

0104

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BEFORE THE WASHINGTON STATE

2

UTILITIES AND TRANSPORTATION COMMISSION

3

WASHINGTON UTILITIES AND )  
TRANSPORTATION COMMISSION, )

5

Complainant, )

v.

) DOCKET NOS. UE-140762

6

) and UE-140617

7

PACIFIC POWER & LIGHT COMPANY, )

) (Consolidated)

8

Respondent. )

8

9

HEARING - VOLUME IV

10

Pages 104 - 372

11

ADMINISTRATIVE LAW JUDGE DENNIS J. MOSS

12

COMMISSION CHAIRMAN DAVID DANNER

13

COMMISSIONER JEFFREY GOLTZ

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COMMISSIONER PHILIP JONES

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9:30 A.M.

15

DECEMBER 16, 2014

16

Washington Utilities and Transportation Commission

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10	RRS-2	Witness Qualifications	368
11	RRS-3	Monthly Peak Demands as a Percent of the Annual System Peak	368
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1 EXHIBIT INDEX (CONTINUING)

2 WITNESS

3 Steve W. Chriss, Senior Manager, Energy Regulatory Analysis,  
4 Walmart Stores, Inc.

5	EXHIBIT NO.	DESCRIPTION	ADMITTED
6	SWC-1T	Response Testimony re: cost of service, rate spread and rate design	368
7	SWC-2	Witness Qualifications	368
8	SWC-3	Schedule 36: Present and Proposed Revenue Requirement by Charge; Cost of Service-Based Revenue Requirement by Function; Generation (non-NPC) and Transmission Demand Cost Recovery; Calculation of Walmart Proposed Illustrative Generation (non-NPC) Charges; Calculation of Walmart Proposed Illustrative Transmission (non-NPC) Charges	368

14 WITNESS

15 Mark Fulmer, Consultant

16	EXHIBIT NO.	DESCRIPTION	ADMITTED
17	MEF-1Tr	Response Testimony re: increase in basic charges	368
18	MEF-2	Witness Qualifications	368
19	MEF-3	TASC Workpaper Supporting Figure 1	368
20	MEF-4	TASC Workpaper Supporting Figure 2	368
21	MEF-5	TASC Fixed Charge Calculation	368
22	MEF-6T	Cross-Answering Testimony Responding to Staff rate design proposal	368
23	MEF-7	Response to UTC DR 84	368

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EXHIBIT INDEX (CONTINUING)

EXHIBIT NO.	DESCRIPTION	ADMITTED
MEF-8	Residential Rate Worksheet	368

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1 OLYMPIA, WASHINGTON DECEMBER 16, 2014

2 9:30 A.M.

3

4 JUDGE MOSS: Let's be on the record. Good  
5 morning, everybody. My name is Dennis Moss. I'm an  
6 administrative law judge with the Washington Utilities and  
7 Transportation Commission.

8 We are convened this morning in the matter  
9 styled Washington Utilities and Transportation Commission  
10 against Pacific Power and Light Company, Docket UE-140762.  
11 This is the company's general rate case.

12 Our order of business today is I'm going to  
13 take appearances here momentarily, using the short form if  
14 you would, please.

15 I'll outline the plan for the hearing.

16 We'll take up the pending objection/motion  
17 concerning Mr. Hill's testimony.

18 I will have a comment or two about the  
19 timeliness of other revisions.

20 And we'll take up any other preliminary  
21 business.

22 And then we'll have Mr. Williams on the stand  
23 as our first witness, I believe.

24 So let's start with appearances, and we'll  
25 begin with the company.

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1 MS. MCDOWELL: Okay. Katherine McDowell here  
2 for PacifiCorp.

3 MS. WALLACE: Sarah Wallace on behalf of  
4 PacifiCorp.

5 MS. DAVISON: Melinda Davison and Jesse  
6 Cowell for Boise Cascade [sic].

7 MR. PURDY: Brad Purdy on behalf of The  
8 Energy Project.

9 MR. FFITCH: Simon ffitch, Senior Assistant  
10 Attorney General for the Office of Public Counsel.

11 MS. CAMERON-RULKOWSKI: Jennifer  
12 Cameron-Rulkowski, Assistant Attorney General on behalf of  
13 Staff.

14 MR. OSHIE: Pat Oshie on behalf of Staff.

15 I'd also like to introduce my colleague,  
16 Brett Shearer, who's sitting in the second row. He'll be  
17 handling certain witnesses in this case, Judge.

18 JUDGE MOSS: All right. Thank you very much.

19 The Commissioners are going to join us  
20 momentarily after we get through the preliminary matters  
21 here. And I'll send somebody out to get them at the  
22 appropriate moment.

23 Our plan for the hearing today is we're going  
24 to have Mr. Williams first, and then we'll proceed through  
25 the order of witnesses that was circulated among the parties

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1 and to me. So Williams will be followed by Strunk, Gorman,  
2 Hill, and Parcell. Each of these witnesses will appear  
3 individually and be subject to cross-examination by counsel.

4 At the conclusion of that process, we will  
5 have all five witnesses impaneled for purposes of questions  
6 from the bench.

7 And after that, the parties may, if they  
8 wish, have follow-up questions relevant to the discussion  
9 between the Commission and the witness panel.

10 And then we'll see if there's a need for  
11 anything further.

12 Now, of course that plan is going to change  
13 here momentarily as we move to the motion that is pending,  
14 or the objection that is pending. I have pending before us  
15 an objection by the company to some late revision to  
16 Mr. Hill's testimony. I have read the objection and the  
17 proposed relief it requests.

18 I have read, Mr. ffitch, your response to  
19 that.

20 I don't really feel the need for anything  
21 further, but in the interest of being conservative in my due  
22 process considerations I'll ask if the parties have anything  
23 further they wish to tell me.

24 MS. MCDOWELL: Your Honor, Katherine McDowell  
25 here for PacifiCorp. We did file that objection, I would

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1 say, reluctantly. We did work hard to try to come up with a  
2 resolution that would work for folks.

3 We're really down to one issue, which is  
4 whether the Company can present supplemental testimony on  
5 the ROR and pre-tax interest coverage ratio. We only have a  
6 couple of questions on that. We don't think it will delay  
7 the proceedings in any way and we think it's fair to allow  
8 the Company to respond to such a material change in the ROR  
9 recommendation.

10 JUDGE MOSS: Mr. ffitch, anything?

11 MR. FFITCH: Thank you, your Honor. I think  
12 while we did make a record on our position and response, I  
13 think the truth is that we're very close. We did not object  
14 to having some supplemental rebuttal by the Company narrowly  
15 tailored, and our dispute really was about how narrow.

16 We still are concerned about additional  
17 testimony regarding rate of return and the interest coverage  
18 issues, which are simply a matter of mathematical changes  
19 flowing through the numbers.

20 The other reason why it was hard for us to  
21 specifically agree to additional testimony by Company  
22 witnesses was that other parties, Commission Staff and the  
23 industrial customers, both addressed those issues. And I  
24 didn't feel like it was appropriate for us to unilaterally  
25 agree to additional Company testimony that might prejudice

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1 their positions.

2 But we abide by the bench's decision on the  
3 scope of the supplemental rebuttal, which we're not  
4 objecting to as a general matter.

5 JUDGE MOSS: All right. Fine. Anybody else  
6 feel compelled to speak to me before I rule on this?

7 All right. Fine. I think the objection was  
8 well taken, and I think the relief proposed was in order. A  
9 60 basis point change in the rate of debt to debt cost  
10 resulting in a 30 basis point change in the overall rate of  
11 return recommendation by the witness, I find to be a  
12 substantial change. And I think the Company is entitled to  
13 inquire into both matters.

14 And of course, as you say, mathematically  
15 that does have an impact on the analysis of coverage ratios,  
16 and I think it's appropriate for the Company to be able to  
17 inquire into that.

18 Now having said all that, of course, I think  
19 the Company is aware and has represented to me that they  
20 intend for this to be brief and narrow. It is my fervent  
21 wish to conclude this hearing no later than noon on  
22 Thursday, maybe sooner. So I don't want to spend a great  
23 deal of time on supplemental or direct examination which may  
24 indeed of course prompt some additional cross-examination  
25 the parties are not presently anticipating.



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1                   So with that all said, I do want to say one  
2 further thing just as a general matter, and that is that I'm  
3 going to just suggest that in the future, parties be a bit  
4 more diligent about these types of revisions and getting  
5 them in early. This throws off not only the other parties,  
6 but also we here at the Commission who are analyzing all of  
7 this.

8                   While the change in Mr. ffitch's view is  
9 obvious, it was not obvious to us. We saw what Mr. Hill had  
10 done, but there's no way we can be certain that that's not  
11 what he intends to do unless you come forward and tell us  
12 it's a mistake. So that came kind of late.

13                   And I was just griping a little bit this  
14 morning at you, Ms. Davison. I just received, at 9:11 this  
15 morning, revised testimony from Mr. Gorham. I'm assuming  
16 that that is very slight, very minor changes you have, the  
17 sort of thing we ordinarily do on the stand. And indeed  
18 we're going to have to do that on the stand today, because I  
19 can't take the time now, between 9:11 and 9:30, to get all  
20 of this stuff rearranged in the Commissioners' notebooks and  
21 the policy advisors' notebooks and my notebook. We're just  
22 going to have to do it on the stand when he takes the stand.

23                   MS. DAVISON: Your Honor, these are normally  
24 revisions that would happen on the stand. And I apologize.  
25 We were trying to be helpful by providing paper copies in

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1 advance to all the parties in advance, which I handed out to  
2 all the parties. But they're not substantive changes.

3 JUDGE MOSS: That's good to hear. I'm  
4 pleased to hear that. I did not make it all the way  
5 through, so I'm not sure what all the changes -- I saw a  
6 couple of them, but I wasn't able to get through all of them  
7 in the time I had.

8 That's just me griping because I'm under a  
9 lot of pressure in the 15 minutes before a hearing starts.  
10 So take that with a grain of salt.

11 All right. With that, any other preliminary  
12 business?

13 MR. ROBERTS: I'd like to make an appearance.  
14 Sam Roberts for Walmart Stores, Inc.

15 JUDGE MOSS: Oh, sorry. Mr. Roberts,  
16 welcome.

17 MR. WIEDMAN: And your Honor, Joseph Wiedman  
18 for The Alliance for Solar Choice.

19 JUDGE MOSS: Welcome as well. I suspect this  
20 is the first time for both of you here. And Wiedman was  
21 your name?

22 MR. WIEDMAN: Wiedman.

23 JUDGE MOSS: Wiedman. All right. Let me jot  
24 these down so that I can address you properly.

25 And you, sir?

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1 MR. ROBERTS: Sam Roberts.

2 JUDGE MOSS: Roberts. Very well. Thank you  
3 very much.

4 And of course you're sitting where the  
5 witness needs to sit. So if you do have questions of  
6 witnesses and so on, then we'll make some substitutions so  
7 you can be at the front table at the appropriate time. All  
8 right? Very good. Thank you.

9 MS. MCDOWELL: Your Honor, one more  
10 appearance: My associate, Adam Lowney, is here with me  
11 today. And he will be handling a couple of the witnesses in  
12 the hearing as well. So I just wanted to introduce him as  
13 well.

14 JUDGE MOSS: So new generations of counsel.  
15 I've lived that long, have I? All right.

16 MS. DAVISON: Your Honor, we have reached a  
17 stipulation with the company on several of our  
18 cross-examination exhibits. I don't know at what point you  
19 would like to take that up. That will greatly help in your  
20 goal of noon on Thursday because we will not need to  
21 cross-examine witnesses to get the exhibits in.

22 And I think there's two that the Company  
23 doesn't agree with.

24 MS. MCDOWELL: We're down to one.

25 MS. DAVISON: We're down to one. Okay.

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1 JUDGE MOSS: Do these concern the cost of  
2 capital witnesses at all, or other witnesses?

3 MS. MCDOWELL: There's a couple for Strunk.

4 JUDGE MOSS: A couple for Strunk. Very well.

5 And that does remind me, and I thank you for  
6 that, that we should discuss briefly the question of  
7 stipulating in exhibits. I typically find it works pretty  
8 well that we can stipulate in all or most all of the  
9 exhibits. Is that agreeable to the parties in this  
10 case? Mr. Oshie?

11 MR. OSHIE: Yes, your Honor. It's agreeable  
12 to Staff. We are very comfortable stipulating to the  
13 admission of the direct testimony.

14 We have three exhibits that are to be used in  
15 cross-examination of our cost of capital witness,  
16 Mr. Parcell, that we have objection to. The objection will  
17 be handled by Jennifer. Thank you.

18 JUDGE MOSS: All right. Thank you. We'll  
19 take up -- and other parties similarly have a very small  
20 number of exhibits to which they wish to object?

21 MS. MCDOWELL: Your Honor, PacifiCorp only  
22 objects to one of Boise's exhibits, and it's an exhibit for  
23 Mr. Duvall.

24 Other than that, we will stipulate to all of  
25 the exhibits of all of the parties, but we do have a couple

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1 of supplements.

2 MS. WALLACE: It's with the agreement of  
3 supplementing -- changing the witness for one of them and  
4 supplementing it, and then supplementing another.

5 JUDGE MOSS: To the extent the parties work  
6 these things out among themselves, I'm pretty amenable to  
7 that sort of thing. I don't want anybody to be taken by  
8 disadvantage here.

9 So maybe you can work out that last one. You  
10 say that's for who, Mr. Strunk? Do you still have a  
11 dispute?

12 MS. DAVISON: No, I don't think there's an  
13 objection to that.

14 MS. WALLACE: One for Mr. Duvall.

15 JUDGE MOSS: Cost of capital?

16 MS. MCDOWELL: We're good to go on cost of  
17 capital except for Staff.

18 And if we're in that place where we're  
19 stipulating to the exhibits, with the exception of the  
20 exhibits to which Staff has reserved an objection, can we  
21 just assume they're all admitted, or do I need to go through  
22 the process of admitting them?

23 JUDGE MOSS: That's right. You can assume  
24 that they're admitted unless otherwise noted. And I'm going  
25 to take care of that with the cost of capital witnesses

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1 right now.

2 Ms. Rulkowski, which exhibits is Staff going  
3 to object to in terms of the cost of capital witnesses?

4 MS. CAMERON-RULKOWSKI: Your Honor, that is  
5 Exhibit DCP-26.

6 JUDGE MOSS: That would be Mr. Parcell?

7 MS. CAMERON-RULKOWSKI: That's correct.

8 JUDGE MOSS: All right.

9 MS. CAMERON-RULKOWSKI: And DCP-27CX.

10 JUDGE MOSS: Okay.

11 MS. CAMERON-RULKOWSKI: And DCP-28CX.

12 JUDGE MOSS: All right, then. With the  
13 exception of those three exhibits that Ms. Cameron-Rulkowski  
14 has just identified for the record, DCP-26CX through 28CX,  
15 the exhibit list shows exhibits for Mr. Parcell, additional  
16 exhibits for Mr. Parcell, and then there are additional  
17 exhibits for Mr. Williams, Mr. Strunk, Mr. Gorman and  
18 Mr. Hill. And those should all be deemed admitted as  
19 marked.

20 All right. Everybody has the exhibit list.

21 (Cost of Capital Exhibits with the  
22 exception of DCP26CX through 28CX  
23 admitted.)

24 MS. CAMERON-RULKOWSKI: Your Honor, just one  
25 other item from Staff.

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1 JUDGE MOSS: Sure.

2 MS. CAMERON-RULKOWSKI: We will be  
3 withdrawing two of our cross exhibits for Mr. Strunk.

4 JUDGE MOSS: Okay. And which are those?

5 MS. CAMERON-RULKOWSKI: KGS-39CX and  
6 KGS-40CX.

7 MS. MCDOWELL: Can you repeat those numbers  
8 again, please.

9 MS. CAMERON-RULKOWSKI: Certainly. KGS-39  
10 and KGS-40.

11 JUDGE MOSS: So Staff is withdrawing KGS-39CX  
12 and KGS40-CX. All right.

13 MS. CAMERON-RULKOWSKI: Unless some other  
14 party is relying on those as exhibits to the record.

15 JUDGE MOSS: I don't think so.

16 MR. FFITCH: And your Honor, just for clarity  
17 of the record on Mr. Hill?

18 JUDGE MOSS: Yes.

19 MR. FFITCH: The exhibit list should reflect  
20 that there's revised testimony, as we've discussed, dated  
21 December 1, 2014. And we communicated with the bench  
22 yesterday about those specifics.

23 JUDGE MOSS: That's 1 and 15?

24 MR. FFITCH: That's 1 and 15 with the  
25 revisions of December 1, 2014.

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1                   Now we had also stated to the Company that we  
2 had no objection to Mr. Hill's original unrevised testimony  
3 remaining in the record. So I'm not sure how you'd like to  
4 proceed on that, but we have no objection to both of them  
5 being in the record.

6                   JUDGE MOSS: Right. And that was part of the  
7 relief requested by the Company that I granted. So we will  
8 have that. It's a little awkward, perhaps, but I have  
9 re-marked the exhibits on the exhibit list to reflect the  
10 revisions of December 1. I didn't put the dates, but they  
11 now have the small letter "r" indicating that SGH-1CT and  
12 SGH-15 are now marked as revised exhibits. I thought I  
13 circulated that, perhaps not.

14                   MS. CAMERON-RULKOWSKI: Your Honor, I have  
15 one comment. And that is that if it turns out that cross  
16 exhibits that we've now stipulated to the admission of, if  
17 they are not actually used in cross-examination, is there a  
18 process whereby they can be withdrawn?

19                   JUDGE MOSS: If a party wants to withdraw  
20 their own cross exhibits, I'm certainly amenable to that.  
21 That's less paper we have to deal with, although we've  
22 already got the paper. So I guess that really makes little  
23 difference.

24                   Or somebody else might want to use them, and  
25 that's always a possibility. They could come up during the



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1 course of examination, in which case I would not allow them  
2 to be withdrawn.

3 MS. MCDOWELL: Your Honor, I think part of  
4 the value of the stipulation is that we don't have to do  
5 cross-examination to lay the foundation for those exhibits  
6 to come in.

7 JUDGE MOSS: Right.

8 MS. MCDOWELL: So my understanding here is  
9 that by the agreement we've just reached, my  
10 cross-examination will now be shorter. So I will not be  
11 examining on all of the exhibits if --

12 JUDGE MOSS: You don't need to.

13 MS. MCDOWELL: Thank you.

14 JUDGE MOSS: I meant to limit that ruling to  
15 if you want to withdraw one of your own exhibits, then I  
16 would allow you to do.

17 But you're not allowed to withdraw somebody  
18 else's exhibits.

19 MS. MCDOWELL: As much as we might like.

20 JUDGE MOSS: As much you'd might want to.

21 MS. DAVISON: Are we just dealing with cost  
22 of capital exhibits?

23 JUDGE MOSS: Right now, yes. I think we're  
24 going to be on that subject all day today, or certainly most  
25 of it. That being the case, I thought I'd just take care of

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1 that right now, and then we'll take care of the others  
2 perhaps at the end of the day today, or maybe I'll start 15  
3 minutes early tomorrow. Is that agreeable?

