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Cross
Exhibit
RMP 2 (RoR)

Testimony of Charles E. Peterson

I. INTRODUCTION AND SUMMARY

Q: Please state your name, business address and title.

A: My name is Charles E. Peterson; my business address is 160 East 300 South, Salt Lake City, Utah 84114; I am a Technical Consultant in the Division of Public Utilities (Division).

Q: On whose behalf are you testifying?

A: The Division.

Q: Please summarize your educational and professional experience.

A: I attended the University of Utah and earned a B.A. in mathematics in 1978 and a Master of Statistics (M.Stat.) through the Graduate School of Business in 1980. In 1990 I earned an M.S. in economics, also from the University of Utah.

Between 1980 and 1991 I worked as an economic and financial consultant and business appraiser for several local firms or local offices of national firms. My work frequently involved litigation support consulting and I have testified as an expert witness in both federal and state courts.

In 1991 I joined the Property Tax Division of the Utah State Tax Commission. In 1992 I was promoted to manager over the Centrally Assessed Utility Valuation Section. I have provided expert testimony regarding valuation, economic and cost of capital issues, both in deposition and formal hearing, before the Utah State Tax Commission.

I joined the Division at the first of January 2005 as a utility analyst; in May 2006 I was promoted to Technical Consultant. I have worked primarily in the energy section of the Division.

My resume is attached as DPU Exhibit 3.1.

Q: Please outline the projects you have worked on since coming to the Division.

A: I was involved in evaluating cost of capital issues in the 2004 rate case that was settled in February 2005. I subsequently co-authored a paper regarding the Capital Asset Pricing Model (CAPM) published in the *The NRRI Journal of Applied Regulation*[1]. I have worked on DSM, service quality and customer guarantees involving PacifiCorp. I was the Division lead on an internal research project regarding ring-fencing that resulted in a report to the Public Service Commission. I was the lead of the economics and finance group within the Division assigned to evaluate the proposed acquisition (the Acquisition) of PacifiCorp (the "Company") by MidAmerican Energy Holdings Company ("MEHC").

Q: Have you previously provided testimony to the Commission?

A: Yes. I first filed testimony in the Uinta Basin Telephone case (Docket No. 05-053-01) regarding ring-fencing issues. I subsequently filed testimony in the PacifiCorp Acquisition matter (Docket No. 05-035-54) as the primary Division witness.

Q: What is the purpose of your testimony in this matter?

A: My testimony covers the cost of capital estimates, including the related capital structure issues, used by the Division in its determination that the overall settlement and Stipulation for the $115 million increased revenue requirement was reasonable. The Stipulation indicates

[1] The NRRI Journal of Applied Research, vol. 3, December 2005, Ohio State University, Columbus, OH, pp. 57-70.

"that PacifiCorp's authorized return on common equity for purposes of this Stipulation will be 10.25%."[2] I will provide testimony supporting the Division's belief that the 10.25 percent return on equity (ROE) is within a reasonable range.

Q: Are you asking the Commission to make substantive findings regarding cost of capital methodologies and results?

A: No. The Division is only asking the Commission to accept the part of the Stipulation referring to the 10.25 percent ROE. The purpose of my testimony is to provide the Commission background to understand why the Division accepts the Stipulation as reasonable and in the public interest. The other Parties to the Stipulation may have differing views regarding cost of capital issues, which the Commission is not being asked to resolve.

Q: Please summarize the work and investigations that you have performed in this matter.

A: I have reviewed and analyzed the testimonies of PacifiCorp witnesses Bruce N. Williams, the Company's Treasurer, and Samuel C. Hadaway, Ph.D., an outside cost of equity expert. Mr. Williams provided testimony regarding cost of debt, cost of preferred stock and capital structure. Dr. Hadaway filed testimony on cost of equity. I also began my own, independent evaluation of these issues, particularly with respect to cost of equity.

Q: Was your independent study of the cost of capital issues completed?

A: No. At the time the settlement was reached the results from my independent analysis were preliminary. However, my analysis had progressed to the point that I had determined a reasonable range for the ROE. I had also determined that the returns on preferred stock and long-term debt proposed by Mr. Williams were in a reasonable range, and that it was unlikely that I would be proposing significant adjustments to those values. Mr. Williams' proposed

[2] Stipulation Regarding Revenue Requirement and Rate Spread ("Stipulation"), Docket No. 06-035-21, paragraph 9.

capital structure was also determined to be largely justifiable, though subject to "tweaking" which will be discussed below.

