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IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE
IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE)
APPLICATION OF ROCKY MOUNTAIN)
POWER FOR APPROVAL OF)
CHANGES TO ITS ELECTRIC)
SERVICE SCHEDULES AND A PRICE)
INCREASE OF \$27.7 MILLION, OR)
APPROXIMATELY 13.7 PERCENT)

CASE NO. PAC-E-10-07

Rebuttal Testimony and Exhibits of

Michael P. Gorman

On behalf of

Monsanto Company

Project 9210
November 16, 2010

BAI
BRUBAKER & ASSOCIATES, INC.
CHESTERFIELD, MO 63017

PACIFICORP dba ROCKY MOUNTAIN POWER
BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION
CASE NO. PAC-E-10-07

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Rebuttal Testimony of Michael P. Gorman

1 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140,
3 Chesterfield, MO 63017.

4 Q ARE YOU THE SAME MICHAEL P. GORMAN WHO PREVIOUSLY FILED
5 TESTIMONY IN THIS PROCEEDING?

6 A Yes.

7 Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

8 A I am appearing on behalf of Monsanto Company, a special contract customer of
9 Rocky Mountain Power ("RMP" or "Company").

10 Q ARE YOU SPONSORING ANY EXHIBITS IN CONNECTION WITH YOUR
11 REBUTTAL TESTIMONY?

12 A Yes, Exhibit No. 232 (MPG-20) and Exhibit No. 233 (MPG-21).

13 Q WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS
14 PROCEEDING?

15 A I will respond and comment on the rate of return recommendation of Idaho Public
16 Utilities Commission Staff witness Terri Carlock.

1 Q PLEASE OUTLINE THE RECOMMENDATIONS MADE BY STAFF WITNESS
2 CARLOCK TO WHICH YOU WILL RESPOND.

3 A Ms. Carlock supports the Company's proposed capital structure, and recommends a
4 return on equity of 10%, which is at the midpoint of her recommended range of 9.5%
5 to 10.5%.

6 Q WHAT REASONS DID MS. CARLOCK GIVE TO SUPPORT THE COMPANY'S
7 PROPOSED CAPITAL STRUCTURE IN THIS PROCEEDING?

8 A Ms. Carlock provided no support or rationale for why she concludes that the
9 Company's proposed capital structure is reasonable for setting rates. For the
10 reasons set forth in my testimony, it is important that the Commission carefully review
11 the Company's capital structure to ensure that it is reasonable, and will minimize the
12 Company's cost of capital, while maintaining its financial integrity and credit standing.

13 Q HOW DID MS. CARLOCK DEVELOP HER RECOMMENDED RETURN ON EQUITY
14 IN THE RANGE OF 9.5% TO 10.5%?

15 A Ms. Carlock performed both a comparable earnings analysis and a discounted cash
16 flow ("DCF") return estimate. Ms. Carlock's comparable earnings analysis was based
17 on earned return on equity for electric utilities followed by *The Value Line Investment*
18 *Survey*, with a financial strength rating of "A." There, she found that the return on
19 equity for these companies falls in the range of 9.0% to 10.5%. (Carlock at 18).
20 However, she does not identify the year of the expected earned return on equity, nor
21 does she show any schedules supporting her findings. Further, Ms. Carlock's
22 comparable earnings analysis indicates that the return for electric utility companies in
23 the West region of the United States, including Idaho utilities, is around 8.6% to 9.0%.

1 Based on this comparable earnings assessment, she concludes that a fair return on
2 equity for PacifiCorp would be in the range of 9.0% to 10.5%.

3 Ms. Carlock also performed a DCF analysis. Based on her DCF analysis, she
4 found that a fair return on common equity would be in the range of 8.8% to 9.3%, with
5 a recommended point estimate at 9.3%. (Carlock at 19-20).

6 Based on these results, Ms. Carlock estimated a return on equity for
7 PacifiCorp in the range of 9.5% to 10.5%. (*Id.* at 21).

8 **Q DO YOU BELIEVE MS. CARLOCK'S COMPARABLE EARNINGS ANALYSIS**
9 **PRODUCES A FAIR RETURN ON EQUITY FOR RMP IN THIS CASE?**

10 **A** No. Earned return on equity for the publicly traded companies followed by *The Value*
11 *Line Investment Survey* does not accurately identify what a fair return on equity for
12 PacifiCorp's investment in regulated utility operations in Idaho would be in today's
13 marketplace. This is true for several reasons. First, the comparable earnings
14 analysis measures an accounting return and not an investor-required return. To the
15 extent the accounting earned return on equity is higher or lower than the
16 investor-required return, then the value of the Company's security would trade at a
17 premium or discount to its underlying book value. Hence, the earned return does not
18 represent fair compensation based on current capital market costs.