4 MS. CAMERON-RULKOWSKI: All right, your  
5 Honor. So I'm going to withdraw my withdrawal of KGS-39 and  
6 40, that being the case.

7 JUDGE MOSS: All right. I'll allow that.

8 MS. CAMERON-RULKOWSKI: Thank you, your  
9 Honor.

10 JUDGE MOSS: Which were those? Tell me  
11 again.

12 MS. CAMERON-RULKOWSKI: KGS-39 and KGS-40.

13 JUDGE MOSS: Now I have to write "not  
14 withdrawn."

15 MS. MCDOWELL: Judge Moss, so one more  
16 preliminary: The exhibits to which Staff objects for Mr.  
17 Parcell will come up very early in my cross-examination of  
18 Mr. Parcell. So it probably makes sense to hear the  
19 argument on that before we begin his examination rather than  
20 have me launch in and immediately stop. So I wanted to give  
21 you --

22 JUDGE MOSS: Sure. I'll count on you to  
23 remind me of that. All right?

24 MS. MCDOWELL: Yes, sir.

25 JUDGE MOSS: And that will certainly be a

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1 good way to proceed today. I'm likely to forget.

2 MS. MCDOWELL: And one other preliminary  
3 matter: Last hearing, we just had the witnesses give their  
4 name and identify any changes they had to their testimony  
5 without going through the predicate information about would  
6 your answers be the same, et cetera. Are you --

7 JUDGE MOSS: I don't really have to hear that  
8 for the thousandth time, no.

9 MS. MCDOWELL: Thank you. It's actually  
10 refreshing not to have to do that.

11 JUDGE MOSS: I'm glad to bring a little  
12 freshness into your life.

13 MS. MCDOWELL: I can use that this morning,  
14 sir.

15 JUDGE MOSS: We can certainly dispense with  
16 those formalities, yes.

17 MS. MCDOWELL: That will help us move along.

18 JUDGE MOSS: Anything else?

19 Yes, Mr. Purdy?

20 MR. PURDY: Yes. In the interest of speeding  
21 this along -- and I don't know if this is out of order or  
22 not -- but with respect to my indication to you yesterday  
23 that there might be some cross of Ms. Steward, we've managed  
24 to work that out, and we will have none.

25 JUDGE MOSS: Okay.

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1                   MR. PURDY: Further I just received an e-mail  
2 from Mr. Eberdt, who was experiencing some transportation  
3 issues. And he was wondering if he could be available by  
4 telephone whenever his turn comes up.

5                   JUDGE MOSS: Is it snowing over there?

6                   MR. PURDY: I didn't hear anything about  
7 snow. Maybe tornadoes again or earthquakes.

8                   JUDGE MOSS: If a witness has difficulty  
9 appearing because of health or transportation issues, then  
10 certainly we have to just go with that. There's nothing we  
11 can do about it, just as there's nothing they can do about  
12 it. So yes, that will be fine.

13                   MR. PURDY: Thank you.

14                   JUDGE MOSS: And I don't think we'll be  
15 seeing Mr. Eberdt before tomorrow in any event.

16                   MS. MCDOWELL: I don't see him on the list.

17                   JUDGE MOSS: He's there.

18                   MR. PURDY: My impression is he did not have  
19 any cross.

20                   JUDGE MOSS: No cross. So in any event, he  
21 would have leave to have him available by phone in any  
22 event.

23                   MR. PURDY: Thank you.

24                   JUDGE MOSS: That was another thing I tried  
25 to improve our process, you know. I never give up. And so

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1 I early on, in my instructions this time, I said if there's  
2 no cross indicated for a witness, they can appear, if they  
3 can be available, by telephone.

4 It didn't work. I still got 15 individual  
5 requests. But maybe next time.

6 MS. MCDOWELL: Sorry about that. We'll  
7 really believe you next time.

8 JUDGE MOSS: So then you can bring some  
9 freshness into my life.

10 MS. MCDOWELL: We'll work on that.

11 JUDGE MOSS: Are we ready to go with  
12 Mr. Williams, then?

13 MS. MCDOWELL: The company is ready.

14 JUDGE MOSS: All right, Mr. Williams.

15 Mr. Kermode is going to help us out by  
16 getting the commissioners.

17 We'll get you sworn and let you get settled.

18

19 BRUCE N. WILLIAMS, witness herein, having been first  
20 duly sworn on oath, was examined and  
21 testified as follows:

22

23 JUDGE MOSS: Please be seated. Get yourself  
24 organized. We have a couple of minutes until the  
25 commissioners arrive. Let's be off the record.

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1 (Recess.)

2 (Commissioners arrive )

3 JUDGE MOSS: Let's be back on the  
4 record. While the commissioners are getting settled in here  
5 a little bit, I'll ask to make sure that everybody has their  
6 cell phones turned off or at least silenced.

7 Commissioners, I have, before you came in,  
8 ruled on the objection that the Company lodged with respect  
9 to Mr. Hill's revised testimony.

10 And we are going to have some oral  
11 supplemental direct examination of Mr. Williams by -- Ms.  
12 McDowell, are you going to conduct that?

13 MS. MCDOWELL: That's correct, your Honor.

14 JUDGE MOSS: And then Mr. ffitch will have an  
15 opportunity for cross-examination.

16 Following that, we will take up Mr. Strunk  
17 and on down the witness order of presentation.

18 When we get to the end of that, those five  
19 witnesses, then we will have the five witnesses impaneled  
20 for purposes of your examination. So that's how we're going  
21 to proceed this morning. All right?

22 The witness has been sworn. Ms. McDowell,  
23 proceed.

24 MS. MCDOWELL: Thank you, your Honor.

25 And good morning, Commissioners.

0166

1 DIRECT EXAMINATION

2 BY MS. MCDOWELL:

3 Q Good morning, Mr. Williams.

4 A Good morning.

5 Q Can you please state your name and spell it for  
6 the record.

7 A Bruce Williams; B-R-U-C-E, W-I-L-L-I-A-M-S.

8 Q Mr. Williams, did you pre-file testimony in this  
9 proceeding?

10 A Yes, I did.

11 Q Do you have any changes or corrections to that?

12 A I have one correction to my rebuttal testimony on  
13 page 11.

14 JUDGE MOSS: Could you give us the exhibit  
15 number, Ms. McDowell?

16 MS. MCDOWELL: That would be BNW-16T.

17 Q (By Ms. McDowell) And again, is that page 11,  
18 Mr. Williams?

19 A Yes, it is. I'll wait until people get there.

20 JUDGE MOSS: Thank you. I think we're there.

21 THE WITNESS: Okay. At the bottom of the  
22 page is a table following line No. 12. The ratings for  
23 Avista should be Baa1/BBB. So delete the plus sign.

24 And the ratings for Puget Sound Energy should  
25 be the same, Baa1 and then BBB. Delete the plus sign there

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1 as well.

2 Those are my changes.

3 JUDGE MOSS: Thank you.

4 Q (By Ms. McDowell) Thank you, Mr. Williams.

5 Have you reviewed the revised testimony of  
6 Mr. Hill on behalf of Public Counsel in this proceeding?

7 A Yes, I have.

8 Q Do you have that testimony with you?

9 A I do.

10 Q Can you turn to page 27 of that testimony, please?

11 A I'm there.

12 Q Now, there Mr. Hill comments on your calculation  
13 of a debt cost that would be used in a hypothetical capital  
14 structure for the company; is that correct?

15 A That is correct. The company calculated a  
16 hypothetical debt cost of 5.80 percent.

17 Q And can you explain why you calculated that 5.80  
18 debt cost?

19 A Certainly. The hypothetical cost of debt would  
20 correspond to the hypothetical capital structure that  
21 contains the 49.1 percent common equity.

22 And in my judgment, and also in discussions and  
23 feedback with the rating agencies and their writings, it's  
24 clear to me that a capital structure with 49.1 percent would  
25 result in a downgrade of the company. I think it's



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1 reasonable to assume that that downgrade would be to a BBB  
2 level. And that is the resulting financing cost that a BBB  
3 utility would have incurred.

4 Q So your 5.80 debt cost is correlated to your  
5 assumption of a BBB rating?

6 A Yes, it is.

7 Q So Mr. Williams, can you turn to the bottom of  
8 page 27. And there, beginning on line 17 and going down to  
9 line 20, Mr. Hill criticizes your analysis by comparing BHE,  
10 or Berkshire Hathaway Energy's capital structure to  
11 PacifiCorp's.

12 What is your response to that criticism?

13 A I think there are several flaws in that criticism.

14 First is it's not an apt comparison to compare the  
15 holding company to PacifiCorp. The holding company is much  
16 broader, more diversified, has a variety of lines of  
17 businesses.

18 The other, I think, flaw is that much of the  
19 financing that Berkshire Hathaway, the ultimate parent  
20 company, has provided to BHE is in the form of debt that's  
21 structured to receive equity credit from the rating  
22 agencies. So when the rating agencies look at the BHE  
23 capital structure, it doesn't appear like Mr. Hill has shown  
24 it here. It appears with more equity and closer to the  
25 company's common equity percentage.

0169

1           The other point I would make, too, is in  
2 Mr. Hill's exhibit it does show that the company is  
3 capitalized with a common equity level right in line with  
4 the other subsidiaries of BHE.

5           Q     So continuing on page 27, beginning lines 21 and  
6 going on to line 22, Mr. Hill states that it's not  
7 reasonable to assume that a roughly 2 percent equity ratio  
8 difference would cause a downgrade.

9           Can you respond to that testimony?

10          A     Certainly. First of all, it's not 2 percent; it's  
11 closer to 3 percent would be the change in the common equity  
12 component.

13           And I mentioned earlier based on my readings of  
14 the rating agency reports, feedback I received from them, I  
15 think it's entirely reasonable and appropriate to assume  
16 that it would be a BBB rating result from that change in the  
17 capital structure.

18          Q     So Mr. Williams, can you turn your attention to  
19 the top of page 28. And there Mr. Hill states that  
20 PacifiCorp's equity ratio increased between 2006 and 2014  
21 without a change in its credit rating. Is that a valid  
22 criticism of your analysis?

23          A     I don't think it's a valid criticism.

24           I think it shows again that the company increased  
25 its common equity percentage, which allowed us to keep the

0170

1 ratings. And those ratings then are what produced the cost  
2 of the debt, the 5.19 percent that's in the actual capital  
3 structure. So I don't think that's a fair comparison.

4 I think also what he's missing is during that time  
5 period, the financial crisis of 2008, put a lot of stress on  
6 the markets and on companies. And I think the company  
7 appropriately adjusted its capital structure in light of  
8 those circumstances and the market turmoil with an eye to  
9 really retaining our credit ratings to help finance the  
10 business as we were going through a period of significant  
11 capital spending, and while trying to keep the debt cost as  
12 low as we could.

13 Q So Mr. Williams, going on down into that  
14 paragraph, Mr. Hill states that both 49 percent -- well,  
15 ratios between 49 percent and 52 percent are well above the  
16 industry average.

17 Do you agree with that testimony?

18 A No, I wholeheartedly disagree. In my rebuttal  
19 testimony on page 3, I show that the average for the  
20 industry was 51.24 percent during the first nine months of  
21 this year through September.

22 And that's also supported by the Company's  
23 response to Data Request Boise 17.10 that shows the average  
24 common equity percentage for 2013-2014 is 51.82 percent.  
25 And that number is very much in line with the Company's 51.7

0171

1 percent common equity percentage.

2 Q So Mr. Williams, just to clarify, the capital  
3 structure that you just referred to in that data request  
4 response, is that related to Mr. Strunk's proxy group?

5 A Yes, that is a response that Mr. Strunk prepared,  
6 Boise 17.10.

7 Q So now lastly, Mr. Hill criticizes your analysis  
8 because you've repriced PacifiCorp's debt cost back to 2006.

9 Can you respond to that criticism?

10 A Yes. He is correct. I have repriced the debt  
11 that was issued beginning in 2006 through the current most  
12 recent issuance.

13 And I believe that is appropriate and reasonable,  
14 given that since 2006 the Commission here has set the  
15 company's capital structure at a level below what the  
16 company actually has. So corresponding to that time period  
17 of that hypothetical capital structure, I have adjusted the  
18 debt since 2006. And I believe that's reasonable and  
19 appropriate.

20 Q So Mr. Williams, can you now turn to page 32.

21 JUDGE MOSS: Of what?

22 MS. MCDOWELL: I'm sorry. Of Mr. Hill's  
23 testimony.

24 JUDGE MOSS: Thank you.

25 Q (By Ms. McDowell) Same testimony, just skipping

0172

1 from page 28 to page 32. And here Mr. Hill addresses your  
2 debt cost for your long-term debt under your actual capital  
3 structure, correct?

4 A Yes. I think it continues on to the top of page  
5 33, I believe. But yes. There's that discussion.

6 Q Now Mr. Hill indicates that PacifiCorp's current  
7 5.19 percent actual cost of debt overstates PacifiCorp's  
8 long-term costs going forward, and that the use of this debt  
9 cost is conservative. Do you agree with that testimony?

10 A No, I do not. It is the company's actual cost of  
11 debt. I don't view it as conservative or non-conservative.  
12 It's what the actual cost is.

13 The company has worked hard to reduce the cost of  
14 debt. And as I mentioned in my direct testimony, not only  
15 have we taken advantage of market opportunities to issue  
16 long-term debt at favorable rates for 10 and 30 years, we've  
17 also done things like negotiate lower underwriting fees of  
18 about nine million dollars since 2006.

19 We've also refinanced the preferred stock that I  
20 discussed in my direct testimony.

21 And we've also reduced some tax-exempt debt, all  
22 of which provides savings to customers, and which we've  
23 passed 100 percent through. The Company isn't trying to  
24 keep any of those. All of those savings are reflected in  
25 the 5.19 cost of the debt, the actual cost.

0173

1 Q Mr. Williams, can you turn to page 33 of  
2 Mr. Hill's testimony?

3 A Yes.

4 Q And I'd like to direct your attention to lines 12  
5 through 14. And there Mr. Hill testifies that PacifiCorp's  
6 cost of debt will continue to decline. Do you see that  
7 testimony on line 14?

8 A I do.

9 Q Do you agree with that testimony?

10 A No. As much as we'd like to have it continue to  
11 decline, I think we all agree that interest rates are going  
12 to increase.

13 And as the company has existing debt that matures  
14 -- and we have over 300 million dollars of debt that will  
15 mature through the next three years, roughly -- that  
16 low-cost debt will be refinanced at market rates. So it's  
17 quite likely that those rates will be higher than current  
18 rates.

19 And so over time, I do expect the company's cost  
20 of debt will increase. Now we will work to try to minimize  
21 that increase as much as we can, but I think it's just our  
22 expectation that the cost of debt will increase.

23 Q So the last couple of questions I want to ask you  
24 are on page 58 of Mr. Hill's testimony. Can you turn to  
25 that, please.

0174

1 A I'm there.

2 Q So in Mr. Hill's revised testimony, his rate of  
3 return recommendation changed from 7.32 percent to 7.01  
4 percent. Are you familiar with that change?

5 A Yes, I am.

6 Q Can you comment on the reasonableness of  
7 Mr. Hill's revised rate of return recommendation?

8 A Yes. I don't believe it's reasonable.

9 In my rebuttal testimony on page 13, I present the  
10 rate of returns of an authorized year to date through  
11 September. That 7.01 as he recommends would be the lowest  
12 rate of return authorized by any commission in any state  
13 this year in this country. So to me it falls out of the  
14 range of reasonableness from that regard.

15 I would say also just from the company's  
16 perspective, we had a recent ruling in Utah where they  
17 authorized a rate of return of 7.57 percent.

18 And then we had deliberations last week in  
19 Wyoming, and those deliberations are going to yield an  
20 overall rate of return of 7.41 percent.

21 So that 7.01 is 40 to 55 basis points lower than  
22 the company's most recent determinations.

23 Q Mr. Williams, would a 7.1 rate of return impact  
24 PacifiCorp's creditworthiness?

25 A Absolutely. And I think it's 7.01.

0175

1           But what that means is the company would have  
2 lower revenues, lower cash flows. And from the rating  
3 agency and investor perspective, cash flows are crucial, and  
4 that's what drives the ratings process.

5           So anything that would reduce the revenues and  
6 cash flows from the currently authorized rates here in  
7 Washington, which the 7.01 would do, would certainly  
8 diminish and weaken the credit quality of the company.

9           MS. MCDOWELL: Thank you, Mr. Williams.

10           That concludes our supplemental rebuttal  
11 testimony. We appreciate the opportunity to present that  
12 testimony, and this witness is available for  
13 cross-examination.

14           JUDGE MOSS: As indicated earlier,  
15 Mr. ffitch, I believe you were the only one now who has  
16 cross-examination for Mr. Williams. So if you would please  
17 proceed.

18           MR. FFITCH: Thank you, your Honor. May I  
19 have just a moment, because we've had new testimony. I just  
20 want to take a look at my cross and see if there's anything  
21 that needs to be adjusted or dropped.

22           JUDGE MOSS: How much time do you need?

23           MR. FFITCH: Just a minute, your Honor.

24           JUDGE MOSS: All right.

25           (Pause in proceedings.)



0176

1 MR. FFITCH: We're ready to proceed.

2 JUDGE MOSS: Go ahead.

3 CROSS-EXAMINATION

4 BY MR. FFITCH:

5 Q Good morning. I'm Simon ffitch with the Public  
6 Counsel office.

7 First of all, your testimony indicates that you're  
8 the vice president and treasurer of Pacific Power and Light  
9 Company, or Pacific Power, right?

10 A Yes, I am.

11 Q And that's a division of PacifiCorp?

12 A Yes. Pacific Power is a division of PacifiCorp.

13 Q All right. Could I ask you, please, to turn to  
14 Cross-examination Exhibit BNW-21CX. That's a response to  
15 Public Counsel Data Request No. 4.

16 A Okay. I'm there.

17 Q All right. And I'm looking at the first page.  
18 And Part A of your response there indicates that Pacific  
19 Power is one of three divisions of PacifiCorp, correct?

20 A Yes, that is correct.

21 Q The other two being Rocky Mountain Power and  
22 PacifiCorp Energy?

23 A Yes.

24 Q Now, Pacific Power serves utility customers in  
25 Washington, Oregon, and California, correct?

0177

1 A That is correct.

2 Q And Rocky Mountain Power serves customers in  
3 Idaho, Wyoming, and Utah?

4 A Yes.

5 Q Now according to your response to Public Counsel  
6 Request 4B, the third division, PacifiCorp Energy, manages  
7 coal mining operations and participates in wholesale energy  
8 trading; is that right?

