Introduction and Summary of Rebuttal Testimony

Q. Are you the same Bruce N. Williams that previously provided direct testimony in this proceeding on behalf of Rocky Mountain Power ("the Company" or "RMP")?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the capital structure recommendation offered by The Federal Executive Agencies ("FEA") witness Mr. Michael Gorman. Mr. Gorman's adjustment to capital structure is flawed and should not be used by the Commission. Further, Mr. Gorman attempts to support his recommendation on capital structure and overall rate of return through the use of a model that does not reflect the operational realities that guide prudent management of the Company's capital structure.

My rebuttal testimony also provides an updated overall cost of capital that reflects recent financing activity and results in a reduced overall cost of capital in this case.

Company witness Dr. Samuel C. Hadaway will address return on equity issues raised by Mr. Gorman, Division of Public Utilities ("DPU") witness Mr. Charles E. Peterson, Office of Consumer Services ("OCS") witness Mr. Daniel J. Lawton and Wal-Mart Stores, Inc. and Sam's West, Inc. witness Mr. Steve W. Chriss. I also comment on Mr. Lawton's pro forma ratio analysis to support his return on equity recommendation.

23 **Review of DPU and OCS Recommendations**

24 **Q. What are the DPU's recommendations on capital structure?**

25 A. Mr. Peterson accepts the Company's proposed capital structure and cost of
26 preferred equity. Additionally, Mr. Peterson accepts the Company's filed cost of
27 long-term debt, subject to adjustment for recent financing activities that I discuss
28 below.

29 **Q. Does OCS witness Mr. Lawton propose any adjustments to the Company's**
30 **capital structure or cost of debt?**

31 A. No, Mr. Lawton does not propose any changes to capital structure or cost of debt,
32 subject to my update to the cost of debt as discussed below.

33 **Recent Financing Activities**

34 **Q. Please discuss these recent financings that the Company has completed.**

35 A. During March, 2012 the Company issued new long-term debt through an
36 additional $100 million principal amount of its 2.95 percent first mortgage bonds
37 due February 1, 2022. These bonds were priced at a slight premium to yield 2.94
38 percent, and the Company was able to complete the issuance without any
39 underwriting fees, thereby providing additional savings to customers. The
40 proceeds of this issuance were then used primarily for the redemption of $83.9
41 million of pollution control revenue bond obligations having a weighted average
42 coupon rate of 5.72 percent.

43 To properly reflect this refinancing, I have removed the four series of debt
44 that have been redeemed and included the additional $100 million of first

45 mortgage bonds. As shown in Exhibit RMP___(BNW-1R) the updated cost of
46 long-term debt is 5.37 percent.

47 **Company's Overall Cost of Capital**

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

49 A. Yes. The Company has updated its cost of long-term debt to reflect these recent
50 financing transactions discussed above. The table below shows the Company's
51 updated overall cost of capital in this proceeding.

Updated Overall Cost of Capital

Component	Percent of Total	Cost	Weighted Average
Long Term Debt	47.6%	5.37%	2.56%
Preferred Stock	0.3%	5.43%	0.02%
Common Stock Equity	52.1%	10.20%	5.31%
Total	100.0%		7.89%

52 **Review of FEA Recommendations**

53 **Q. Please summarize FEA's recommendations on capital structure and the**
54 **resulting impacts to customers and the Company's credit rating.**

55 A. While Mr. Gorman does not take issue with the cost of debt or the cost of
56 preferred equity, he does propose a series of adjustments to reduce the common
57 equity component of the capital structure from the Company's initial filing of
58 52.1 percent to 51.0 percent.

59 As further documented below, Mr. Gorman's erroneous removal of utility
60 operation investments from the equity component of the capital structure, when

61 combined with his recommendations for a lower return on equity and overall rate
62 of return, would result in a serious risk of the Company's credit ratings being
63 reduced by at least one notch. Mr. Gorman ignores the financial impacts on the
64 Company and its customers by such adjustments and likely resulting downgrade.
65 Customers would see increased costs reflected in rates, offsetting over time the
66 near term revenue requirement reduction he proposes. In this highly sensitive
67 credit environment, such recommendations are ill conceived.

68 **Reply to FEA's Capital Structure Adjustment**

69 **Q. What is Mr. Gorman's proposed common equity percentage in the**
70 **Company's capital structure and the basis for his recommendation?**

71 A. Mr. Gorman is proposing a 51.0 percent common equity component in the
72 Company's capital structure.[1] Mr. Gorman proposes a series of adjustments to
73 PacifiCorp's filed capital structure to remove certain items he assumes are non-
74 utility related.

75 **Q. Please identify the fundamental problems in Mr. Gorman's analysis**
76 **regarding the removal of "non-utility" investments from the capital**
77 **structure.**

78 A. The fundamental problem with Mr. Gorman's adjustments is his assumption that
79 these investments do not relate to the cost of providing utility service in Utah or
80 RMP's other jurisdictions.

81 The investments Mr. Gorman proposes to remove from the common
82 equity component of the capital structure <u>do</u> relate to the utility operations of the
83 Company. Mr. Gorman has incorrectly assumed that these investments relate to

[1]Gorman Direct testimony page 13, Table 3.

84 unregulated non-utility activities. By virtue of the orders of the six states that
85 approved the acquisition of PacifiCorp by MidAmerican, PacifiCorp is not
86 permitted to have non-utility or unregulated business. Mr. Gorman's adjustments
87 pertain to the Company's regulated utility business, primarily to investments the
88 Company has made in its coal mining operations and activities, such as the
89 Bridger mine in Wyoming, plus investments related to other mining activities that
90 fuel power plants, fund reclamation and environmental liabilities, employee
91 benefits plans, customer weatherization loans and other utility activities.

