BEFORE THE

PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power for Authority to Increase its Retail Electric Utility Service Rates in Utah and for Approval of its Proposed Electric Service Schedules and Electric Service Regulations	**Docket No. 11-035-200**

Direct Testimony and Exhibits of

Michael P. Gorman

on Cost of Capital Issues

On behalf of

The Federal Executive Agencies (FEA)

Project 9584
May 31, 2012

BRUBAKER & ASSOCIATES, INC.
CHESTERFIELD, MO 63017

> **Improved Risk Profile:** Since being acquired by MidAmerican Energy Holdings Company (MEHC) in 2006, the utility's business risk has been improved by the adoption of rate mechanisms designed to reduce regulatory lag and facilitate timely recovery of fuel and purchased power costs.[12]

RMP's Proposed Capital Structure

Q WHAT CAPITAL STRUCTURE IS THE COMPANY REQUESTING TO USE TO DEVELOP ITS OVERALL RATE OF RETURN FOR ELECTRIC OPERATIONS IN THIS PROCEEDING?

A RMP's 2010 forecasted capital structure, as supported by RMP witness Mr. Bruce N. Williams, is shown below in Table 2.

TABLE 2

RMP's Proposed Capital Structure

Description	Percent of Total Capital
Long-Term Debt	47.6%
Preferred Stock	0.3%
Common Equity	52.1%
Total Capital Structure	100.0%

Source: Williams Direct at 2.

RMP's proposed capital structure reflects common equity investments supporting non-utility assets. Specifically, RMP's balance sheet reflects significant investments in subsidiary companies and non-utility investments. It is not appropriate to include the equity capital supporting these non-utility assets in a regulated utility's capital structure. The cost associated with the capital supporting these non-regulated investments is not related to the cost of providing utility service in Utah or RMP's

[12] FitchRatings Corporates: "PacifiCorp," November 16, 2011, provided by RMP in Attachment D.18b.

other utility jurisdictions. Hence, the Company's proposed capital structure should be modified to remove the common equity supporting these non-utility investments.

Q PLEASE DESCRIBE YOUR PROPOSED ADJUSTMENT TO RMP'S CAPITAL STRUCTURE.

A I propose to remove the common equity supporting non-utility investments from RMP's proposed capital structure. Mr. Williams projected a capital structure described at page 2 of his testimony. At page 13 of his testimony, Mr. Williams described that he developed his proposed capital structure by averaging the five quarters ending March 31, 2013. From that capital structure, I propose to remove common equity investments recorded on PacifiCorp's FERC Form 1 balance sheet, that are non-utility related. These non-utility investments include net non-utility property and investments in subsidiary companies, and other investments. The amount of these investments has been relatively stable through calendar year 2011, and I assume that they will continue to be stable through the end of the test year. Removing this amount of equity investments from the Company's proposed capital structure, will reduce the amount of common equity to total capital ratio for the ratemaking capital structure.

Q WHY IS IT REASONABLE TO ASSUME THAT THE NON-REGULATED INVESTMENTS ARE SUPPORTED WITH ONLY COMMON EQUITY CAPITAL?

A It is not reasonable to assume that utility debt is being used to fund investments in non-utility assets. PacifiCorp has both secured and unsecured utility bond debt issuances recorded on its balance sheet and included in the development of its test year capital structure. It would increase the investment risk on these debt securities if

PacifiCorp was not dedicating these debt securities to its low-risk utility operations. If it was issuing utility debt to invest in non-regulated properties, that would likely increase its investment risk exposure and increase its cost of debt. I do not believe PacifiCorp has undertaken this, and I do not believe it would be appropriate for it to do so.

Q HOW DID YOU ADJUST THE LONG-TERM DEBT BALANCE AND THE EMBEDDED COST OF DEBT?

A In his rebuttal testimony in RMP's Wyoming rate case filing, Mr. Williams described several new financing activities that were not reflected in his direct testimony in this regulatory proceeding. Therefore, including the new $100 million debt issuance used to refinance some of the outstanding pollution control bonds increases the long-term debt balance and reduces the embedded cost of debt from 5.41% down to 5.36%.[13]

Q WHAT IS YOUR PROPOSED CAPITAL STRUCTURE IN THIS PROCEEDING?

A My proposed capital structure is shown below in Table 3.

TABLE 3

Proposed Capital Structure

Description	Percent of Total Capital
Long-Term Debt	48.7%
Preferred Stock	0.3%
Common Equity	51.0%
Total Capital Structure	100.0%

Source: Exhibit FEA-1 (MPG-1).

[13]Wyoming Public Service Commission Docket No. 20000-405-ER-11, Exhibit RMP___ (BNW-1R).

Q WHY IS YOUR PROPOSED CAPITAL STRUCTURE GENERALLY CONSISTENT WITH RMP'S TARGET CAPITAL STRUCTURE FOR UTILITY OPERATIONS?

A Mr. Williams has stated a capital structure target for utility operations of 50%/50% debt/equity. The capital structure outlined in Table 3 approximates this targeted utility capitalization mix.

Q WILL YOUR PROPOSED CAPITAL STRUCTURE SUPPORT RMP'S FINANCIAL INTEGRITY AND CREDIT RATING?

A Yes. As I will discuss later in my testimony, my proposed capital structure is consistent with RMP's current credit rating and will support RMP's financial integrity.

RETURN ON EQUITY

Q PLEASE DESCRIBE WHAT IS MEANT BY A "UTILITY'S COST OF COMMON EQUITY."

A A utility's cost of common equity is the return investors require on an investment in the utility. Investors expect to achieve their return requirement from receiving dividends and stock price appreciation.

Q PLEASE DESCRIBE THE FRAMEWORK FOR DETERMINING A REGULATED UTILITY'S COST OF COMMON EQUITY.

A In general, determining a fair cost of common equity for a regulated utility has been framed by two hallmark decisions of the U.S. Supreme Court: *Bluefield Water Works & Improvement Co. v. Public Serv. Commission of West Virginia,* 262 U.S. 679 (1923) and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).