9 A Yes.

10 Q Do the coal mining and energy trading operations  
11 of PacifiCorp Energy affect the credit rating of PacifiCorp?

12 A When the rating agencies do their credit  
13 assessment of PacifiCorp, they're looking at the entire  
14 company, which would include the mining, the generation, the  
15 fuel, as well as the regulated distribution businesses of  
16 Pacific Power and Rocky Mountain Power.

17 Q All right. Now can I get you to turn to page 2 of  
18 this exhibit, please.

19 A Okay.

20 Q According to your response to this part of the  
21 exhibit, the intercompany revenues attributed to PacifiCorp  
22 Energy are nearly double those attributed to Pacific Power  
23 in the first quarter of 2014; is that right?

24 I'm looking at the far right-hand column?

25 A Yes. I wouldn't say double, but they're

0178

1 significantly larger than Pacific Power's revenues, yes.

2 Q All right. None of these divisions that we've  
3 just been talking about, PacifiCorp Energy, Pacific Power,  
4 and Rocky Mountain Power have standalone capital structures,  
5 do they?

6 A No, they do not. Just one capital structure,  
7 PacifiCorp.

8 Q All right. And is it fair to say that the  
9 Washington operations of Pacific Power comprise about 7  
10 percent of the PacifiCorp overall business?

11 A Yes. I believe Washington is about 7 percent of  
12 the overall revenues of PacifiCorp.

13 Q All right. Now, in this case -- I think perhaps  
14 you've already alluded to this -- you're presenting two  
15 capital structures that could be used for ratemaking  
16 purposes.

17 One of them is a common equity ratio of 51.73  
18 percent, and the other is 49.1 percent common equity,  
19 correct?

20 A Yes, that is correct.

21 Q And the lower of those two is based on the  
22 ratemaking capital structure that the Commission used in  
23 PacifiCorp's last general rate case, correct?

24 A Yes. That's what I referred to as the  
25 hypothetical capital structure.

0179

1           Q     All right. Did Pacific Power's credit rating  
2 decline following the order in the last Washington State  
3 general rate case for PacifiCorp?

4           A     Well, first, Pacific Power doesn't have a credit  
5 rating.

6                     It's PacifiCorp that has the credit ratings.

7                     To answer your question, no, PacifiCorp's credit  
8 rating did not decline, but that's because we don't finance  
9 PacifiCorp consistent with a hypothetical capital structure.

10                    I would also say that that order with the  
11 hypothetical capital structure has been noticed by the  
12 rating agencies, and I do show that in my direct testimony.

13           Q     It's your testimony in this case, though, that if  
14 rates are set using the 49.1 percent common equity ratio  
15 that PacifiCorp's, the parent, credit rating will decline;  
16 not might decline, but will decline. Isn't that your  
17 testimony?

18           A     No, I think you've mischaracterized it.

19                    I think my testimony is if the company actually  
20 capitalized itself at the 49.1 common equity level, it would  
21 be downgraded to BBB. So then it's appropriate to have a  
22 cost of debt that is consistent with that credit rating, the  
23 BBB, which is the 5.80.

24           Q     So you're not saying it will be downgraded; it's  
25 just your speculation that it might be downgraded?

0180

1           A     No, again, I think you're mischaracterizing it.

2                     I think the company hasn't been downgraded because  
3 we haven't implemented that hypothetical capital structure.  
4 We've maintained that 51.7 percent level.

5                     If the Commission would like to set rates at that  
6 49.1 percent hypothetical level, it's fair and appropriate,  
7 then, to have a cost of debt that conforms to that capital  
8 structure and the BBB rating that would likely result from  
9 that.

10           Q     When you refer to the company, the capitalization  
11 of the company, you're referring to PacifiCorp, the parent,  
12 correct?

13           A     Yes, I am. As we talked earlier, there's not a  
14 separate capital structure for Pacific Power, Rocky Mountain  
15 Power, or PacifiCorp Energy. There's just one consolidated  
16 capital structure.

17           Q     Okay. Can I ask you to please turn to your Cross  
18 Exhibit No. 26. That's your Company response to Public  
19 Counsel Data Request 47.

20           A     Okay. I'm there.

21           Q     Thank you. Now, in this data request we asked you  
22 to provide any examples of a 2 percent change in common  
23 equity ratio causing a three-notch change in a utility's  
24 bond rating, correct?

25           A     Yes.

0181

1           Q     And you replied, quote, Mr. Williams is presently  
2 not aware of any examples in the electric utility industry  
3 in which a two percent change in common equity ratio from an  
4 operation that comprises less than 10 percent caused the  
5 utility's bond rating to decline by three bond rating  
6 notches."

7                     That was your response, correct?

8           A     That was part of the response.

9                     The next paragraph continues that the only  
10 situation I'm aware of is the company here in the state of  
11 Washington. And as we've talked about earlier, the company  
12 is not financing itself at that lower common equity level.  
13 So it's kind of a hypothetical situation.

14                    I'm not aware of anybody else that meets those  
15 requirements, solely the company.

16           Q     But it's not your testimony that there was  
17 actually a three-notch bond rate downgrade for PacifiCorp,  
18 correct?

19           A     No. I'm not saying we've been downgraded. We  
20 have maintained the ratings.

21           Q     Since you provided this answer, have you become  
22 aware of any such bond rating downgrades due to the 2  
23 percentage point difference in common equity ratio?

24           A     No. This is the only circumstance I'm aware of  
25 that would meet these requirements, is the company here in

0182

1 Washington.

2 Q Please turn to Cross Exhibit 22. That's your  
3 response to Public Counsel Request 33.

4 A Public Counsel 33?

5 Q Correct.

6 A Yes, I'm there.

7 Q And again, Cross Exhibit BNW-22CX for the record.

8 In that question, we asked the company to provide  
9 the common equity ratio at year end from 2006 forward  
10 through 2013, together with the corporate credit or issue  
11 rating for each of the rating agencies, correct?

12 A Yes.

13 Q And that is shown on page 2 of the exhibit, if we  
14 turn the page. Do you have that?

15 A I do.

16 Q And that data shows, does it not, that the  
17 company's credit rating was unchanged during that period  
18 from 2006 to 2013, although the common equity ratio had  
19 fluctuated from 49.2 to 53 percent?

20 A Yes, that's correct.

21 Q Can we turn, please to Cross Exhibit 24-CX.  
22 That's in response to Public Counsel Data Request 39.

23 A Okay, I'm there.

24 Q All right. In that data request, we asked you to  
25 provide your marginal cost of debt over the 2011, 2012, and

0183

1 2013 period. And you provided that.

2 And I'm going to ask you to turn to page 12 of the  
3 exhibit, the last page of the cross exhibit.

4 A I'm there.

5 Q All right. And that exhibit shows an average cost  
6 rate for ten-year debt of 3.4 percent. Would you agree with  
7 that?

8 A I don't know. I didn't calculate the average cost  
9 of the ten-year debt. So subject to check, I'll accept your  
10 averaging.

11 There's also some 30-year debt in there.

12 Q Yes.

13 A So I don't know if you averaged that one in or  
14 not.

15 Q I was going to get to that, actually.

16 A Okay.

17 Q But perhaps you could tell us which lines -- well,  
18 actually we can see in Column -- Column E has the term of  
19 the debt, correct?

20 A Correct. That's the maturity.

21 Q So would you accept subject to check that the  
22 ten-year debt there at the interest rates are shown in  
23 Column A, that averages out to 3.4 percent?

24 A I'm sorry. You were looking at the interest rate  
25 in Column A?



0184

1 Q Right. For the ten-year debt?

2 A I think it's probably more appropriate to look at  
3 Column M, the cost of money to the company.

4 But either way, I think that rate is probably  
5 reasonable for the average.

6 Q Okay. Thank you.

7 And then with regard to -- you mentioned the  
8 30-year debt. That's also shown in this table, correct?

9 A Yes. That's on line 4, I believe.

10 Q And that's a cost rate of 4.17 percent, correct?

11 A Yes.

12 Q Those are both well below your current embedded  
13 debt cost of 5.19 percent; is that right?

14 A That is correct.

15 MR. FFITCH: Thank you, Mr. Williams.

16 We don't have any other questions for the  
17 witness, your Honor.

18 JUDGE MOSS: All right. I suppose we ought  
19 to go ahead and ask if there's any redirect at this time.

20 MS. MCDOWELL: No.

21 MS. DAVISON: Your Honor, if I may ask just a  
22 couple of quick questions as a result of the live testimony  
23 that Mr. Williams gave on the witness stand?

24 JUDGE MOSS: I suppose we'll allow that.

25 MS. DAVISON: Thank you.

0185

1 CROSS-EXAMINATION

2 BY MS. DAVISON:

3 Q Mr. Williams, you mentioned in your live testimony  
4 the ROR that Wyoming is proposing to give to Rocky Mountain  
5 Power; is that correct?

6 A Yes.

7 Q And is that based on a decision meeting that was  
8 held in Wyoming last week?

9 A Yes.

10 Q During that decision meeting, did the Wyoming  
11 commissioners indicate that they were inclined to give Rocky  
12 Mountain Power a 9.5 percent ROE?

13 A I believe so. I didn't participate directly in  
14 the call. But that's what I heard.

15 Q And what's your current ROE?

16 A Where?

17 Q In Wyoming?

18 A I believe it's 9.8 percent.

19 MS. DAVISON: Thank you. No further  
20 questions.

21 JUDGE MOSS: Okay. Thank you.

22 Ms. McDowell?

23 MS. MCDOWELL: Just one redirect question,  
24 your Honor.

25

0186

1 RE-DIRECT EXAMINATION

2 BY MS. MCDOWELL:

3 Q So you've supplied the rate of return in Wyoming,  
4 and that's 7.41 percent? Does that sound correct?

5 A Let me just double check that. Yes, 7.41 percent.

6 Q And I guess the tentative ROE is 9.5 percent?

7 A Yes, that's my understanding.

8 Q And what do you understand the capital structure,  
9 the equity ratio in the capital structure to be?

10 A 51.4 percent.

11 MS. MCDOWELL: That's all the questions I  
12 have, your Honor.

13 JUDGE MOSS: Thank you.

14 All right. Mr. Williams, you heard my plan.  
15 I think you were in the hearing room earlier this morning.

16 THE WITNESS: Yes.

17 JUDGE MOSS: So I'm going to release you from  
18 the stand subject to recall later by the panel. So that's  
19 our testimony.

20 I believe Mr. Strunk is our next witness.

21 Do you all want a break?

22 COMMISSIONER GOLTZ: Let's keep going.

23 JUDGE MOSS: Mr. Strunk, if you'll remain  
24 standing I'll swear you in.

25

0187

1 KURT STRUNK, witness herein, having been first duly  
2 sworn on oath, was examined and testified  
3 as follows:

4

5 MS. MCDOWELL: Thank you, your Honor.

6 DIRECT EXAMINATION

7 BY MS. MCDOWELL:

8 Q Good morning, Mr. Strunk.

9 A Good morning.

10 Q Can you please state your name and spell it for  
11 the record?

12 A My name is Kurt Strunk; K-U-R-T, S-T-R-U-N K.

13 Q Mr. Strunk, have you prepared direct and rebuttal  
14 testimony in this proceeding?

15 A Yes, I have.

16 Q Do you have any changes or corrections to that  
17 testimony?

18 A I have a few corrections to the rebuttal  
19 testimony. The first one is on page 13.

20 JUDGE MOSS: You need to give us a minute.

21 That's 17-T? Exhibit 17-T?

22 THE WITNESS: Yes.

23 JUDGE MOSS: What page?

24 THE WITNESS: Page 13. At the bottom of the  
25 page on line 20, the words "and in Exhibit No. KGS-22"

0188

1 should be stricken.

2 JUDGE MOSS: Okay.

3 THE WITNESS: The next change is on page 33.

4 JUDGE MOSS: Go ahead.

5 THE WITNESS: There's a Q and A running from  
6 line 4 to line 11. That Q and A is stricken.

7 JUDGE MOSS: Okay.

8 THE WITNESS: The next is on Exhibit KGS-22.  
9 I have three changes to that exhibit.

10 JUDGE MOSS: All right.

11 THE WITNESS: The first one is in the title.  
12 Over the period 1987 to 2011, that should read through 2012.

13 JUDGE MOSS: All right.

14 THE WITNESS: Then below the table, where it  
15 says "Count of years greater than 11.95 percent," that  
16 should read count of years greater than 12.15 percent.

17 And finally, in the footnote at the bottom,  
18 the last footnote, where it says, "The source for the 11.95  
19 percent market-implied return," that should read the source  
20 for the 12.15 percent market implied return.

21 Those are all the changes.

22 MR. STRUNK: Thank you, Mr. Strunk.

23 Mr. Strunk is available for  
24 cross-examination.

25 JUDGE MOSS: All right. In the way of

0189

1 cross-examination, we have Staff has indicated 20 minutes.

2 You may proceed.

3 MS. CAMERON-RULKOWSKI: Thank you, your

4 Honor.

5 CROSS-EXAMINATION

6 BY MS. CAMERON-RULKOWSKI:

7 Q Good morning, Mr. Strunk.

8 A Good morning.

9 Q My name is Jennifer Cameron-Rulkowski. I'm with  
10 the Attorney General's Office, representing Staff.

11 I would ask to you first please turn to page 7 of  
12 your rebuttal testimony. And that's Exhibit KGS-17T.

13 JUDGE MOSS: What page?

14 MS. CAMERON-RULKOWSKI: This is page 7.

15 JUDGE MOSS: Thank you.

16 Q (By Ms. Cameron-Rulkowski) And this is referring  
17 to lines 8 through 11 and 16 through 18. I think it will be  
18 easiest if I have you read lines 8 through 11 quickly for  
19 the record.

20 A Of course. Line 8 begins, "Messrs. Parcell, Hill,  
21 and Gorman removed the allowed returns for Virginia Power's  
22 generation facilities, claiming that they are not  
23 comparable, without removing other observations that would  
24 logically be excluded if a rigorous compatibility screen  
25 were applied."

0190

1 Q Thank you, Mr. Strunk.

2 And then also line 16, that full sentence that  
3 ends at line 18?

4 A "In light of the weight the published averages are  
5 given by investment analysts, it is appropriate to use them  
6 as the proper benchmark for industry allowed returns."

7 Q Thank you.

8 And now I'm going to ask you to please turn to  
9 Staff's Cross Exhibit KGS41-CX.

10 A I have the cross exhibits printed, but they're not  
11 labeled with numbers. So if you could tell me what the  
12 document, is that would be very helpful.

13 Q Certainly. This is Regulatory Research Associates  
14 Regulatory Focus dated January 15, 2014, titled Major Rate  
15 Case Decisions Calendar 2013.

16 CHAIRMAN DANNER: I'm sorry. What was the  
17 number?

18 MS. CAMERON-RULKOWSKI: The number of the  
19 exhibit is KGS41-CX.

20 Q (By Ms. Cameron-Rulkowski) And Mr. Strunk, would  
21 you please read that top paragraph?

22 A "The average return on equity authorized electric  
23 utilities was 10.02 percent in 2013 compared to 10.17  
24 percent in 2012. There were 48 electric ROE determinations  
25 in 2013 vs. 58 in 2012. We note that the data includes

0191

1 several surcharge rider generation cases in Virginia that  
2 incorporate plant specific ROE premiums. Virginia statutes  
3 authorize the State Corporation Commission to approve ROE  
4 premiums of up to 200 basis points for certain generation  
5 projects. See the Virginia Commission profile. Excluding  
6 these Virginia surcharge rider generation cases from the  
7 data, the average authorized electric ROE was 9.8 percent in  
8 2013 compared to 10.01 percent in 2012.

9 Q And we can stop there. Thank you, Mr. Strunk.

10 MS. MCDOWELL: Your Honor, may I approach and  
11 give him a numbered version?

12 JUDGE MOSS: That would be helpful. Thank  
13 you.

14 Q (By Ms. Cameron-Rulkowski) Now, Mr. Strunk, do  
15 you think Regulatory Research Associates would emphasize the  
16 Virginia information in that paragraph that you just read if  
17 they did not think was meaningful information for its  
18 readers?

19 A Yes, they do think it's meaningful information for  
20 its readers.

21 But my testimony that we read earlier is with  
22 respect to what investment analysts look at and what the  
23 investment community looks at, and that is the average  
24 number.

25 There's no reference in analysts' reports to the



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1 average number excluding Virginia. That just doesn't --  
2 analysts' reports do not present it that way.

3 Q And I'll ask to you turn to page 5 of that  
4 exhibit.

5 JUDGE MOSS: Which exhibit?

6 MS. CAMERON-RULKOWSKI: This is still  
7 KGS41-CX.

8 Q (By Ms. Cameron-Rulkowski) Do you see that  
9 Virginia Electric and Power in Virginia is listed four times  
10 on that page?

11 A Yes, I do.

12 Q And these are all in 2013, correct?

13 A They are.

14 Q And so is it fair to say that these cannot all be  
15 general rate cases?

16 A Yes. RRA classifies which cases are riders and  
17 which cases relate to distribution-only utilities, which  
18 cases relate to transmission-only utilities, and so that  
19 allows for a more close comparison to vertically integrated  
20 utilities. And that's the comparison that I present in my  
21 rebuttal this morning.

22 Q Thank you.

23 Now I'm going to ask you to turn to page 37 of  
24 your rebuttal testimony. That's KGS17-T, page 37. And I'm  
25 going to ask to you just read lines 20 to 21 and continue on

0193

1 to the following page 38.

2 JUDGE MOSS: Ms. Cameron-Rulkowski, there's  
3 no reason to have the witness read what what's in his  
4 pre-filed testimony. If you have a question about it, feel  
5 free to ask your question. But there's no reason to have  
6 him read it into the record. That just takes up time  
7 unnecessarily.

8 MS. CAMERON-RULKOWSKI: I'm fine with that,  
9 your Honor.

10 Q (By Ms. Cameron-Rulkowski) So, Mr. Strunk, I  
11 would ask you to refer to the testimony at the bottom of  
12 page 37 and the top of page 38 through your Table 3 there.

13 Is it your testimony that coal-fired generation is  
14 more risky?

15 A That's not exactly my testimony, no.

16 My testimony relates to Pacific Power and  
17 PacifiCorp generally with respect to the challenges that are  
18 faced by some of the new regulations that are likely to be  
19 implemented over the coming years, and the challenge of  
20 moving off coal-fired generation to cleaner energy sources.

21 And those challenges are -- present financial  
22 challenges because such a move and such a transition is a  
23 costly one and requires a financially strong utility.

24 Q When rating agencies assign ratings, they consider  
25 all relevant information, correct?

0194

1 A Yes, they do.

2 Q And were you here when Mr. Williams was testifying  
3 a few minutes ago?

4 A Yes, I was.

5 Q And did you hear him say that rating agencies  
6 consider not just mining operations, but also  
7 coal-generating operations when they're setting their  
8 ratings?