92 Using the Bridger mine as an example, the Company's share of Bridger
93 assets are included in rate base and the Company recovers the costs of fuel
94 purchased from Bridger at Bridger's cost. These investments are clearly utility
95 assets and have been made to facilitate utility operations. The Bridger mine does
96 not perform any income producing activities and instead is dedicated to support
97 the Company's (and other joint owners) fuel needs for their respective interests in
98 the Jim Bridger plant.

99 The table below shows the composition of the investments that Mr.
100 Gorman proposes to remove from the equity component of the Company's capital
101 structure.

FEA Proposed Adjustment (thousands)	$ 338,434
Consisting of investments related to:	
Bridger mining activities	188,206
Trapper and other mining activities	32,246
Environmental Remediation	20,505
Employee benefit programs	75,931
Advances to minority owned plants	6,190
Customer weatherization loans	1,828
Other/Land purchases related to utility operations	13,528

102

103 These investments in coal mining, environmental remediation, employee
104 benefit programs and these other activities do relate to Utah utility service and
105 should not be treated as a reduction to the Company's common equity as Mr.
106 Gorman proposes.

107 **Q. Do you have any additional comments on these proposed adjustments by Mr.**
108 **Gorman?**

109 A. Yes. I should note that the Company has contributed a substantial amount of
110 funds to its pension plan, primarily due to the 2008 financial crisis and the change
111 in funding requirements due to the Pension Protection Act of 2006. These
112 contributions are well in excess of the pension expense that has been recovered
113 from customers. In fact, as of March 31, 2012, the excess of cumulative funding
114 over cumulative expense is approximately $270 million. Further, this prepayment
115 is expected to continue to increase over the next few years.

116 The Company must finance these utility employee pension contributions
117 in excess of amounts recovered from customers, yet the prepayment balance is not
118 presently part of rate base and does not receive any carrying charge from
119 customers. In essence, these costs appropriately utilize the Company's long-term
120 financing yet receive no carrying charge reimbursement from customers.

121 The Commission should reject Mr. Gorman's proposed adjustment based
122 on his flawed assumption that investments in coal mining and other activities are
123 not related to the cost of providing utility services in Utah. The pension expense
124 prepayment balance discussed above highlights the unreasonableness and one-
125 sided nature of Mr. Gorman's proposed adjustment.

126 **Credit Metric Analysis**

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

129 A. Mr. Gorman attempts to support his proposed capital structure, return on equity
130 and the resulting overall rate of return through an analysis of key credit metrics.

131 **Q. Do you agree with Mr. Gorman's credit metric analysis?**

132 A. No. I disagree with Mr. Gorman's analysis and conclusions for several reasons.
133 First, Mr. Gorman's calculations do not accurately reflect the adjustments that
134 rating agencies make when calculating their credit metrics. For instance, my
135 direct testimony stated that Standard &Poor's adds nearly $900 million of debt
136 and $75 million of interest to PacifiCorp's published results.[2] However, Mr.
137 Gorman only included approximately $275 million of these debt adjustments and

[2] Mr. Williams Direct Testimony, page 18 lines 398 – 400.

138 about $16 million of the interest adjustments.[3] These amounts are less than one-
139 half of the adjustments that Standard & Poor's makes. Had Mr. Gorman included
140 the amounts that Standard & Poor's actually uses it would have weakened his
141 resulting ratios.

142 Second, Mr. Gorman's model also excludes a significant amount of
143 interest expense that the Company reports on its financial statements such as
144 interest expense on customer deposits, interest on capital leases, regulatory
145 liabilities and others.

146 Further, Mr. Gorman ignores the rating agencies' published expectations
147 for PacifiCorp and instead measures the flawed results of his model against the
148 general utility industry. In fact, Mr. Gorman's model did not calculate funds from
149 operations ("FFO") to interest, one of the three key ratios that Standard & Poor's
150 has published their expectations for PacifiCorp to achieve.

151 For all these reasons the Commission should disregard Mr. Gorman's
152 model. It does not support his proposed overall rate of return including return on
153 equity which, as discussed by Dr. Hadaway, should also be rejected.

154 **Q. Have you also reviewed the financial integrity portion of Mr. Lawton's**
155 **testimony?**

156 A. Yes, and I found it suffers from many of the same problems as Mr. Gorman's
157 ratio analysis that I previously detailed. These include failing to make adjustments
158 to the published financial results that rating agencies make, not using the specific
159 rating agency published targets for the Company as well as not modeling key
160 credit metrics.

[3] Exhibit FEA-17(MPG-17) Page 4 lines 6 and 12.

161 In addition, Mr. Lawton has an additional flaw with the conclusion that his
162 recommended return on equity would result in credit ratios that would support a B
163 bond rating.[4] This rating level is significantly below the Company's current rating
164 and in fact would be non-investment grade or what is often referred to as a "junk
165 bond" rating. If Mr. Lawton's conclusion is correct, not only would the Company
166 face significantly higher financing costs, it would likely be shut-out of financial
167 markets at times of market stress or turmoil. These consequences are not in the
168 best interests of the Company's customers. Therefore, the Commission should
169 reject Mr. Lawton's claim that his return on equity recommendation is reasonable
170 in light of his credit metrics analysis.

171 **Q. Does this conclude your rebuttal testimony?**

172 A. Yes.

[4] Lawton Direct Testimony, page 38 line 949.