19 Further, the companies relied on by Ms. Carlock to measure her comparable
20 earned return on equity of 10.5% are on average trading at a significant premium to
21 book value. For example, as shown on my Exhibit No. 232 (MPG-20), the average
22 market-to-book ratio for the companies followed by *The Value Line Investment*
23 *Survey* that have a financial strength rating in the "A" category, had a median return
24 on equity for 2009 of 10.5%, and a median market-to-book ratio of 141%. In
25 significant contrast, the median earned return for the utilities followed by *The Value*

1 *Line Investment Survey* in the West District portion of the U.S. had a median return
2 on equity of 8.6%, and a median market-to-book ratio of 121%. This evidence clearly
3 suggests that a 10.5% return on equity exceeds the current market's required return
4 on equity, because the price of security was bid up in response to this above-market
5 earnings opportunity. Therefore, her earned return on equity estimate exceeds the
6 required return on investment by the market, and a 10.5% return on equity is
7 unreasonably high in today's very low capital market cost.

8 **Q ARE THERE OTHER CONCERNS WITH THE COMPARABLE EARNINGS**
9 **ANALYSIS USED BY MS. CARLOCK TO ESTIMATE A FAIR RETURN FOR RMP**
10 **IN THIS PROCEEDING?**

11 A Yes. Many of the companies included in the group of *Value Line* companies with a
12 financial strength rating of "A," include companies that have subsidiaries in merchant
13 generation and other commodity-related businesses. Indeed, these companies
14 demonstrate the highest earned return on equity during 2009. For example, Entergy
15 Corp. had a return on equity of 14.3%, Exelon Corp. had a return on equity of 22.5%,
16 and Sempra Energy had a return on equity of 13.1%. These companies in particular
17 had very high earned returns on equity, which may have largely been driven by their
18 merchant generation affiliates. Earnings on merchant generation activities or other
19 non-regulated businesses are not reasonable risk proxies for PacifiCorp and do not
20 produce a fair return on equity estimate to use to set rates.

21 **Q DOES MS. CARLOCK'S DCF RETURN ESTIMATE SUFFER FROM THE SAME**
22 **SHORTCOMINGS AS HER COMPARABLE EARNINGS ANALYSIS?**

23 A No. A DCF return does measure the investor-required return, but will increase and
24 decrease based on markets' demand for higher compensation for assuming the risk

1 of investment, or for changes in market capital costs that are driven by changes in
2 underlying security valuations. Hence, the DCF return estimate does measure the
3 correct return, and that is the return investors are currently requiring in order to
4 assume the underlying investment risk of a company.

5 **Q SETTING ASIDE YOUR CONCERN WITH THE VALIDITY OF A COMPARABLE**
6 **EARNINGS ANALYSIS, WOULD A COMPARABLE EARNINGS ANALYSIS OF**
7 **THE VALUE LINE COMPANIES WITH A FINANCIAL STRENGTH OF "A"**
8 **SUPPORT A 10.5% RETURN BASED ON 2010 DATA?**

9 A No. As shown on Exhibit No. 233 (MPG-21), while the earned return on equity for
10 companies followed by *The Value Line Investment Survey* in 2009 was at a median
11 10.5%, using the same data in 2010 suggests a return on equity of 10.0% for these
12 same companies. Using this more recent data, and reflecting current expected
13 earned returns on equity, Ms. Carlock's return on equity range would top out at 10%,
14 rather than the 10.5% she estimated. Further, if the low-end is set at her 9.3% DCF
15 return, then the adjusted Carlock range would be 9.3% to 10.0%, with a midpoint of
16 9.65%. This adjusted point estimate is comparable to my recommended return on
17 equity for RMP in this case of 9.6%.