9 A Yes, I did.

10 Q And would you agree with that?

11 A I would agree with that. Rating agencies are  
12 focused on bondholders who are looking at the cost of equity  
13 here.

14 Q So would the factor of coal generation be  
15 reflected in PacifiCorp ratings?

16 A Yes, it would, insofar as it's relevant to the  
17 bondholders, yes.

18 Q And are PacifiCorp senior ratings all single A?

19 A That is my understanding, yes.

20 The unsecured ratings are A minus.

21 Q Did you include the ratings of your proxy group  
22 companies in your testimony?

23 A I included them in my work papers as part of the  
24 credit rating screen that I performed to select across the  
25 group, yes.

0195

1 Q I'm going to have you turn to the exhibit that now  
2 is in the record prepared by Mr. Parcell. It is Exhibit  
3 DCP-8.

4 Do you have a copy of that?

5 A If you could provide a copy of that, I would be  
6 very grateful. Thank you.

7 Q Do you see the ratings list there for your proxy  
8 group?

9 A I do.

10 Q Now under the S&P column in your proxy group, do  
11 you see any companies that have the same rating as  
12 PacifiCorp?

13 A The way the ratings are presented here, it doesn't  
14 specify whether they're talking about secured ratings or  
15 unsecured ratings. So it's hard to tell.

16 Q Let's assume that they're senior secured ratings.

17 A They don't look like senior secured ratings to me.  
18 But...

19 MS. MCDOWELL: I'm going to object to that  
20 question. I think he's being asked to assume facts.

21 JUDGE MOSS: He already answered it. There's  
22 no reason to object now.

23 MS. MCDOWELL: Fair enough.

24 Q (By Ms. Cameron-Rulkowski) I will ask you to look  
25 at the Moody's column. And you do you see any companies in

0196

1 the Moody's column that have the same ratings as  
2 PacifiCorp?

3 MS. MCDOWELL: Objection, your Honor. You  
4 know, I think he's just testified that he doesn't know what  
5 the source of these ratings are. And so I think the  
6 question is assuming facts not in evidence.

7 JUDGE MOSS: I think he can answer that  
8 question. Mr. Strunk seems to be a very capable witness,  
9 and I'll let him go ahead and answer that. If he wants to  
10 give the same answer, he's certainly free to do so.

11 THE WITNESS: There are 13 companies there  
12 that have the A3 rating which would correspond to the senior  
13 unsecured PacifiCorp rating of A minus.

14 Q (By Ms. Cameron-Rulkowski) So Mr. Strunk, do you  
15 see Moody's bond rating for PacifiCorp on this exhibit at  
16 the top of the page?

17 A Yes.

18 Q And what is that rating?

19 A That's A1.

20 Q And do you see any companies in your proxy group  
21 that have that identical rating?

22 A I don't think the -- we're comparing apples and  
23 oranges here. But to the extent that what's shown in the  
24 exhibit is not shown, that doesn't mean that there aren't  
25 any, because these are not necessarily the same class of

0197

1 bonds or ratings.

2 Q Well, I appreciate the answer, but if I could just  
3 have you answer my question I would appreciate it.

4 JUDGE MOSS: I think he did answer your  
5 question, Ms. Rulkowski.

6 MS. MCDOWELL: Thank you, your Honor.

7 Staff has no further questions for  
8 Mr. Strunk.

9 JUDGE MOSS: All right.

10 Then Mr. Ffitch, you appear to be the other  
11 party who has indicated cross for Mr. Strunk, and you've  
12 indicated a half an hour. I'm feeling rested and relaxed.  
13 Unless we have some need, I'd say let's proceed.

14 MR. FFITCH: I will proceed. Thank you, your  
15 Honor.

16 CROSS-EXAMINATION

17 BY MR. FFITCH:

18 Q Good morning, Mr. Strunk.

19 A Good morning, Mr. Ffitch.

20 Q Mr. Strunk, you are the vice president or a vice  
21 president of National Economic Research Associates, or NERA;  
22 is that right?

23 A Yes, that's correct.

24 Q And you've testified that you have served as  
25 advisor in other 50 rate cases; is that correct?

0198

1 A Yes, that's correct.

2 Q Can you please turn to Cross Exhibit  
3 42-CX? That's your -- the company response to Public  
4 Counsel Request 15.

5 JUDGE MOSS: Which exhibit?

6 MR. FFITCH: 42-CX. Just let me know when  
7 you get there.

8 THE WITNESS: I have it in front of me.

9 Q (By Mr. ffitich) And in that question, we asked  
10 you for a list of rate cases in the U.S. in which you have  
11 presented cost of capital testimony. And this is the list  
12 which you provided, correct?

13 A Yes, that's correct.

14 Q And your list includes six cases other than this  
15 current case that we're in right now, right?

16 A I count seven in the list.

17 Q That's including this current case, right?

18 A Yes.

19 Q And of those cases shown on this page, only three  
20 of those involve regulated utilities; is that correct, other  
21 than this case?

22 A No, they all involve regulated utilities.

23 Q Well, the first case on the list, automobile  
24 insurance companies, that's not a regulated utility company,  
25 is it?

0199

1 A In Newfoundland, in Labrador, it is, yes.

2 Q Insurance is a utility service in your view?

3 A In the view of the Newfoundland and Labrador Board  
4 of Commissioners of Public Utilities it is, yes.

5 Q All right. But in the view of the United States  
6 electric and utility industry, that would be a different  
7 type of business, correct?

8 A It is a different type of business, yes.

9 Q And the electricity transmission cases before  
10 FERC, those are not retail electric rate cases, are they?

11 A They would have to do with the OATT rates that are  
12 wheeling transactions.

13 Q Now you provided a cost of equity analysis in your  
14 rebuttal testimony, correct?

15 A Yes, I did.

16 Q So in that update, your current equity costs --  
17 current equity cost estimate is 9 percent under your most  
18 recent DCF result. Do I have that right?

19 A You're referring to Summary Exhibit KGS-18?

20 Q Correct. And the DCF result is shown in KGS-27?

21 A Well, there are actually two DCF results. One is  
22 for the proxy group and one is for an industry group. So  
23 one of them is 9 percent, that's correct. And the other is  
24 10.1 percent.

25 Q All right. Now in selecting a group of companies



0200

1 to study for your DCF analysis, you started with all of the  
2 electricity companies or the electric utilities followed by  
3 Value Line, correct?

4 A Yes, that was the starting point.

5 Q And then you screened for various items such as  
6 bond rating similarities, mergers, et cetera?

7 A Those are parts of it. Those were two of the  
8 screening elements. There were others, yes.

9 Q Okay. And all of the Value Line companies operate  
10 in the United States, correct?

11 A Yes, they do.

12 Q Now, in your analysis, you undertake another DCF  
13 analysis that you call the yield plus growth model, am I  
14 right?

15 A That's correct.

16 Q And in your updated cost of the capital analysis  
17 in your rebuttal, you performed that yield plus growth DCF  
18 analysis again in the update, correct?

19 A I performed it in both the direct and rebuttal,  
20 yes.

21 Q All right. And did you perform that analysis in  
22 the same manner in the rebuttal that you did in your direct  
23 testimony?

24 A Yes.

25 Q And in that analysis, you add the Value Line

0201

1 electric utility dividend yield to the projected earnings  
2 growth that you derive from the Zacks investment reference,  
3 correct?

4 A That's fair, yes.

5 Q Let me ask to you turn to Exhibit 44, Cross  
6 Exhibit 44. That's your response to Public Counsel Data  
7 Request 20.

8 A I'm with you.

9 Q It's the case, isn't it, Mr. Strunk, that  
10 according to the data you provided in response to this DR,  
11 the Zacks earning growth rate projections are for electric  
12 companies outside the U.S., including Chile, Brazil, China,  
13 and Korea; is that right?

14 A That's not a fair characterization. The Zacks  
15 list which is included here in the exhibit, Cross Exhibit  
16 44, includes all 47 of the Value Line companies. And it  
17 also includes 27 additional companies. Some of these  
18 companies do operate outside of U.S.

19 Q Okay. Including Chile, Brazil, China, and Korea,  
20 correct?

21 A Yes. And some of those entities would have ADR's  
22 that trade on the New York Stock Exchange. They're  
23 classified as the electric utilities industry by the  
24 investment service Zacks.

25 Q And you're referring to pages 2 and 3 of the

0202

1 exhibit which lists all the companies on the Zacks list,  
2 right?

3 A Right. Those are the 74 companies that are  
4 covered by Zacks.

5 Q And in addition to the foreign companies, this  
6 list includes unregulated generation companies in the U.S.  
7 such as Calpine; isn't that right?

8 A It includes generators, it includes distributors  
9 it includes transmission companies. It includes a mix of  
10 what investors consider to be the utility industry.

11 Q Okay. So that's a yes answer?

12 A It is.

13 Q Are you aware that 30 percent of the companies  
14 included in the Zacks growth rate are either companies that  
15 operate outside the U.S. or are unregulated generation  
16 companies?

17 A I've answered that question with respect to the  
18 number of companies. There are 47 of the Value Line  
19 utilities are in that list and then 24 additional companies.  
20 I haven't confirmed whether all of those 24 additional  
21 companies operate outside the U.S. But I think it's fair to  
22 say a number of them do, yes.

23 Q All right. So you don't disagree with that  
24 magnitude of this portion of the companies, approximately 30  
25 percent?

0203

1           A     Well, I can't confirm the number. I'd have to  
2 look at each company.

3                     But as I've said, 24 of the -- 27 of the 74  
4 companies are not in the Value Line group and may have  
5 operations outside the U.S.

6           Q     All right. Well, can you turn to page 2 of the  
7 exhibit, please?

8                     JUDGE MOSS: Can you give us a number,  
9 please?

10                    MR. FFITCH: Sorry, your Honor. We're still  
11 on page 44.

12           Q     (By Mr. ffitch) The last two pages are a list of  
13 the companies. Second company on the list, A-E-S-A-Y,  
14 what's that?

15           A     That company operates in Brazil. It's a  
16 subsidiary of AES, or it's related to AES, which is a U.S.  
17 company.

18           Q     All right. If we go down the list to Atlantic, or  
19 AT, what's that?

20           A     My understanding is that that would be Atlantic  
21 Path 15 California transmission.

22           Q     And then there are two Brookfield companies  
23 further down the list?

24           A     Right. Brookfield is a Canadian utility. They  
25 have -- they operate electric sector assets in the U.S. and

0204

1 Canada.

2 Q And then we have Calpine.

3 Fair to say if we continue on down this list, a  
4 significant percentage of these are either foreign companies  
5 or deregulated generation companies, correct?

6 I can continue down the list if you'd like.

7 A I'm not going to split hairs with you on this.

8 There are a number of companies that are outside  
9 the U.S., and some of them include generators.

10 Q Okay. Thank you.

11 I'm not sure if we need a page reference for this.  
12 I'll just ask you. In your direct testimony, Mr. Strunk,  
13 you cite the Australian energy regulator as authority for  
14 increasing the market risk premium based on many factors,  
15 including a forward looking risk premium, correct?

16 A Yes, that's correct.

17 Q And just for context, the market risk premium is a  
18 key element in the CAPM, or Capital Asset Pricing Model,  
19 correct?

20 A It's one of the key elements, yes.

21 Q And under that model, the theory is that the cost  
22 of the equity equals the risk-free rate plus beta times the  
23 market risk premium, correct?

24 A Yes.

25 Q Could you please turn to Cross Exhibit 45, your

0205

1 Cross Exhibit KGS 45? That's your response to Public  
2 Counsel Data Request 21.

3 A I'm there.

4 Q And there you note that the Australian energy  
5 regulator recently increased the market risk premium from 6  
6 percent to 6.5 percent, correct?

7 A It did.

8 Q And in this data request we asked you to calculate  
9 your CAPM cost of equity using your risk-free rate, the  
10 Australian market risk premium, a U.S. beta. And that's  
11 shown at the bottom of the page, page 1 of the exhibit,  
12 right?

13 A It is. It's shown at the bottom.

14 I also explain in the response why such a  
15 calculation is not an appropriate calculation.

16 Q Okay. But that does, according to this  
17 calculation at least, read or generate a result of 8.315  
18 percent as a cost of equity estimate?

19 A Right. But it's mixing a market risk premium that  
20 was calculated off of a different interest rate which was  
21 calculated off the Australian risk-free rate with the -- and  
22 applying it to something that -- to a model that's applied  
23 to the U.S. risk-free rate. And that doesn't make sense.

24 Q But you, in your direct testimony, cite the  
25 Australian energy regulator as authority for increasing the

0206

1 risk premium?

2 A I do. I do. And the reason I do that is because  
3 they want -- they considered the forward looking risk  
4 premium. They used a DCF model to estimate what the market  
5 return was expected to be, and they used that to inform  
6 their equity risk premium for the CAPM. That's what I  
7 cited.

8 But to think you can just apply a risk premium  
9 that's calculated off of their risk-free rate to our  
10 risk-free rate here in America is not a valid comparison.

11 Q Just addressing your updated CAPM now, Mr. Strunk,  
12 that shows that your current risk-free rate is 3.09 percent,  
13 correct?

14 A Yes. That was the prevailing rate at the time of  
15 my testimony.

16 Q And that's roughly 60 basis points below the 3.7  
17 percent you used in your direct, correct?

18 A Yes, it is.

19 Q Now we just noted a few minutes ago that your  
20 current DCF equity cost estimate was 9 percent, correct?

21 A Yes, for the proxy group.

22 Q And your original DCF was 9.23 percent, am I  
23 correct?

24 A Yes, you are.

25 Q So these DCF results alone indicate that the cost

0207

1 of equity capital has declined since you filed your direct  
2 testimony, don't they?

3 A They provide one indication, yes.

4 I've included a variety of models. And certain of  
5 the other models indicate an increase.

6 But it's true if you look exclusively at one of  
7 the models, that model does show a decrease.

8 Q All right. Thank you. Thank you, Mr. Strunk.

9 MR. FFITCH: No further questions, your  
10 Honor.

11 JUDGE MOSS: All right. Any redirect?

12 MS. MCDOWELL: No, your Honor.

13 JUDGE MOSS: Mr. Strunk, as with  
14 Mr. Williams, I'll release you from the stand at this time  
15 subject to recall by our panel. That's probably going to be  
16 this afternoon sometime. Thank you.

17 We'll take a short break. Looks like it's  
18 11:00 straight up, so let's try to be back here by five  
19 after and in our seats by ten after.

20 (Recess.)

21 JUDGE MOSS: We're on the record.

22

23 MICHAEL GORMAN, witness herein, having been first  
24 duly sworn on oath, was examined and  
25 testified as follows:



0208

1 DIRECT EXAMINATION

2 BY MS. DAVISON:

3 Q Thank you, your Honor.

4 Mr. Gorman, can you state your full name for the  
5 record?

6 A Michael Gorman.

7 Q And did you submit pre-filed written testimony in  
8 this proceeding?

9 A Yes.

10 Q And is it also correct that we made a filing this  
11 morning of some corrections to your pre-filed written  
12 testimony?

13 A Yes.

14 Q Do you have any other corrections besides the ones  
15 that were submitted this morning?

16 A I do not.

17 JUDGE MOSS: All right. I'll have the record  
18 reflect that those were pre-distributed and the parties have  
19 no objection to the minor changes in Mr. Gorman's testimony.

20 All right. So Mr. Gorman is now available  
21 for cross, I take it?

22 MS. DAVISON: Yes, your Honor.

23 JUDGE MOSS: You've indicated an hour and a  
24 half for this witness. And I'm fervently hoping you can  
25 compress that into a briefer period, but you've designated

0209

1 what you've designated. So have at it.

2 MS. MCDOWELL: Well, I think it's going to be  
3 an hour.

4 JUDGE MOSS: Well, if it's an hour, we can  
5 finish before lunch.

6 MS. MCDOWELL: Then I would get a medal. But  
7 if I went over, I would not. So that's the line  
8 designation.

9 JUDGE MOSS: I can't offer to buy you lunch.

10 MS. MCDOWELL: I understand. I understand.

11 CROSS-EXAMINATION

12 BY MS. MCDOWELL:

13 Q Good morning, Mr. Gorman.

14 A Good morning.

15 Q I'm going to be asking you some questions about  
16 your responsive testimony in this proceeding. And for the  
17 record, it's MPG-1T. Do you have your testimony with you?

18 A I do, yes.

19 Q Can you turn to page 18 and 19 of your testimony  
20 to begin with?

21 A I'm there.

22 Q And there you recommend that the Commission adopt  
23 a hypothetical capital structure including a 49.1 percent  
24 common equity ratio; is that correct?

25 A It is.

0210

1 Q And you support -- in that testimony, on pages 18  
2 and 19, you support that argument by pointing to industry  
3 averages for equity ratios.

4 Do you see that in the table on page 19 that has  
5 those ratios?

6 A It is one of the reasons to show that the  
7 hypothetical is reasonable, that's correct.

8 Q And at the bottom of page 19, you point to this  
9 data and say, "This is clear evidence that PacifiCorp's  
10 proposed capital structure contains too much common equity,  
11 and is not reasonable."

12 Do you see that?

13 A Yes.

14 Q So in discovery in this case, Pacific Power asked  
15 you whether you had ever proposed or supported a  
16 hypothetical capital structure containing less equity than a  
17 company's actual capital structure in other regulatory  
18 proceedings. Do you recall that request?

19 A I do.

20 Q And subject to check -- and the data request is  
21 2.2 -- you listed two Washington cases and then a case from  
22 Illinois. Does that sound right?

23 A Yes.

24 Q So in that response you failed to mention that on  
25 October 16, 2014, FERC just issued a new order involving the

0211

1 use of hypothetical capital structure in one of your cases,  
2 correct?

3 A Can you repeat? Your wording is important on  
4 that.

5 Q Okay. I just wanted to say in that response, you  
6 failed to mention that on October 16, 2014, FERC issued a  
7 new order involving the use of hypothetical capital  
8 structures in one of your cases, correct?

9 A I think the FERC decided not to take up the issue  
10 of hypothetical capital structures in that proceeding.

11 Q And you did not list that in your data request  
12 response where we asked about cases where you had been  
13 involved that addressed capital structure -- hypothetical  
14 capital structures, correct?

15 A Correct. That was a complaint where FERC had not  
16 yet set it for hearing. So I hadn't filed testimony in  
17 support of that adjustment. But that was an issue in that  
18 case. And I apologize. It should have been disclosed.