Q: What was the Company's original filed position regarding cost of capital?

A: The Company asked for the following cost of capital rates of return:[3] Long-term Debt, 6.41 percent; Preferred Stock, 6.54 percent; Common Stock, 11.40 percent.

The following capital structure was also requested: Long-term Debt, 46.2 percent; Preferred Stock, 1.0 percent; Common Stock, 52.8 percent.

Q: With respect to the Company's filed testimony and the Stipulation what have you concluded?

A: I determined that the cost of long-term debt and the cost of preferred stock were within the reasonable range for settlement. Likewise, with the exception of a small change in the requested capital structure, the requested capital structure was determined to be reasonable. The 10.25 percent ROE figure set forth in the Stipulation likewise was determined to be within a reasonable range.

The Division used these values related to cost of capital and capital structure as part of its determination that the settlement represented by the Stipulation was reasonable and in the public interest. The Division supports and recommends to the Commission the 10.25 percent authorized ROE as it is set forth in the Stipulation. DPU Exhibit 3.2 summarizes the results of my cost of common equity analysis.

[3] Direct Testimony of Bruce N. Williams, page 3.

II. CAPITAL STRUCTURE

Q: What capital structure did the Division consider when evaluating potential settlement positions?

A: The Division began with the latest actual capital structure of the Company that was available from the Company's SEC Form 10-K as of March 31, 2006. At that date the capital structure was 50 percent common equity, 49 percent long-term debt and 1 percent preferred stock. Subsequently, the Company announced on June 29, 2006 that its parent company, MEHC had made an equity contribution of $73.5 million. By itself this capital infusion would increase the capital structure to about 50.4 percent common equity. Furthermore, since for its fiscal year ended March 31, 2006 PacifiCorp had net income of approximately $360 million, or an average of $90 million per quarter, and since PacifiCorp management has stated that it does not intend to pay dividends on common stock for at least the next 12 months,[4] it seems likely that the Company's actual capital structure at June 30, 2006 was approximately 51 percent common equity, 48 percent long-term debt and 1 percent preferred stock. Company representatives indicated that this was correct. I extrapolated this trend to December 2006, when any new rates would take effect under the Stipulation, if approved by the Commission. This extrapolation resulted in a common percentage of 51.5 to 52 percent of capital without any further contributions from MEHC. The Division concluded that 52 percent common equity was a reasonable figure for the Company's capital structure in its evaluation of the settlement.[5]

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[4] PacifiCorp SEC Form 10-K, March 31, 2005, p. 45.

[5] Subsequent events: The Division has received the Company's SEC Form 10-Q for the quarter ended June 30, 2006. At that time PacifiCorp's capital structure was approximately 50.65 percent common equity. The Division has also learned that on August 8, 2006 PacifiCorp issued $350 million in long-term debt, apparently to mostly pay down short-term obligations. By itself, this debt issuance would lower the common equity percentage to about 49 percent. However, Standard & Poor's indicates that it expects further equity infusions from MEHC.

Q: Did the Division consider the capital structure effects on the Company's debt ratings?

A: Yes. Standard & Poor's published criteria indicated that among other factors, a company with PacifiCorp's risk profile[6] needs to have an equity (common and preferred) percentage of 50 percent, or higher, to maintain PacifiCorp's current bond rating. Because Standard & Poor's includes short-term debt and adds an amount for purchased power agreements to the debt side of the equation, the result is the regulatory capital structure needs to be higher than 50 percent equity in order to satisfy this particular rating agency criterion. The Division estimates that the 52 percent common equity along with 1 percent preferred stock puts the Company close to the minimum capital structure required by the Standard & Poor's criterion. Therefore the Company's efforts to date to increase its equity capital are reasonable in light of this rating agency criterion.

III. COST OF DEBT AND PREFERRED STOCK

Q: What did you do with respect to the cost of debt and preferred stock?

A: I studied the testimony of Bruce Williams and the related exhibits. Mr. Williams requested the following cost of capital rates of return: Long-term Debt, 6.41 percent and Preferred Stock, 6.54 percent. In addition to this testimony and exhibits, I submitted a number of data requests asking for clarification and further information. The Company satisfactorily answered these data requests. I studied the answers to these data requests as well as compared this information to readily available public information.

Q: What conclusions did you draw from this analysis?

[6] Standard & Poor's gives a utility a risk profile grade between 1 and 10 (1 is best), based on its evaluation of the company's business and regulatory environment. PacifiCorp has a risk rating of 5, the middle of the range.