18 **Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

19 A Yes, it does.

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Rocky Mountain Power

Market to Book Ratio

<u>Line</u>	<u>Company</u>	<u>Industry Name</u> (1)	<u>Financial Strength</u> (2)	<u>2009 Return on Equity</u> (3)	<u>Market To Book</u> (4)
<u>Value Line Electric Utility Companies with a Financial Strength of "A"</u>					
1	ALLETE	Electric Utility (Central)	A	6.6%	131%
2	Alliant Energy	Electric Utility (Central)	A	6.8%	134%
3	Entergy Corp.	Electric Utility (Central)	A	14.3%	166%
4	MGE Energy	Electric Utility (Central)	A	10.2%	170%
5	OGE Energy	Electric Utility (Central)	A	12.7%	178%
6	Otter Tail Corp.	Electric Utility (Central)	A	3.8%	102%
7	Vectren Corp.	Electric Utility (Central)	A	10.5%	136%
8	CH Energy Group	Electric Utility (East)	A	8.1%	122%
9	Consol. Edison	Electric Utility (East)	A+	8.5%	127%
10	Duke Energy	Electric Utility (East)	A	6.7%	105%
11	Exelon Corp.	Electric Utility (East)	A+	22.5%	198%
12	NextEra Energy	Electric Utility (East)	A	12.5%	153%
13	NSTAR	Electric Utility (East)	A	13.0%	208%
14	Public Serv. Enterprise	Electric Utility (East)	A	17.8%	169%
15	SCANA Corp.	Electric Utility (East)	A	10.2%	134%
16	Southern Co.	Electric Utility (East)	A	12.4%	188%
17	Sempra Energy	Electric Utility (West)	A	13.1%	141%
18	Average			11.2%	151%
19	Median			10.5%	141%
<u>Value Line Western Electric Utility Companies</u>					
20	Avista Corp.	Electric Utility (West)	B++	8.3%	108%
21	Black Hills	Electric Utility (West)	B+	8.3%	117%
22	Edison Int'l	Electric Utility (West)	B++	10.8%	110%
23	El Paso Electric	Electric Utility (West)	B++	9.3%	131%
24	Hawaiian Elec.	Electric Utility (West)	B+	5.8%	141%
25	IDACORP, Inc.	Electric Utility (West)	B+	8.9%	120%
26	NV Energy Inc.	Electric Utility (West)	B	5.7%	95%
27	PG&E Corp.	Electric Utility (West)	B++	11.2%	167%
28	Pinnacle West Capital	Electric Utility (West)	B+	6.9%	123%
29	PNM Resources	Electric Utility (West)	B	3.2%	61%
30	Portland General	Electric Utility (West)	B+	6.2%	98%
31	Sempra Energy	Electric Utility (West)	A	13.1%	141%
32	UniSource Energy	Electric Utility (West)	C++	13.9%	157%
33	Xcel Energy Inc.	Electric Utility (West)	B++	9.4%	144%
34	Average			8.6%	122%
35	Median			8.6%	121%

Source:

The Value Line Investment Survey, August 27, September 24, and November 5, 2010.

Rocky Mountain Power

Return on Common Equity Comparison

<u>Line</u>	<u>Company</u>	<u>Industry Name</u> (1)	<u>Financial Strength</u> (2)	<u>Return on Equity</u>	
				<u>2009</u> (3)	<u>2010</u> (4)
<u>Value Line Electric Utility Companies with a Financial Strength of "A"</u>					
1	ALLETE	Electric Utility (Central)	A	6.6%	8.0%
2	Alliant Energy	Electric Utility (Central)	A	6.8%	9.5%
3	Entergy Corp.	Electric Utility (Central)	A	14.3%	14.5%
4	MGE Energy	Electric Utility (Central)	A	10.2%	10.5%
5	OGE Energy	Electric Utility (Central)	A	12.7%	13.0%
6	Otter Tail Corp.	Electric Utility (Central)	A	3.8%	4.5%
7	Vectren Corp.	Electric Utility (Central)	A	10.5%	9.5%
8	CH Energy Group	Electric Utility (East)	A	8.1%	8.5%
9	Consol. Edison	Electric Utility (East)	A+	8.5%	9.0%
10	Duke Energy	Electric Utility (East)	A	6.7%	8.0%
11	Exelon Corp.	Electric Utility (East)	A+	22.5%	18.5%
12	NextEra Energy	Electric Utility (East)	A	12.5%	14.0%
13	NSTAR	Electric Utility (East)	A	13.0%	13.5%
14	Public Serv. Enterprise	Electric Utility (East)	A	17.8%	16.0%
15	SCANA Corp.	Electric Utility (East)	A	10.2%	10.0%
16	Southern Co.	Electric Utility (East)	A	12.4%	13.0%
17	Sempra Energy	Electric Utility (West)	A	13.1%	10.0%
18	Average			11.2%	11.2%
19	Median			10.5%	10.0%
<u>Value Line Western Electric Utility Companies</u>					
20	Avista Corp.	Electric Utility (West)	B++	8.3%	8.0%
21	Black Hills	Electric Utility (West)	B+	8.3%	5.5%
22	Edison Int'l	Electric Utility (West)	B++	10.8%	10.0%
23	El Paso Electric	Electric Utility (West)	B++	9.3%	11.0%
24	Hawaiian Elec.	Electric Utility (West)	B+	5.8%	8.0%
25	IDACORP, Inc.	Electric Utility (West)	B+	8.9%	9.5%
26	NV Energy Inc.	Electric Utility (West)	B	5.7%	6.5%
27	PG&E Corp.	Electric Utility (West)	B++	11.2%	10.5%
28	Pinnacle West Capital	Electric Utility (West)	B+	6.9%	9.0%
29	PNM Resources	Electric Utility (West)	B	3.2%	3.5%
30	Portland General	Electric Utility (West)	B+	6.2%	8.0%
31	Sempra Energy	Electric Utility (West)	A	13.1%	10.0%
32	UniSource Energy	Electric Utility (West)	C++	13.9%	13.5%
33	Xcel Energy Inc.	Electric Utility (West)	B++	9.4%	9.5%
34	Average			8.6%	8.8%
35	Median			8.6%	9.3%

Source:

The Value Line Investment Survey, August 27, September 24, and November 5, 2010.