19 Q And you did file about a 50-page affidavit in that  
20 case, correct?

21 A I did. But again, it was a complaint to request  
22 that FERC take the issue for settlement in that litigation.

23 Q Well --

24 A It was not a hearing.

25 Q I'm sorry. I didn't mean to interrupt.

0212

1 I have copies of that case and I'd like to ask you  
2 a couple questions about it.

3 MS. MCDOWELL: Your Honor, may I distribute  
4 that case?

5 THE COURT: Are you proposing this as a new  
6 cross exhibit?

7 MS. MCDOWELL: Your Honor, it's a case, so I  
8 would not propose --

9 JUDGE MOSS: An order?

10 MS. MCDOWELL: Excuse me; an order.

11 JUDGE MOSS: All right. You can ask him  
12 about a published order. Sure.

13 MS. MCDOWELL: That's what I was planning to  
14 do. And I have copies.

15 JUDGE MOSS: That's fine. So it looks like a  
16 typical FERC order, about a thousand pages.

17 MS. MCDOWELL: A thousand pardons.

18 JUDGE MOSS. I guess I don't have any room to  
19 talk. It's 96 pages, and I think my last one was about 200.

20 Q (By Ms. McDowell) Now for the record, I've just  
21 handed you an order. And the citation to the order is 148  
22 FERC Paragraph 61,049. And this case involved cost of  
23 capital issues around MISO utilities, correct?

24 A On a complaint based on those issues, yes.

25 Q And this case involved 21 different MISO

0213

1 transmission operators; does that sound right?

2 A Transmission owners across MISO, yes, that sounds  
3 about right.

4 Q And there were multiple parties and experts in  
5 that case, including you, Mr. Hill, and Mr. Parcell?

6 A That's correct.

7 Q Now, in that case you argued for a 50 percent cap  
8 on equity ratios for those companies, correct?

9 MS. DAVISON: Your Honor, I object to this  
10 line of questioning on several bases.

11 One is relevance. I don't see what the  
12 relevance is of a FERC complaint case to Mr. Gorman's  
13 testimony.

14 Second, we had not been provided this order  
15 in advance. It's a very lengthy order. I've had no  
16 opportunity to review it and to make any judgment about it  
17 whatsoever.

18 JUDGE MOSS: All right. Your objection is  
19 overruled.

20 Go ahead.

21 MS. MCDOWELL: Thank you.

22 Q (By Ms. McDowell) So just so the record is clear,  
23 because I'm not sure I heard your answer to my last  
24 question, in that case you argued for a 50 percent cap on  
25 equity ratios for those MISO companies, correct?

0214

1 A The transmission-owning entities, yes.

2 Q And can you turn to page 10 of this order?

3 A I'm there.

4 Q And there in numbered paragraph 13 it indicates  
5 that the complainants were supporting that position based on  
6 your national proxy group, which had an average common  
7 equity ratio of 48.8 percent. Do you see that?

8 A I do.

9 Q So that's similar to the industry average data you  
10 provided in this case on Table MPG-3 on page 19, correct?

11 A Yes.

12 Q And turning to page 84 of that order?

13 A 84?

14 Q Yes, please.

15 A I'm there.

16 Q And I'm going to be asking you about comments on  
17 both pages 84 and 85. But it's true, isn't it, that FERC  
18 denied your argument that capital structures with more than  
19 50 percent are unreasonable?

20 A Can you refer me to the paragraph you're  
21 referencing?

22 Q So paragraph -- page 85, top of the page there, it  
23 states the requested 50 percent cap appears both arbitrary  
24 and unduly restrictive.

25 Does that refresh your recollection about the FERC

0215

1 ruling in that case?

2 MS. DAVISON: I believe for the record that  
3 the ruling appears to be paragraph 195.

4 JUDGE MOSS: Thank you. That's where I'm  
5 reading.

6 THE WITNESS: Well, the sentence preceding it  
7 simply said that they didn't believe we made our case; that  
8 50 percent is the reasonable cap for a common equity ratio  
9 for a transmission owner.

10 Q (By Ms. McDowell) So the FERC refused to even  
11 set the issue for hearing; correct?

12 A That's correct.

13 Q Now I wanted to direct your attention to paragraph  
14 194 there. And do you see where FERC said it is reasonable  
15 to assume that individual utilities are subject to different  
16 risk factors, have different investment needs, and may  
17 pursue different business strategies, all of which affect  
18 capitalization decisions.

19 Do you see that?

20 A I do.

21 Q And isn't it true that your capital structure  
22 recommendation for PacifiCorp in this case is based on  
23 similar evidence that FERC just flatly rejected?

24 MS. DAVISON: Objection. I'm not sure  
25 there's a foundation to make that claim.



0216

1                   JUDGE MOSS: I'm not following that question  
2 either, Ms. McDowell.

3           Q        (By Ms. McDowell) Well, Mr. Gorman, you rely on  
4 industry average data to support your hypothetical capital  
5 structure in this case, correct?

6           A        In part, yes.

7           Q        And you presented that same evidence to FERC in  
8 this case, correct?

9           A        I provided that evidence at FERC, but I provided  
10 additional evidence in this case.

11          Q        But in any event, FERC agreed that evidence was  
12 not sufficient to take the case to hearing, correct?

13          A        That that information by itself was not  
14 sufficient.

15          Q        So can you turn to page 39 of your testimony,  
16 please?

17          A        I'm there.

18          Q        And I want to direct your attention to your  
19 testimony beginning on line 17; page 39, line 17.

20          A        I'm there.

21          Q        Now there you testified that you believe there was  
22 additional risk in long-term interest rate markets created  
23 by this Federal Reserve stimulus policy.

24                   Do you see that?

25          A        I do.

0217

1 Q And you're referring there to the end of the bond  
2 purchasing program by the Feds?

3 A Well, the quantitative easing program and duration  
4 of it has come to an end now. But the liquidity placed into  
5 the long-term interest rate market is still there.

6 So while the additional acquisitions of Treasury  
7 securities and collateralized mortgage securities have  
8 ended, that liquidity still persists.

9 Q So you acknowledge that there is new market risk  
10 associated with long-term interest rates; is that correct?

11 A I'm sorry. Where are you reading?

12 Q Lines 19 and 20, you talk about the greater  
13 current market rate risk?

14 A It's created by that Federal Reserve stimulus in  
15 the capital markets and particularly the interest rate  
16 markets over the last five or six years. Because I believe  
17 that there is -- interest rates are relatively low, and I  
18 think there is risk at those low interest rates, I  
19 considered that in forming what I believe to be an  
20 appropriate forward-looking equity risk premium.

21 Q So let me ask you about that. And that's really  
22 in the next couple of lines where you indicate that you  
23 provided a 70 percent weight to the high end of your  
24 estimates and a 30 percent weight to the low end of your  
25 risk premium estimates to address that market risk

0218

1 associated with long-term interest rates; is that correct?

2 A That's correct.

3 Q So in doing that, you just took the high end of  
4 your results, gave them 70 percent; low end, 30 percent; is  
5 that how that works?

6 A It is. At the end of the evaluation, that's what  
7 I did.

8 Q So can you turn to cross Exhibit 27-CX?

9 A Right. 26-CX?

10 Q It's 27-CX, which is your response testimony in  
11 PacifiCorp's last rate case.

12 A Right. I'm there.

13 Q And can you turn to page 35 of that exhibit?

14 A I'm there.

15 Q So this is actually 33 -- page 33 of the  
16 testimony, page 35 of the exhibit. Are you with me?

17 I just didn't want to confuse you.

18 A I'm there, yes.

19 Q So in the last case you testified in involving  
20 PacifiCorp in Washington, you gave a similar weighting to  
21 your risk premium results, correct?

22 A Similar, but the interest rates were even lower at  
23 that time. So I gave more weight to the high end of the  
24 risk premium than to the low.

25 Q So I was going to ask you about that. In this

0219

1 case, you say for interest rate risk, you weight it at 70  
2 percent.

3 In the last case, without any mention of interest  
4 rate risk, you actually gave it a higher weighting?

5 A Well, during this time period, the Federal Reserve  
6 action became a hot issue in rate proceedings. So I gave it  
7 more discussion in my testimony more recently.

8 But the weighting was based on my assessment of  
9 interest rate risk at that time, which was largely impacted  
10 by the Federal Reserve stimulus policy which was ongoing at  
11 that time. And there was great uncertainty about what would  
12 happen in the interest rates once it was ended, once it did  
13 end.

14 We have some assurance that now that it has  
15 ended, interest rates didn't skyrocket. So some of that  
16 uncertainty is now clearer. But there is still some  
17 lingering impacts about whether or not today's -- actually  
18 lower interest rates today than when I filed the testimony  
19 will remain low or whether or not they'll creep up over  
20 time.

21 Q But it's true --

22 A That seemed risk-important to recognize that risk  
23 in a risk premium model.

24 Q But it's true, isn't it, in your testimony last  
25 year where you gave a greater weighting, you never even

0220

1 mentioned interest rate risk?

2 A Had you asked me why I did that I would have  
3 explained it that way, because I was cross-examined on that  
4 in several rate cases -- and I believe some involved  
5 PacifiCorp -- on the Federal Reserve's stimulus policies.

6 Q So can you turn to Exhibit 26-CX please?

7 A Okay.

8 Q And this is testimony filed about two weeks ago in  
9 the Puget Sound Energy case that's pending here at the  
10 Commission?

11 A Yes, it is.

12 Q Can you turn to page 31 of that exhibit, please?

13 A I'm there.

14 Q And so it's page 31 of the exhibit, page 29 of the  
15 testimony, lines 19 through 21. There you indicate that you  
16 provide 75 percent weight to the high end of the risk  
17 premium estimates and 25 percent to the low end. Do you see  
18 that?

19 A I do.

20 Q So that's the same weighting you gave to  
21 PacifiCorp last year, but a different and higher weighting  
22 than you gave to PacifiCorp this year, correct?

23 A That's correct. And again that is because  
24 interest rates dropped again at the end of this year to be  
25 in line with where they were in the PacifiCorp prior rate

0221

1 case.

2           Again there's a relationship, I believe, to the  
3 level of interest rates and the uncertainty of where  
4 interest rates are going to go going forward.

5           So at the time this testimony was filed, interest  
6 rates kind of crept back up with the expectation that the  
7 quantitative easing policy would end and interest rates  
8 would increase some and stabilize without the Federal  
9 Reserve stimulus policy.

10           But when it ended, they actually dropped. So when  
11 they dropped it caused me to have some greater concern about  
12 whether or not they're going to creep back up again. So  
13 again, it deals with that risk and appropriate equity risk  
14 premium relationship when you develop an equity risk premium  
15 study.

16           Q     So, Mr. Gorman, I'm confused because you just  
17 filed this testimony two weeks ago, correct?

18           A     Yes. What I'm referring --

19           Q     After you filed testimony in the PacifiCorp case,  
20 correct?

21           A     Yes.

22           Q     And this testimony relates to current cost of  
23 capital, correct?

24           A     Would you like me to explain the difference?

25           Q     Yes, I would.

0222

1           A     It's pretty straightforward, and it's shown right  
2     on the schedules.  In this case -- in this testimony --  
3     sorry.  On my Schedule 17 in this case --

4                   MS. DAVISON:  Can you give us the exhibit  
5     number?

6                   THE WITNESS:  MPG-17, page 1, shows an  
7     average Treasury bond yield of 3.27 and a decline in  
8     interest -- Treasury bond yield down to about 3.29 in the  
9     most recent estimate.  That's in this case.

10                  The more recent testimony, Puget Sound, the  
11     13-week average dropped to about 3.14.  But the most recent  
12     spot estimate was a little more than 3 percent.

13                  The BAA utility bond yields dropped  
14     marginally -- or increased from 4.69 up to 4.71 and then  
15     single A utility bonds dropped by about seven basis points.

16                  Again, the most recent numbers showed a  
17     decline relative to those of PacifiCorp.  It was that  
18     decline in interest rates at the end of the quantitative  
19     easing program by the Federal Reserve that just caused me to  
20     pause in determining what I felt to be an appropriate  
21     risk-adjusted equity risk premium.

22                  Everyone in the market, I think as  
23     Mr. Williams said when he was on the stand earlier today,  
24     expected interest rates to increase when the quantitative  
25     easing program ended.  They didn't do that.  They declined.

0223

1 That raised concerns, particularly more recently when  
2 interest rates dropped down to levels that were lower than  
3 they had been even during the stimulus program.

4 So it was a judgment call on my part. I  
5 thought the appropriate weight to the high end, recognizing  
6 that the decline in interest rates and facing an expectation  
7 of increasing interest rates, suggested to me that there's  
8 risk in this interest rate market.

9 Q (By Ms. McDowell) So Mr. Gorman, it's true, isn't  
10 it, that if you weighted the PacifiCorp high end results  
11 with that 75 percent ratio you used in the last PacifiCorp  
12 case and in the current Puget testimony, your high-end  
13 results would be over 10 percent?

14 And the calculations are in your footnote on pages  
15 22 -- footnote 22 and 23 on page 40.

16 JUDGE MOSS: This is page 40 of his  
17 testimony?

18 MS. MCDOWELL: Of his testimony in this case.

19 THE WITNESS: Well, the high end right now is  
20 9.95 percent. So I imagine that would go up to over 10  
21 percent, yes.

22 MS. DAVISON: Just so the record is clear,  
23 that we're referring to CAPM testimony only, correct?

24 THE WITNESS: It's risk premium.

25 MS. DAVISON: It's risk premium testimony,



0224

1 CAPM.

2 Q (By Ms. McDowell) This is your risk premium  
3 testimony, correct, not just CAPM?

4 A It is. The CAPM starts right after line 4. So  
5 the footnote deals with the first four lines on that page.

6 Q Thank you.

7 MS. DAVISON: Thank you.

8 Q (By Ms. McDowell) So can you turn to page 66 of  
9 your testimony, please?

10 A I'm there.

11 Q And on lines 1 to 3 you testified that the trend  
12 in authorized ROE'S is decreasing, and that on that basis on  
13 line 6, you encourage the Commission to reduce PacifiCorp's  
14 return on equity.

15 Do you see that testimony?

16 A Well, this testimony recognizes a climbing trend  
17 in authorized returns on equity, and that the low returns on  
18 equity have been low and should stay low.

19 And this testimony is based on my understanding of  
20 commissions typically use a sense of gradualism in adjusting  
21 the authorized return on equity. So they don't move it as  
22 fast as the market may drop the cost of capital because it  
23 may go up just as fast.

24 So the point I was trying to make with this  
25 testimony is we've seen a decreasing trend over time to very

0225

1 low capital market costs, and it's been sustained at low  
2 levels. So this is really intended to help give some  
3 confidence to the Commission that in a gradualistic  
4 determination of a fair return on equity in this proceeding,  
5 capital market costs have been low for a long time, they  
6 stay low, and the authorized return on equity should be low.

7 Q So PacifiCorp's current ROE is 9.5 percent,  
8 correct?

9 A Correct.

10 Q And you're proposing a decrease of 20 basis points  
11 to 9.3 percent, correct?

12 A Correct.

13 Q And PacifiCorp's current return on equity was set  
14 last December, December 2013, correct?

15 A Yes.

16 Q Now can you turn to -- back to 27-CX, page 3 of  
17 that testimony?

18 JUDGE MOSS: Page 3 of the exhibit or page 3  
19 of the testimony?

20 CHAIRMAN DANNER: Page 3 of --

21 THE WITNESS: The June 13 Pacific Power  
22 testimony?

23 Q (By Ms. McDowell) That's correct. So it's page  
24 3 of the exhibit, page 1 of the testimony.

25 A I'm there.

0226

1 Q And at the bottom of the page, do you see your ROE  
2 recommendation last year for PacifiCorp?

3 A I do.

4 Q And do you see that was 9.20?

5 A I do.

6 Q So that's compared to your recommendation of 9.3  
7 in this case, correct?

8 A Correct.

9 Q So your models show an increase in the ROE in this  
10 case vs. the last, correct?

11 A It shows what I believe to be a fair return on  
12 equity, which is slightly higher now than in the last case,  
13 but still lower than the 9.5 authorized return on equity.

14 Q Well, let me ask you to turn to -- back to Exhibit  
15 26-CX, your testimony in the PSE remand case.

16 A Sorry. What page?

17 Q And this would be page 5 of the exhibit, page 3 of  
18 the testimony.

19 CHAIRMAN DANNER: What was the exhibit  
20 number?

21 MS. MCDOWELL: 26-CX.

22 CHAIRMAN DANNER: Thank you.

23 THE WITNESS: I'm there.

24 Q (By Ms. McDowell) And on lines 3 through 7, you  
25 indicate your recommendation in that case of 9.3 percent,

0227

1 beginning on line 3, that the previous 9.8 percent return on  
2 equity exceeded market -- PSE's market cost of equity in  
3 early 2013 and continues to exceed its current market cost  
4 of equity. This overstatement of costs ranges from at least  
5 50 basis points in April 2013 to no fewer than 20 basis  
6 points today.

7 Do you see that testimony?

8 A I do.

9 Q And that again reinforces the point that your  
10 models are increasing in terms of their return on equity  
11 results, not decreasing, correct?

12 A Well, the high end of my model, yes; they're  
13 higher today, yes.

14 Q So can you turn to MPG-23CX, please? And --

15 A I'm sorry. MPG-23?

16 Q 23CX, which is a response to a data request, 5.2?

17 A Yes. Okay.

18 Q And there you stated in that response that for  
19 your proxy group you did not consider companies -- which  
20 companies had PCAMs or decoupling other risk sharing  
21 mechanisms.

22 Do you see that response?

23 A I said I didn't do an independent determination of  
24 those specific risk factors.

25 But all of those regulatory mechanisms are

0228

1 considered in a business risk assessment by credit rating  
2 agencies and are captured in their bond rating.

3 Q And you agree that for PacifiCorp, its credit  
4 rating is based on its actual consolidated capitalization,  
5 correct?

6 A It's a PacifiCorp-wide bond rating, that's  
7 correct.

8 Q And since your position is that credit ratings  
9 reflect the company's risk and the credit ratings are the  
10 total company, then it follows that the company's risk state  
11 by state is the same?

12 A Generally, yes.

13 But if there are specific regulatory mechanisms or  
14 changes that are unique to a specific jurisdiction, the risk  
15 impact of that regulatory mechanism could be considered in  
16 estimating a fair return for that jurisdiction.

17 Q So can you turn to Cross Exhibit MPG-24CX, please?

18 A I'm there.

19 Q And this is testimony you filed in a Pacific Power  
20 Utah rate case in April of 2014, correct?

21 A Yes.

22 Q And you were here this morning when Mr. Williams  
23 testified about the results of that case?

24 A That settled case?

25 Q Correct.

0229

1 A Yes.

2 Q So now can you turn to page 2 of that exhibit,  
3 which I think is also page 2 of the testimony?

4 A I'm there.

5 Q And this is actually your corrected testimony, so  
6 it's redlined. I just want to be clear that this is the  
7 redlined testimony from the filed testimony. This is not a  
8 change that was inserted into this cross exhibit.

9 You recognize that change to the --

10 A I do.

11 Q -- rate of return?

12 A I do.

13 Q So that corrected rate of return is 7.41 percent  
14 that you recommended in Utah, correct?

15 A Yes.

16 Q And that's based on an ROE of 9.4 percent and an  
17 equity ratio of 51.6 percent.

18 Does that sound correct?

19 A Well, the recommended return was based on my  
20 recommended return on equity and the company's proposed  
21 capital structure.

