English's forward looking[6] five-year average proposal it would assure under recovery of 60 to 80 percent of the 2010 contributions depending on the timing of the Company's next rate case.

Q. Is there an alternative method that the Commission could consider?

A. It is my understanding that the Commission has traditionally preferred historical data with adjustments for known and measurable changes. As such, the use of a historical average, updated for actual 2010 contributions, would be appropriate. If the Commission wished to consider an alternative to the Company's proposed 2010 cash contributions, the Company would suggest a three-year average of historical contributions. In addition, the Company would recommend updating the 2010 contribution to the actual contribution amount of $112.8 million. This approach would smooth the impact of the pension contributions while providing the Company an opportunity to recover its actual pension contributions.

However, if the Commission were to adopt the use of a historical average of cash contributions, the Company respectfully requests that this be made as a policy decision to ensure consistency and is applied in all future rate cases. The

---

[6] This treatment in effect becomes a forecasted revenue requirement item in the case based on information beyond the test period and is a mismatch with the test period convention followed by the Company in its Application.

use of a historical average, if adopted and consistently followed, should ensure that over time the Company collects an amount equal to its contributions.

Q. What have been the actual contributions over the historical three year period?

A. The contributions and the resulting average are as follows:

	Cash Contributions
2010	$112.8 million
2009	49.6 million
2008	65.6 million
Average	$76.0 million

Q. Would use of a historical average allay the concerns that Mr. English cited in his direct testimony?

A. Yes. Mr. English expressed a concern that including the 2010 contribution amount in rates that go into effect in 2011 and potentially remaining in effect for several years could allow the Company to collect significantly more in revenue than necessary to meet its pension obligations.[7]

Q. What is the resulting adjustment if the Commission adopts a three-year average of historical contributions?

A. The result of the three-year historical average would be a reduction of $19.11 million from the total Company O & M expense in the Company's direct case or $1.03 million to Idaho. Company witness Mr. McDougal details how the adjustment was calculated in his testimony. However, such an adjustment would

[7] English direct testimony page 9 lines 17 through 21.

only be appropriate if it is accompanied by a policy decision by the Commission that consistently applies this treatment in future rate case proceedings so that the Company has a reasonable opportunity to collect its pension contributions over time.

Q. Does that conclude your rebuttal testimony?

A. Yes.