22 Q So even though your position is that PacifiCorp's  
23 risk is the same in every state, just six months ago you  
24 recommended a materially higher rate of return for  
25 PacifiCorp in Utah, correct?

0230

1 MS. DAVISON: Objection. I believe that  
2 misstates Mr. Gorman's testimony.

3 He didn't say that the risk was the same in  
4 each state. He elaborated on various factors that  
5 contribute to the risk of each state.

6 JUDGE MOSS: Ms. McDowell, you might want to  
7 lay the foundation.

8 Q (By Ms. McDowell) So Mr. Gorman, I believe your  
9 testimony was that the risks for PacifiCorp are generally  
10 the same state by state, given possible mechanisms in each  
11 state?

12 A I said generally the PacifiCorp-wide risk is the  
13 same. But in setting a fair return on equity, there may be  
14 unique circumstances to that jurisdiction that would be  
15 taken into consideration.

16 Q So even though your position is that PacifiCorp's  
17 risk is generally the same in each state, just six months  
18 ago you recommended a materially higher rate of return for  
19 PacifiCorp in Utah, correct?

20 A Well, again, you're misrepresenting what my  
21 testimony was in that jurisdiction.

22 What I recommended in Utah was a return on equity  
23 of 9.4 percent. In Utah, they use an actual capital  
24 structure to set the overall rate of return. So I didn't  
25 make an adjustment to that capital structure because it's

0231

1 inconsistent with the general practice of Utah. So I  
2 accepted the company's capital structure in that  
3 jurisdiction.

4 And with the company's capital structure, my  
5 recommended return on equity, my recommended overall rate of  
6 return, is 7.41 percent.

7 Q So Mr. Gorman, can you turn back to Exhibit 20C --  
8 26CX, please, your testimony in the Puget case?

9 A Sorry. 27CX?

10 Q It's 26CX?

11 A Thank you. I'm sorry.

12 Q And all the way to the last page, page 44, which  
13 is your exhibit MPG-24?

14 A Page 64?

15 Q Page 44. Now --

16 A I don't think I'm at the right place.

17 Q I'm in MPG-26CX, the last page, which is a rate of  
18 return table. Do you have that?

19 A The very last page of the entire document?

20 Q Of the exhibit. It's a 44-page exhibit.

21 A Of Exhibit MPG-41, page 404?

22 Q No. MPG-26CX. And it's your Exhibit 24 to that  
23 testimony, which would be page 44 of the exhibit.

24 A I'm there.

25 Q So it's true, isn't it, that that PacifiCorp Utah



0232

1 rate of return, the 7.57, is actually quite close to your  
2 recommended rate of return for Puget, isn't it, at 7.53  
3 percent?

4 A Well, my recommended return on equity for Puget is  
5 9.3 and for PacifiCorp is 9.4. So those are close numbers.

6 Q And the rate of return that you're recommending  
7 for Puget in this jurisdiction at this time is 7.53 percent,  
8 correct?

9 A Based on the capital structure I found to be  
10 appropriate and based on the company's contractual and  
11 obligated embedded cost of debt, yes.

12 Q And that's 33 basis points higher than your  
13 recommended rate of return for PacifiCorp in this case,  
14 correct?

15 A What is?

16 Q Your recommended rate of return for PSE is at 7.53  
17 percent; your recommended rate of return for PacifiCorp is  
18 at 7.2 percent.

19 Does that sound right?

20 A In this case?

21 Q That's correct.

22 A Yes.

23 Q So your recommended rate of return for Puget Sound  
24 Energy is 30 points higher than for PacifiCorp, correct?

25 A Based on the determination of an appropriate

0233

1 balanced rate of return, including a fair return on equity,  
2 appropriate capital structure, and the contractual cost of  
3 their embedded securities, yes.

4 Q So can you turn to page -- or the last exhibit I  
5 wanted to ask you about, which is MPG-25CX.

6 A The Fitch Ratings report?

7 Q That's correct.

8 A Yes, I'm there.

9 Q And I'm going to direct your attention to -- let  
10 me just lay the foundation. This is a document that you  
11 cited in your testimony as part of your discussion of the  
12 economic outlook for utilities; is that correct?

13 A Yes, it is.

14 Q And the report was dated December 12, 2013?

15 A Yes.

16 Q Now, I've got to find my spot. So just give me  
17 one moment.

18 In the fourth paragraph down, do you see the words  
19 "electric industry challenged"?

20 A Yes.

21 Q And there there's a quote stating that the  
22 electric industry faces stagnant growth prospects as the  
23 recent trend of declining per capita consumption is expected  
24 to continue, if not accelerate.

25 Do you see that?

0234

1 A I do.

2 Q And then I wanted to ask you about a second quote  
3 in this document that you referenced in your testimony. And  
4 this is at page 4.

5 A Page 4 of the Fitch document?

6 Q That's correct.

7 A I'm there.

8 Q And this is the last paragraph on the page there,  
9 on page 4.

10 COMMISSIONER GOLTZ: I'm sorry. What exhibit  
11 number is it?

12 MS. MCDOWELL: I'm on page 25CX, which is the  
13 Fitch electric industry outlook for 2014 cited in  
14 Mr. Gorman's testimony and included in his work papers.

15 Q (By Ms. McDowell) So the quote I wanted to ask  
16 you about is it states here that the credit impacts to  
17 utilities from weak or lost electricity sales to efficiency  
18 are largely neutral over the near term, as most utilities  
19 have riders or decoupling mechanisms in their tariffs that  
20 recover the gross margins that were lost due to lower sales.

21 Do you see that?

22 A I do.

23 Q Now to your knowledge, Pacific Power has no rider  
24 or decoupling mechanism in Washington, does it?

25 A It's my understanding it does not.

0235

1 Q In your opinion, all else equal, do you agree that  
2 PacifiCorp's ROE should be 20 to 30 basis points higher than  
3 a utility that has a decoupling mechanism?

4 A In my judgment, PacifiCorp's fair return on equity  
5 should be based on the evidence I reviewed in determining  
6 what an appropriate return on equity is for PacifiCorp.

7 Q So can I --

8 A The utility is filing annual rate cases. It can  
9 mitigate the risk of declining sales. Its rates are  
10 continuously calibrated to reflect its sales level and its  
11 cost of service.

12 So to the extent PacifiCorp can manage its sales  
13 risk by annually adjusting its cost of service and rate  
14 structure, then it can manage changes in sales and sales  
15 risk, as well as all the other operating and financial risks  
16 that it must manage in operating an electric utility.

17 Q So Mr. Gorman, can you turn to -- back to MPG-26CX  
18 please?

19 This is your testimony in the Puget Sound remand  
20 proceeding, page 7 of the exhibit, page 5 of the testimony.

21 A I'm there.

22 Q And there you -- on lines 4 through 6, you state  
23 your belief that an authorized utility return on equity  
24 should be decreased in the range of 20 to 30 basis points if  
25 a decoupling mechanism is in place?

0236

1           A     I do.

2           Q     So since PacifiCorp has no decoupling mechanism in  
3 Washington, wouldn't you agree that it should have an ROE  
4 that's 20 to 30 basis points higher than a utility that does  
5 have such a mechanism?

6           A     You're misrepresenting this testimony.

7                     What this testimony did was estimate a fair return  
8 on equity for a company without a decoupling mechanism.  If  
9 you implement a decoupling mechanism, you change the  
10 regulatory procedures and reduce the risk to the utility.

11                    There's transfer issues around that too.

12                    So if you start with a utility without one, you  
13 implement a new regulatory procedure, then it's important to  
14 recognize that in reducing the return on equity.

15                    For PacifiCorp, I measured a fair return on equity  
16 based on its investment risk right now.  Had you -- which  
17 includes no decoupling mechanism.  So the rate of the return  
18 I'm finding appropriate for PacifiCorp reflects its  
19 investment risk without a decoupling mechanism.

20                    So there would be no need and it would be  
21 inappropriate to increase that authorized return on equity  
22 based on some other utility who at that time was seeking a  
23 decoupling mechanism in its regulatory mechanism.

24                    MS. MCDOWELL:  Thank you, Mr. Gorman.  That's  
25 all I have.

0237

1 JUDGE MOSS: Thank you. I don't believe any  
2 other party has cross for you. That would be the case.

3 All right. Well, Mr. Gorman, as the other  
4 cost of capital witnesses, you're subject to recall this  
5 afternoon.

6 MS. DAVISON: I have some redirect.

7 JUDGE MOSS: All right. And following brief  
8 redirect.

9 MS. DAVISON: I do have some redirect.

10 JUDGE MOSS: Go ahead.

11 MS. DAVISON: Thank you, your Honor. It will  
12 be brief, I promise.

13 JUDGE MOSS: I thought it probably would be.

14 RE-DIRECT EXAMINATION

15 BY MS. DAVISON:

16 Q So Mr. Gorman, Ms. McDowell is trying to suggest  
17 that your analysis for the remand case should be the same  
18 for a PacifiCorp general rate case. Can you explain why  
19 that is an oversimplistic analysis?

20 A Because they haven't been properly calibrated in  
21 relationship to one another.

22 In this case I estimated a proxy group that had  
23 similar investment risk to PacifiCorp.

24 In the Puget case I estimated a proxy group that  
25 had similar investment risks to Puget Sound at the time of

0238

1 the analysis.

2 In this case, if there are changes to the risk  
3 structure of PacifiCorp, I would have noted those and  
4 commented on whether or not they impacted a fair return on  
5 equity in this case. I did not note any changes in this  
6 case.

7 In Puget Sound, the origin of that case was the  
8 issue of whether or not the authorized return on equity  
9 based on my study, which reflected Puget Sound's beginning  
10 investment risk, should reflect a risk reduction because a  
11 regulatory mechanism would be implemented that would lower  
12 its operating risk.

13 The circumstances in this case are very different  
14 than that case. And the procedures to produce a fair return  
15 on equity required a few more steps in Puget Sound than they  
16 do here.

17 MS. DAVISON: No further questions.

18 JUDGE MOSS: Thank you. All right. I'll  
19 look around this time so I don't make any further missteps.

20 All right. With that, Mr. Gorman, you may  
21 step down subject to this afternoon's process with the  
22 panel.

23 It is approaching the noon hour.

24 Ms. McDowell did a fine job getting us to lunch before our  
25 stomachs start complaining. And we appreciate that effort.

0239

1 Let's come back at 1:15. Thank you.

2 (Luncheon Recess.)

3

4 STEPHEN G. HILL, witness herein, having been first

5 duly sworn on oath, was examined and

6 testified as follows:

7 JUDGE MOSS: Anything preliminary?

8 MR. FFITCH: Just briefly, your Honor.

9

10 DIRECT EXAMINATION

11 BY MR. FFITCH:

12 Q Good afternoon, Mr. Hill.

13 A Good afternoon.

14 Q And you were retained by the Public Counsel Office  
15 to prepare cost of capital testimony in this case, correct?

16 A Correct.

17 Q And do you have any changes or corrections to your  
18 testimony?

19 A I have one change that was incorporated in the  
20 refiled testimony of December 1.

21 Q Thank you.

22 A Other than that, I have no other changes.

23 MR. FFITCH: Thank you, your Honor. The  
24 witness is available for cross.

25 JUDGE MOSS: And we all have that updated



0240

1 testimony.

2 So for Mr. Hill, again it's the Company, one  
3 and a half hours. Ms. McDowell?

4 MS. MCDOWELL: I can assure you I'll be less  
5 than that.

6 JUDGE MOSS: That's nice. That's good.

7 CROSS-EXAMINATION

8 BY MS. MCDOWELL:

9 Q So good afternoon, Mr. Hill.

10 A Good afternoon.

11 Q I wanted to ask you just a couple of questions  
12 about the revision to your testimony that you just  
13 mentioned.

14 And just so we have the dates straight, you filed  
15 your original testimony on October 10; does that sound  
16 right?

17 A Correct.

18 Q The Company filed rebuttal on November 14.

19 And then you filed your revised testimony on  
20 December 1; does that sound correct?

21 A Right.

22 Q Now, at page 6 of Mr. Williams' testimony, he  
23 states, "Mr. Hill accepts my recommended cost of long-term  
24 debt and short-term debt of 5.80 percent and 2.11 percent  
25 respectively if a hypothetical capital is utilized."

0241

1           Now, your use of a 5.80 percent cost of debt was  
2   apparent for Mr. -- in the face of Mr. Williams' testimony,  
3   correct?

4           A    I'd have to say yes to that.

5           Q    Hard to miss even with a cursory review, correct?

6           A    Yes. In fact, his testimony is what alerted me to  
7   the fact that I had made an error, because I knew I was not  
8   in agreement with Mr. Williams. And so when he said that we  
9   were in agreement, I knew there was an error.

10           At that point, when I -- and I didn't read -- I  
11   wasn't able to read his testimony right when it was filed.  
12   But I read it some days later. And upon that realization, I  
13   contacted Public Counsel and began the wheels turning to get  
14   my testimony changed.

15           Q    Now, your counsel indicated in his filing on this  
16   issue yesterday that your testimony was revised as soon as  
17   you discovered the error.

18           So can you tell me, please, the exact date on  
19   which you read Mr. Williams' testimony for the first time  
20   and discovered your error?

21           A    No, I can't tell you the exact date. No.

22           Q    Well, your testimony revision was filed on  
23   December 1, correct?

24           A    Right, after we made the change and the testimony  
25   was reprocessed and all that sort of stuff. My recollection

0242

1 is that it happened over the Thanksgiving holiday.

2 So I don't know whether it began production before  
3 Thanksgiving or after Thanksgiving, but reading Mr.  
4 Williams' testimony alerted me to the fact that I had made  
5 the error. And we made the changes as rapidly as we could.

6 Q So isn't that true that you served a data request  
7 on PacifiCorp, PC-161, that asked about the hypothetical  
8 debt costs on Monday, November 21, 2014?

9 Do you recall that?

10 A I don't recall it sitting here specifically.

11 But I know that I did quite a bit of investigation  
12 on the 5.8 number. And there's quite a bit of testimony in  
13 my direct about why that is not appropriate for ratemaking  
14 purposes. So I'm not surprised that I asked a data request  
15 about it, because I investigated it quite thoroughly.

16 Q But presumably those data requests that you issued  
17 on November 21 were issued in response to your reviewing  
18 Mr. Williams' rebuttal testimony, correct?

19 A I can't answer that as I sit here.

20 When did you say his rebuttal testimony was  
21 submitted?

22 Q The rebuttal testimony was filed on November 14.  
23 Your data requests were filed on November 24.

24 A Well, that would stand to reason.

25 Q So you believe you discovered the error before you

0243

1 filed those data requests; is that correct?

2 A No. That wouldn't make sense.

3 Q So you filed a data request asking about page 5 of  
4 Mr. Williams' testimony even though page 6 of Mr. Williams'  
5 testimony has the information about him accepting your cost  
6 of debt -- your accepting his hypothetical cost of debt.

7 And you're saying before you filed those data  
8 requests you did not realize the error in your testimony?

9 A I believe that's the sequence of events.

10 Q Can you turn to your revised Exhibit SGH-15R,  
11 please?

12 A I'm there.

13 Q And this is your corrected overall cost of capital  
14 exhibit; is that right?

15 A Yes.

16 Q And there you've corrected the long-term debt, the  
17 weighted average cost rate, and the overall ROR; is that  
18 correct?

19 A Yes.

20 Q And then the pre-tax interest coverage discussion  
21 is also revised?

22 A Right. Those are just mathematical outcomes of  
23 changing the debt from 5.8 to 5.19.

24 Q Now, Mr. Hill, isn't it true that the short-term  
25 debt number of 2.11 percent is Mr. Williams' hypothetical

0244

1 short-term debt number?

2 A It's the same one that Mr. Williams used, yes.

3 Q For his hypothetical capital structure, the actual  
4 short-term debt number is 1.73 percent; isn't that correct?

5 A That may be correct. The ultimate outcome of it  
6 is it's a zero weighted cost.

7 Q I'm just trying to clarify, are you accepting that  
8 portion of the hypothetical capital structure, or is that  
9 another mistake?

10 A The 2.11 figure is the figure that he used in the  
11 hypothetical capital structure. It's immaterial whether you  
12 use 2.11 or some other figure; it works out to a zero  
13 percent weighted cost rate.

14 Q So just to be clear, are you accepting that  
15 hypothetical short-term debt number, or is that another  
16 mistake?

17 A It probably should be changed to the actual  
18 short-term debt. The result will be identical.

19 Q Now, of all of your many exhibits in this case,  
20 wouldn't you agree that SGH-15 is the most straightforward  
21 to calculate?

22 A Well, they're all arithmetic, so they're all  
23 pretty straightforward.

24 Q And don't the problems in this exhibit suggest the  
25 need to carefully scrutinize all of your other exhibits?

0245

1 A I carefully scrutinize all of my exhibits.

2 Q So do you recall testifying in the 2009 Puget rate  
3 case?

4 A Yes.

5 Q And I believe that was Dockets UE-090704 and  
6 UG-090705; does that sound correct?

7 A I'll accept your representation.

8 Q And was that the last time that you presented your  
9 complete cost of equity models in a fully litigated  
10 Washington rate case?

11 A I can't recall. I'll take that representation.  
12 It seems about right.

13 Q So will you refer to your Cross Exhibit SGH-24CX?

14 A I have it.

15 Q And do you recognize this as an excerpt from your  
16 testimony in the Puget case?

17 A It appears to be, yes.

18 Q And can you refer to page 6 of that exhibit, which  
19 is page 31 of the testimony?

20 A I have it.

21 Q And there beginning on line 12, you describe how  
22 you calculated your DCF growth rates.

23 Do you see that?

24 A Yes.

25 Q And now can you compare that testimony to page 39

0246

1 of your testimony in this case, SGH-1CTR?

2 And I'd like you to again turn to page 39 if you  
3 could.

4 A All right.

5 Q And I've compared your testimony in the Puget case  
6 and the testimony in this case and they appear to be  
7 virtually identical.

8 Would you accept that you basically filed the same  
9 testimony on DCF growth rates?

10 A No. The testimony is very different. The wording  
11 is largely the same.

12 This is a section of my testimony where I explain  
13 the process by which I estimate the long-term DCF growth  
14 rate. It's rather lengthy. It's very detailed. And it's  
15 meant to explain the process because the other growth rate  
16 analyses that I have are contained in my appendix to another  
17 exhibit. And this explains one company in detail.

18 So the process is the same from company to  
19 company. But the numbers are different. The analysis is  
20 different.

21 Q The inputs are different, correct, but your growth  
22 rates that you use are the same?

23 A No. The growth rates are not the same.

24 Q The growth rate methodologies are the same?

25 A The methodology is the same, yes.

0247

1           My description of it is largely the same, just  
2 like my description of Hope and Bluefield is largely the  
3 same from testimony to testimony.

4           Q     I understand. I was really interested in your  
5 methodologies. And I think you were indicating that those  
6 were demonstrated in your exhibits. And I believe you have  
7 a growth rate exhibit which contains a lot of that  
8 information in the Puget case that is on page 23 of the  
9 exhibit.

10          A     Are you back in the cross exhibit now?

11          Q     I am.

12          A     24CX. Page what?

13          Q     Page 23.

14          A     I have it.

15          Q     And can you compare that to your Exhibit SGH-6 in  
16 this case?

17          A     Okay.

18          Q     So this demonstrates what we just discussed, which  
19 is the use of the same methodologies, but with different  
20 inputs and different growth rates coming out of those  
21 inputs; is that a fair summary?

22          A     Yes.

23          Q     I'd like to hand you an excerpt from the order in  
24 the Puget case we were just discussing.

25                 MS. MCDOWELL: Your Honor, may I distribute



0248

1 these?

2 JUDGE MOSS: Sure.

3 MS. MCDOWELL: Now I've handed you an excerpt  
4 from Order 11 in the 2009 PSE case. And I wanted to direct  
5 your attention to paragraph 299 of that order.

6 A I have it.

7 Q And there the Commission states, "In this context  
8 we find that Mr. Hill's DCF estimates for Public Counsel are  
9 persuasively critiqued by Dr. Morin for the Company because  
10 they rely on growth rates that are obscure and not subject  
11 to replication."

12 Do you see that?

13 A I see that.

14 Q And despite this criticism, you rely on those same  
15 growth rate methodologies in this case, don't you, Mr. Hill?

16 A I do rely on the same growth rate methodologies.  
17 I've relied on them for 30 years. I believe they are  
18 accurate. They produce a reliable cost of equity capital  
19 and I will continue to rely on them.

20 Q So Mr. Hill, can you now turn to Exhibit SGH-21CX?

21 A I'm there.

22 Q And this is your testimony in the current PSE  
23 case. Do you recognize that testimony?

24 A Yes, I do.

25 Q And in this case, in the Puget case, you propose

0249

1 the same range of 8.5 percent to 9.5 percent for your ROE  
2 recommendation, the same one for PSE as you do for  
3 PacifiCorp, correct?

4 A Correct.

5 Q But isn't that true that for PacifiCorp your DCF  
6 results are 20 basis points higher and your CAPM results are  
7 35 basis points higher?

8 A That may very well be true.

9 Q Now, can you go back to page 16 of your testimony  
10 in this case?

11 A 16?

12 Q That's correct.

13 A All right.

14 Q And on the subject of interest rates, you comment  
15 that interest rates are predicted to increase as the economy  
16 improves. Do you see that?

17 A I do see that.

18 Q And on page 17, the next page, you cite Value  
19 Line's quarterly forecast from August 2014. Do you see  
20 that?

21 A You're talking about after the quote?

22 Q Yes. It begins on line 3, going down to --

23 A Yes.

24 Q And in the Value Line comments it indicates that  
25 GDP was a much better than expected 4 percent during the

0250

1 second quarter. Do you see that?

2 A I do see that.

3 Q And also that growth will average 3 to 3.5  
4 percent.

5 Do you see that also?

6 A I do see that.

7 Q Now, can you, while keeping this page of your  
8 current testimony, can you turn to SGH-22CX, please?

9 A I'm there.

10 Q Now, do you recognize this as the testimony you  
11 filed in the recent Avista rate case?

12 A I do, yes.

13 Q And can you turn to page 18 of that exhibit,  
14 please?

15 A I'm there.

16 Q And there you have a similar quote to Value Line,  
17 but the February 2014 publication; do you see that?

18 A Yes.

19 Q And there, as of February, Value Line was  
20 predicting GDP of only 2 to 2.5 percent.

21 Do you see that, line 17?

22 A That's not a prediction. They were thinking that  
23 in the first quarter of 2014 -- well, I guess it was a  
24 prediction at that time, but it hadn't come out. But they  
25 were talking about the quarter in which they were writing.

0251

1 It's not a future prediction.

2 Q So according to this Value Line data that you have  
3 relied on, the economic outlook has improved over the course  
4 of the year, hasn't it?

5 A I think what you'd have to say is the economic  
6 outlook has stabilized to some degree.

7 But just as Mr. Gorman said earlier today, with  
8 that stabilization has come lower interest rates. So  
9 contrary to what you might expect, i.e., the GDP increasing  
10 and the interest rates -- inflation increasing and interest  
11 rates increasing, the reverse has happened.

12 GDP has improved somewhat, stabilized a little  
13 above 3, and yet interest rates have declined. Even after  
14 the Fed stopped buying its own bonds, interest rates have  
15 declined.

16 So I talk at some point in my testimony in this  
17 proceeding about Value Line and its projections of increased  
18 bond yields over -- in the future periods not being as  
19 reliable because they've been projecting increased bond  
20 yields for several years and they haven't come to pass.

21 Q I wanted to ask you about that, because you  
22 include that criticism of Value Line in your PacifiCorp  
23 testimony, but you didn't include that criticism in the  
24 Avista testimony you filed just a few months ago; isn't that  
25 correct?

0252

1           A     That's correct.

2           Q     And when PacifiCorp asked you about whether you  
3 considered Value Line a reliable forecaster in discovery,  
4 you agreed that Value Line was reliable, didn't you?

5           A     I use Value Line and always have in my cost of  
6 capital analysis. And I use their projections, I use their  
7 projected growth rates, I use projected yields. I think you  
8 have to take those into account.

9                     But you also have to be aware of what the reality  
10 is. And over the past few years, the expectation has been  
11 for increased GDP growth and increased inflation as usually  
12 happens in recoveries. It's been my experience in every  
13 recovery that we've had that those two things have gone hand  
14 in hand. And with those things go increased bond yields.  
15 It's what everyone expected and what everyone has been  
16 expecting for four years. It hasn't happened because the  
17 inflationary pressures are not there.

18                     So those projections have been consistently  
19 incorrect. So I think you have to temper what those  
20 projections are with what really is happening.

21           Q     So can you turn to page 5 of your testimony  
22 please, your testimony in this case?

23           A     I am there.

24           Q     And so on the top of page 5, you recognize a  
25 reduction of 10 basis points in your ROE recommendation for

0253

1 PacifiCorp because it has less risk than the proxy group.

2 Do you see that?

3 A Specifically it's for capital structure  
4 differences, reduced financial risk. You see that on line  
5 9, reduced financial risk.

6 Q Right. What I was looking at is on lines 5  
7 through 6. With a slightly higher bond rating and higher  
8 common equity ratio, the group has lower than average  
9 financial risk?

10 A Yes.

11 Q So your testimony here is that you're not relying  
12 on the bond rating; you're relying on the equity ratio?

13 A I'm relying on both. But the actual  
14 quantification was through the Hamada Equation, which deals  
15 with the difference in capital structure.

16 Q So just to be clear, a portion of this 10 percent  
17 reduction in PacifiCorp's ROE is related to the fact that  
18 you believe they have a higher bond rating than the proxy  
19 group; is that correct?

20 A They have a slightly higher bond rating than the  
21 proxy group.

22 And their common equity ratio is higher than the  
23 proxy group. They use the common equity ratio to quantify  
24 what the increase in ROE ought to be for a 1 percent  
25 decrease in the common equity ratio.

0254

1 Q So Mr. Hill, can you turn to page 58 of your  
2 testimony, please?

3 A I have it.

4 Q And there you indicate at the top of page 58 that  
5 PacifiCorp's bond rating is generally similar to the proxy  
6 group. Do you see that?

7 A Slightly higher than, but generally similar to.

8 Q So that's really not a legitimate basis for  
9 decreasing PacifiCorp's ROE in this case, correct, if the  
10 bond rating is generally similar to that of the proxy group?

11 A It's slightly higher than the proxy group, but  
12 generally similar. So yes, it is a rationale for decreasing  
13 the ROE.

14 That's not what I did. I decreased the ROE -- as  
15 I said, the metric for the decrease was based on the  
16 difference in the common equity ratio. The 49 percent  
17 hypothetical common equity ratio that I recommend for  
18 PacifiCorp is higher than the average common equity ratio of  
19 the market traded companies I use in my sample or that Mr.  
20 Strunk uses in his sample.

21 So the ratemaking common equity ratio has more  
22 common equity than the market traded companies that we used  
23 to estimate the cost of the equity. So therefore, this  
24 company, PacifiCorp, has less financial risk.

25 Q So Mr. Hill, were you here this morning when

0255

1 Mr. Williams testified?

2 A I was.

3 Q Did you hear Mr. Williams testify that when in Mr.  
4 Strunk's proxy group, the common equity is calculated on an  
5 operating company basis and not a holding company basis; in  
6 fact, the equity ratio is 51 to 52 percent?

7 A I did hear that. And that would be fine if you  
8 estimated the cost of equity using operating company capital  
9 structures. But you don't.

10 You estimate the cost of equity using the market  
11 base data you have for market traded companies. Operating  
12 companies are not market traded companies.

13 So the capital structure that's important to  
14 stockholders, and the one that determines the cost of  
15 equity, is the capital structure of the holding companies,  
16 the market traded companies. That's the comparison you need  
17 to make when you determine the cost of equity that needs to  
18 be allowed to the applicant utility.

19 Q And that's not true in every case, is it?

20 When the company has its own credit rating, that  
21 is the credit rating folks use for the purposes of  
22 determining equity ratios; isn't that correct?

23 A Credit rating is only one aspect of determining  
24 equity risk. I think when you're doing -- if you're doing a  
25 DCF or you're doing a CAPM, you're using market data. So



0256

1 you have to use the capital structure of the market based  
2 companies. And those are the holding companies, not the  
3 operating companies.

4 Q So can you turn to page 21 of your testimony in  
5 the Puget case, CX21 again, page 54 of the exhibit.

6 A I have it.

7 MR. FFITCH: Just to be clear, Counsel,  
8 you're referring to page 51 of the testimony, page 54 of the  
9 exhibit?

10 MS. MCDOWELL: That's right.

11 Q (By Ms. McDowell) So I want to ask you about  
12 your testimony from lines 16 through 19 on this page where  
13 you were actually comparing your estimate for the PSE  
14 proceeding with your estimate in this case.

15 Do you see that?

16 A Yes.

17 Q And there you testify that the cost of equity  
18 estimate in this case for 2014 is in the same range as what  
19 was determined for the target 2013 time period you were  
20 dealing with in the PSE case.

21 Is that a correct summary of your testimony?

22 A That's a general description. What's going on  
23 here is part of the Commission's examination in the PSE case  
24 is, is a cost of equity determined in 2013 still appropriate  
25 now and for the future.

0257

1           So my analysis in the PSE was backcast to 2013.  
2   And I'm comparing it to the result I had for PacifiCorp,  
3   saying they're generally the same, so that my backcast 2013  
4   cost of equity was reasonable for today as well as the  
5   future.

6           Q     So your position is that ROE results are generally  
7   constant from 2013 to 2014; is that a fair summary?

8           A     That's been my experience.

9           Q     But yet you're in here proposing a decrease of 60  
10   basis points to PacifiCorp's ROE from the ROE this  
11   Commission set in 2013?

12          A     And what's the question?

13          Q     Well, your testimony was just that ROE rates are  
14   constant in 2013 to 2014, but you're here in 2014 arguing  
15   for a 60 basis points reduction from the ROE that was set in  
16   2013 by this Commission?

17          A     I guess my suggestion is that the Commission's  
18   allowed ROE in 2013 was a little too high, because in my  
19   experience as a cost of capital expert, the cost of capital  
20   hasn't changed much since 2013.

21          Q     Can you refer to your Cross Exhibit 23CX please.

22          A     I have it.

23          Q     And do you recognize this as a paper you wrote  
24   called "What is ROE"?

25          A     I do.

0258

1 Q And this paper was submitted to the Alabama Public  
2 Service Commission by the AARP in March 2013; is that  
3 correct?

4 A That is correct.

5 Q Now can you refer to page 10 of this exhibit,  
6 please?

7 A I have it.

8 Q I wanted to direct your attention to what you  
9 indicated --

10 COMMISSIONER GOLTZ: Sorry; what page are you  
11 on?

12 MS. MCDOWELL: I'm on page 10 of 23CX, page 8  
13 of the exhibit.

14 JUDGE MOSS: Just to be perfectly clear,  
15 you're on page 10 of the exhibit, which is page 8 of the  
16 article.

17 MS. MCDOWELL: I said it the exact opposite.  
18 Excuse me.

19 JUDGE MOSS: That's all right. That's why  
20 I'm here.

21 MS. MCDOWELL: To humble me.

22 JUDGE MOSS: No, to have a good clear record.

23 MS. MCDOWELL: Thank you.

24 JUDGE MOSS: Not to humble you.

25 Q (By Ms. McDowell) Okay, Mr. Hill, I was going to

0259

1 ask you about a portion of your paper discussing Mobile  
2 Gas's ROE of between 13.35 percent and 13.85 percent.

3 Do you see that at the top of the page there?

4 A I do.

5 Q And there, continuing on a couple sentences down,  
6 you indicate that the return on equity currently being  
7 allowed by Mobile Gas as evidenced by the 10 percent ROE's  
8 currently being allowed for other utilities in the U.S.  
9 exceeds the company's cost of common equity.

10 So isn't it true that in this paper you were  
11 advocating for a reduction to a 10 percent ROE in March of  
12 2013 for Mobile Gas?

13 A It is true that I wrote this paper for AARP to  
14 present to the Alabama Public Utilities Commission, which  
15 hadn't had a rate case in 30 years.

16 And they had consistently awarded the electric and  
17 gas companies in that state ROE's in the neighborhood of 14  
18 percent. The AARP was able to convince the Commission to  
19 have a round table -- not a hearing, but a round table  
20 discussion, and felt that in the sense of trying to  
21 cooperate with the Commission and companies and in the sense  
22 of gradualism would ask for a 10 percent return on equity.

23 My recommendation to the Commission, not only in  
24 this case, but also Alabama Power and one other gas case in  
25 2013, was that the cost of equity was from 8.5 to 9 or 9.5

0260

1 percent, but that in order to be conciliatory, AARP going to  
2 request 10 percent.

3 So the short answer to your question is yes, but I  
4 feel like it needs some explanation.

5 Q Well, it is curious, because your testimony is  
6 that ROE's are constant between 2013 and 2014, yet you're  
7 proposing a 10 percent ROE for this company in 2013 and an  
8 8.9 percent ROE for PacifiCorp in 2014?

9 A I explained why the difference is. The cost of  
10 capital has been constant. And I told the Alabama Public  
11 Service Commission the same thing. The cost of capital is  
12 between 8.5 and 9.5 percent, but AARP wanted to request a  
13 conciliatory number with this commission.

14 Q So Mr. Hill, can you turn to page 5 of your  
15 revised testimony, please.

16 A I am almost there. I'm there.

17 Q Now, Mr. Hill, in your testimony revisions, you  
18 changed on line 15, the ROR, rate of return, from 7.32 to  
19 7.01.

20 Do you see that?

21 A Yes.

22 Q And you also -- that triggered a change in the  
23 pre-tax interest coverage calculation you did; is that  
24 correct?

25 A Yes, that's correct.

0261

1 Q And that's why you've changed the number 3.28 to  
2 3.56; is that correct?

3 A That's correct.

4 Q Now, a pre-tax interest coverage ratio of 3.56 is  
5 stronger than a 3.28 ratio; is that correct?

6 A Right. Pre-tax interest coverage went up because  
7 the cost of debt went down.

8 Q But isn't it true that because the company's rate  
9 of return was reduced by 31 basis points, the company's cash  
10 flow would be reduced?

11 A No. It's exactly what I just said. The pre-tax  
12 interest coverage went up because the cost of debt, the  
13 interest that it has to cover, went down.

14 Q But --

15 A It's explained best on my Exhibit 15. It's just a  
16 mathematical equation. Pre-tax interest divided by the  
17 weighted interest costs gives you the number.

18 Q But I understand the math, but I guess I'm asking  
19 about the logic. Under the logic of your financial metric,  
20 isn't it your position that the Commission could just keep  
21 reducing PacifiCorp's rate of return and improve its  
22 financial metrics?

23 A They could keep reducing the cost of debt and  
24 improve its financial metrics.

25 But they can't really do that. They don't have

0262

1 the power to do that. The cost of debt is what it is.

2 Q Then that metric doesn't make any sense, does it?

3 A Yes, it does. It makes a lot of sense.

4 Q Well, it's a debt metric, not an overall cost of  
5 capital metrics?

6 A It's a pre-tax interest coverage metric.

7 MS. MCDOWELL: That's all I have. Thank you.

8 JUDGE MOSS: Thank you very much.

9 Mr. ffitch, do you have any redirect?

10 MR. FFITCH: I may have one or two questions,  
11 your Honor.

12 RE-DIRECT EXAMINATION

13 BY MR. FFITCH:

14 Q Just briefly, Mr. Hill, the Company's asked a lot  
15 of questions about the revision.

16 Just to be clear, there was one basic change to  
17 your testimony, and that was to the cost of debt; is that  
18 correct?

19 A That's right.

20 Q And the only other changes were numerical changes  
21 that resulted from the mathematics and that flowing through  
22 to, for example, the interest coverage that we just heard  
23 about?

24 A That's correct.

25 Q And there was no testimony to your narrative -- no

0263

1 change to your narrative testimony?

2 A No. The narrative testimony I have that outlines  
3 why 5.8 is not acceptable and why 5.19 is acceptable didn't  
4 change.

5 Q Can I get you to turn to page 32 of your revised  
6 testimony, please.

7 A I have it.

8 Q And at line 20, there you support the use of the  
9 5.19 percent debt amount; is that correct?

10 A Yes. I say that 5.19 percent is reasonable for  
11 ratemaking purposes, and I go on to say that it's probably  
12 even conservative because the company's current embedded  
13 cost of debt is 5.19.

14 Their marginal cost of debt, we heard from  
15 Mr. Williams earlier today, is between 3 and 4. So as long  
16 as they keep adding debt at 3 to 4 percent, that overall  
17 cost of debt is going to come down.

18 So 5.19 is reasonable. It's probably even  
19 conservative.

20 Q And that was in your original testimony, which was  
21 not revised; is that correct?

22 A That's correct.

23 Q You were asked by counsel if the last time you  
24 presented a fully developed cost of capital in a fully  
25 litigated case was in the 2009 Puget case; do you recall



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1 that?

2 A I recall that. I recall that I couldn't recall  
3 for sure.

4 Q If you turn to Cross Exhibit 22CX that was  
5 provided to you by the Company?

6 A Yes, I have that.

7 Q That is a copy of your testimony in the 2014  
8 Avista general rate case, correct?

9 A Yes.

10 Q And that's a fully developed cost of capital  
11 analysis, is it not?

12 A Yes, it is.

13 Q Now that case ultimately was settled, as I recall.  
14 But in that case you filed with the Commission a fully  
15 developed analysis, correct?

16 A Yes.

17 Q You were asked about Dr. Morin's critique of your  
18 growth rate methodology, and you indicated that you stood by  
19 your analysis and continue to use that.

20 Q Could you just elaborate a little bit on why you  
21 have continued to use that analysis notwithstanding Dr.  
22 Morin's position?

23 A The analysis that I developed using the  
24 sustainable growth rate, I believe is derived directly from  
25 the work of Myron Gordon, who is often known as the father

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1 of DCF. He indicated that sustainable growth rate of the B  
2 times R plus SV growth rate that I used was the most  
3 reliable DCF growth rate.

4 I believe it's important to use that methodology  
5 along with other growth rate measures like projected  
6 earnings, projected dividends, book value, that sort of  
7 thing, to estimate the cost the equity.

8 And it's not mechanistic. In other words, we  
9 don't just plug numbers in and get a DCF. There's some  
10 math; there's some amount of judgment involved in it. But I  
11 think that's a process that investors most likely go through  
12 in reaching a determination about what a long-term growth  
13 rate is.

14 We've seen examples even in this case of analysts  
15 rejecting negative growth rates. In other words, they're  
16 saying earnings growth rates are the only things that  
17 investors look at, but not the negative ones. Well, if  
18 earnings growth rate is all investors consider, then you've  
19 got to take them all. But they're not willing to take them  
20 all.

21 My point is that growth rate analysis is much more  
22 complicated than a plug and play kind of approach. And I  
23 believe that kind of analysis that I've done since day one  
24 takes into consideration what the likely long-term  
25 sustainable growth rate will be for the DCF. And that's the

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1 idea behind DCF; that in fact, growth rates have to be  
2 sustainable over the long term to be realistic. And I  
3 believe this is the best way to get at that.

4 MR. FFITCH: Those are all my questions.

5 JUDGE MOSS: Anything further?

6 Mr. Hill, we appreciate your being here  
7 individually, and we'll see you later as part of our panel.

8 And in the meantime, Mr. Parcell can collect  
9 his goods and so forth.

10

11 DAVID C. PARCELL, witness herein, having been first  
12 duly sworn on oath, was examined and  
13 testified as follows:

14

15 DIRECT EXAMINATION

16 BY MS. CAMERON-RULKOWSKI:

17 Q Good afternoon.

18 A Good afternoon.

19 Q Would you please state your name for the record?

20 A Certainly. David C. Parcell, P-A-R-C-E-L-L.

21 Q Do you have any corrections to the testimony or  
22 exhibits that you filed?

23 A I do.

24 Q Would you please go ahead and go through those?

25 A Certainly. If you'll turn, please, to page 3,

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1 line 9, there were the word "two" appears in that sentence.  
2 Strike "two" and put in "three." Change "two" to "three."

3 Page 16, line 1, after "U.S.," insert the word  
4 "utility," U-T-I-L-I-T-Y.

5 CHAIRMAN DANNER: I'm sorry. I can't catch  
6 that. Tell me again.

7 THE WITNESS: U.S. utility.

8 CHAIRMAN DANNER: What line?

9 THE WITNESS: Line 1.

10 JUDGE MOSS: After U S. Line 1.

11 THE WITNESS: Page 19, line 9; page 19, line  
12 9, after the word "remained," insert "at or," -- A-T, O-R --  
13 "remain at or below."

14 Page 36, line 11; page 36, line 11, under the  
15 Strunk Group column, there's a number, 149 percent. Change  
16 that to 154 percent. Change "149" to "154."

17 And on line 16, make the same change. Change  
18 "149" to "154."

19 Page 40, line 19; page 40, line 19, the word  
20 "exceeds," mark through that and insert the word "matches,"  
21 M-A-T-C-H-E-S.

22 Page 44, the general vicinity of lines 14,  
23 you'll see two references to a footnote 10. Both of those  
24 should be footnote 9. So footnote 9 should be three lines  
25 in a row. So change footnote 10 to footnote 9.

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1                   Finally on page 47; page 47, line 9, the 19.3  
2                   should be 20.3. Change 19.3 to 20.3.

3                   And finally, on DCP-5, for the row 2009,  
4                   under the Moody's, it shows A3. That should be A2. In  
5                   other words, Moody's upgraded one year sooner than I showed  
6                   it. So A3 becomes A2 in 2009.

7                   And that completes my changes, taking into  
8                   consideration we gave out some revised schedules yesterday.

9                   MS. CAMERON-RULKOWSKI: Indeed. Thank you,  
10                  Mr. Parcell.

11                  Mr. Parcell is now available for  
12                  cross-examination.

13                  JUDGE MOSS: Thank you. All right.

14                  Then the Company has indicated again 1.5  
15                  hours. Ms. McDowell, are you going to take the bat again?

16                  MS. MCDOWELL: I am, your Honor. And I will  
17                  also say that right off the bat, I'm going to be asking  
18                  about an exhibit that I know Staff has an objection to.

19                  JUDGE MOSS: All right. Let's do that. Let  
20                  me get to the right place in my exhibit list here.

21                  So this is DCP-26 we're going to talk  
22                  about?

23                  MS. MCDOWELL: That's correct.

24                  JUDGE MOSS: All right. Staff has an  
25                  objection. Please state it.

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1 MS. CAMERON-RULKOWSKI: The objection is  
2 relevance. It's not clear at all that this testimony is  
3 relevant to this proceeding.

4 And I can elaborate a little bit. We  
5 listened to testimony from Mr. -- on Mr. Gorman's testimony  
6 and then also on Mr. Hill's testimony. But I'm really not  
7 sure what the -- how Mr. Parcell's testimony in this  
8 proceeding would be relevant.

9 JUDGE MOSS: Well a witness's testimony from  
10 other proceedings, particularly expert witnesses such as  
11 those we've had with us today, can certainly be relevant in  
12 terms of drawing comparisons to the testimony in this case.

13 So we'll wait and see if you use the exhibit  
14 or not and how you use it. I can't really make a  
15 determination in the abstract.

16 MS. CAMERON-RULKOWSKI: After I heard the  
17 testimony that was elicited from Mr. Gorman, I --  
18 Mr. Parcell's testimony is based on 2013 data.

19 But then I heard that there was testimony  
20 elicited from Mr. Hill, and he does have testimony also on  
21 2013. So I'll be very interested here.

22 JUDGE MOSS: My best guess is that this is  
23 going to prove to be relevant.

24 But in any event, make your objection at the  
25 time you think it's appropriate to do so, and I can rule on

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1 the individual question at that time. I don't think I can  
2 address this objection at this point in time.

3 What about the other two?

4 MS. CAMERON-RULKOWSKI: So the objection to  
5 Mr. Schooley's testimony, the objection there is also  
6 relevance. I don't understand how his testimony would be  
7 relevant to this proceeding because it's testimony of  
8 someone who is not here on the stand today. He does not  
9 testify in any detail about return on equity or cost of  
10 capital. So again, I don't know why it would be relevant.

11 JUDGE MOSS: All right.

12 Is your objection to DCP-28 also relevance.

13 MS. CAMERON-RULKOWSKI: It is not.

14 JUDGE MOSS: Well, again, with respect to  
15 27CX I can't make an abstract determination without a  
16 relevant objection. I have to hear the question before I  
17 determine whether it's relevant or not. So we'll have to  
18 wait on that one as well.

19 MS. CAMERON-RULKOWSKI: Fair enough, your  
20 Honor.

21 JUDGE MOSS: What about 28?

22 MS. CAMERON-RULKOWSKI: Now 28 is only a  
23 small portion of Mr. Parcell's exhibit -- of Mr. Parcell's  
24 testimony in this case. His testimony also had multiple  
25 exhibits attached to it.

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1                   And so only using this very small portion  
2    which was then elaborated on later in this -- in the  
3    complete document would mischaracterize his testimony. And  
4    that's the concern there.

5                   JUDGE MOSS: Well, under the rule of optional  
6    completeness, if you feel it is appropriate to do so we can  
7    expand this exhibit to include other portions if that's  
8    appropriate. I don't want to do it if it's not needed, but  
9    that's an option that you have. If she uses the exhibit and  
10   you wish to assert that right, I will allow it.

11                   MS. CAMERON-RULKOWSKI: Thank you, your  
12   Honor.

13                   MS. MCDOWELL: We have no objection to that.  
14   And we've put a small amount in just to save trees, but  
15   happy to have it all in.

16                   JUDGE MOSS: Maybe you all can confer before  
17   we finalize this later this afternoon or tomorrow morning  
18   and see if there's some need to do that. Again, we don't  
19   want to unnecessarily put paper in the record. If it's  
20   important to the case, then we'll do so.

21                   All right. Why don't you go ahead and  
22   proceed with your questions.

23                   MS. MCDOWELL: Thank you, your Honor.

24

25



0272

1 CROSS-EXAMINATION

2 BY MS. MCDOWELL:

3 Q Good afternoon, Mr. Parcell.

4 A Good afternoon.

5 Q So can you turn to page 4 of your testimony in  
6 this case, DCP-1T?

7 A Sure. I have that.

8 Q And there at the top of page 4, just to get our  
9 bearings here, you're -- you testified that your common  
10 equity range for PacifiCorp is a range of 9 to 9.5.

11 Do you see that?

12 A Yes.

13 Q And you have a range for your ROR, your rate of  
14 return, 7.07 to 7.31.

15 Do you see that?

16 A Yes, ma'am.

17 Q In both cases you select the bottom of those  
18 ranges, so a 9 percent ROE and a 7.07 percent ROR, correct?

19 A For my point recommendation, that is correct.

20 Q Now, can you turn to page -- or to Cross Exhibit  
21 DCP-26 --

22 A 26, you said?

23 Q 26.

24 A Sure. That's the PSE case, right?

25 Q Yes. That's the case we were just discussing.

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1 A Yes, I have that.

2 Q And this testimony was filed a couple of weeks ago  
3 in the PSE case; is that correct?

4 A Yes, December 3.

5 Q And you filed that testimony on behalf of the  
6 Commission Staff, correct?

7 A Also correct.

8 Q Now can you turn to the summary of your results on  
9 page 30 of this exhibit?

10 A 30?

11 Q That's correct. It's 30 of the exhibit, 27 of the  
12 testimony.

13 A Okay. Bear with me if you would because I just  
14 brought a copy of my testimony. I did not print out what  
15 you sent me. So I want to make sure we're on the same page.  
16 But I'm with you on the one now for sure.

17 Q I'll try to give you the alternative page numbers.

18 A I appreciate that.

19 Q Now on lines 22 -- 21 to 22, you recommend a  
20 return on equity range of 9.0 percent to 10.0 percent.

21 Do you see that?

22 A Yes, I do.

23 Q And your -- the top of your range in terms of the  
24 results you show there on page 27 would be the top of your  
25 CE range, your comparable earnings range; is that correct?

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1 A That is correct.

2 Q Now, based on this range of 9.0 to 10.0 percent  
3 for PSE, you select a point estimate of 9.5 percent; is that  
4 correct?

5 A Yes. As of the early 2013 time frame, correct.

6 Q And then on the -- following on to the following  
7 page, lines 11 through 12, you also indicate that a 9.8  
8 percent number, which is PSE's current ROE as I understand  
9 it, is within your recommended range.

10 Do you see that?

11 A Within it, that is correct.

12 Q Now can you turn to page 38 of your testimony in  
13 this case?

14 A Current case?

15 Q Current case.

16 A 38, you said?

17 Q Yes.

18 A Thank you. I have that.

19 Q Now, there you set out a summary table that looks  
20 similar. Do you see that line -- it's in between lines 16  
21 and line 20?

22 A Yes, ma'am.

23 Q And there you have the exact same CE range for  
24 PacifiCorp that you have for PSE, correct, 9.0 to 10.0?

25 A For CE, correct.

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1 Q But for PacifiCorp, you set your range as 9.0  
2 percent to 9.5 percent, correct?

3 A No. In PacifiCorp the range was 9 to 10, but I  
4 put the midpoint of the range at 9.5. But I compared the  
5 midpoint of the DCF range of 9.0.

6 So I was using midpoints to determine a more  
7 narrow range for PacifiCorp than the broader range I took in  
8 the case of PSE because of the nature of this different  
9 proceeding, which I'll gladly explain if you'd like.

10 Q Well, let me just focus on your testimony here.

11 A Sure.

12 Q On lines 22 to 23, you say, "I recommend a return  
13 on equity range of 9.0 to 9.5 percent for PacifiCorp."

14 Do you see that?

15 A You said 9 to 9.5, correct?

16 Q Correct.

17 A That is correct, yes, ma'am.

18 Q And in basically the same part of the page in your  
19 PSE testimony, lines 21 to 22, you say you recommend a  
20 return on equity range of 9.0 percent to 10 percent for PSE?

21 A Right. For the early 2013 time period, that is  
22 correct, yes, ma'am.

23 Q And the basis for your top of the range 10 percent  
24 recommendation for PSE was your CE outcome, correct?

25 A Yes, ma'am, that's right.

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1 Q And you have the same CE outcome in the PacifiCorp  
2 case, correct?

3 A Correct.

4 Q But yet you cut the range off at 9.5 percent, not  
5 at 10 percent, correct?

6 A Right. As I indicated before, in the PSE case I'm  
7 using the broader range based upon my understanding of the  
8 directives of that case; whereas in the PacifiCorp case, I'm  
9 using the midpoints of both my comparable earnings in DCF  
10 range to get a mid point of 9.25.

11 I might add if I had used the upper and lower end  
12 of my DCF and CE in this case, it would have been 8.6 for  
13 DCF, 10.0 for CAPM, for CE. That's a midpoint of 9.35,  
14 about the same as my 9.25.

15 So it's just about I did them differently because  
16 of the nature of that remand proceeding and my  
17 interpretation of what information was being requested and  
18 how to best respond to that request.

19 Q Well, you certainly don't include that explanation  
20 anywhere in the PSE testimony, do you?

21 A Well, that testimony stands on its own. My PSE  
22 testimony is not built upon incorporating my PacifiCorp  
23 testimony. My PSE testimony stands by itself.

24 It would not be appropriate, in my humble opinion,  
25 to be quoting PacifiCorp in my PSE testimony, especially

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1 since it took place two years earlier.

2 Q So can you turn to page 39 of your testimony in  
3 this case, please?

4 A Sorry. 39?

5 Q 39?

6 A Sure. I'm there. Thank you.

7 Q And on line 4 of that testimony?

8 A Yes.

9 Q You indicate that you selected the low end of the  
10 range, 9.0 percent, because your DCF and CE conclusions  
11 focus on the highest results, do you see that?

12 A Yes, ma'am.

13 Q But it's clear from what we just looked at that  
14 you don't use the highest results from your CE method for  
15 PacifiCorp, do you; you cut off your CE results at the  
16 midpoint, correct?

17 A That is correct. But I'm referring here to the  
18 fact that -- I think you also asked me a data request to  
19 this effect -- I did not use a formula approach to determine  
20 my CE results. So Mr. Hill, for example, does use a formula  
21 approach. And that would have been the more adjustment, if  
22 you will.

23 I focused just primarily on the actual earnings  
24 and the resulting market to book ratios. So from my  
25 perspective, if 9.5 -- 9 .495, which is a common CE result

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1 for the industry, and proxy groups have been accompanied by  
2 market book ratios of above 100 percent, that is adequate.  
3 And that is, to my way of thinking, high end results.

4 Q Well, I'd like to go through your CE results a  
5 little bit.

6 A Sure.

7 Q On page 37, you summarize the cost of equity  
8 indicated by your CE results. And there you indicate recent  
9 returns of 9.4 percent to 10.3 percent for your historical  
10 CE analysis, correct?

11 A Correct.

12 Q And prospective returns of 9.5 percent to 11.1  
13 percent; do you see that?

14 A Yes.

15 Q And in neither case is the bottom of your range of  
16 results 9.0 percent, correct?

17 A Right. But you didn't mention -- you left out the  
18 part where I referred to 133 percent market book ratio for  
19 the historic and over 150 percent market book ratio for  
20 prospective. Those are relevant considerations to  
21 determining the CE results. And those are in the same  
22 sentence as you quoted.

23 Q But you don't adjust the results anywhere in your  
24 testimony, do you?

25 A I'm sorry. Could you repeat that.

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1 Q Your ranges that you state are bottomed out at 9.4  
2 and 9.5 respectively, correct?

3 They aren't bottomed out. They reflect the  
4 investor expectation that a return of no more than 9.5  
5 percent is adequate to produce market book ratios well above  
6 100 percent. That's not bottoming out, no.

7 Q Let's turn to your CE discussion.

8 A My what?

9 Q The discussion of your CE analysis?

10 A Sure.

11 Q I believe it's on page 36. Now, there you list 16  
12 different results for the proxy group and this front group.

13 Do you see that?

14 A Those are actually ranges. There's more results  
15 of that embedded within those. But those are the high and  
16 low for each of those categories, yes.

17 Q And again, there's nowhere in these ranges that  
18 you state is there a result as low as 9.0 percent?

19 A That's correct. But the 9.4 to 9.5 are  
20 accompanied by market book ratios of over 135 percent.

21 Q Well, let's turn to the data request I think you  
22 referred to, which is DCP-25CX?

23 A Yes, thank you. Sure. I have that one.

24 You said 25, didn't you?

25 Q I did.



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1 A Yes, thank you.

2 Q And there PacifiCorp asks you to reconcile the  
3 fact that you were recommending a bottom of the range that  
4 was not indicated by any of your results?

5 A Right.

6 Q And the Company specifically asked you did you  
7 make an adjustment for market to book ratios.

8 And nowhere in that data request response do you  
9 say the words "yes," correct?

10 A That's correct, because the adjustment for the  
11 ratios would be as the so-called market to book approach  
12 like Mr. Hill uses, where you actually have a formula that  
13 throws in market to book retention growth, internal growth,  
14 external growth. And that to me is an adjustment in this  
15 context.

16 And I don't use that. I've seen Mr. Hill use it,  
17 but I don't use that adjustment.

18 Q You don't demonstrate that anywhere in your work  
19 papers or even in this response to the data request, do you?

20 A No, because I don't do it. I don't say what I  
21 don't do.

22 Q But you showed the result --

23 A I've never -- I apologize.

24 Q And I apologize to you. I don't mean to talk over  
25 you.

0281

1 A Just be nice.

2 Q I will if you will.

3 A So let me just ask you another question, then,  
4 about your Data Request 55. Your response is that in  
5 response to the question why you set a range of 9 to 10 in  
6 light of the results that were higher than that, you  
7 indicate that six of the eight period averages are 10.1  
8 percent or less, and four of the eight are 9.8 percent or  
9 less.

10 Do you see that?

11 A I do.

12 Q But doesn't that still mean that half of your  
13 period averages are greater than 9.8 percent?

14 A That is correct.

15 But again, the accompanying book ratios are well  
16 over 130 percent.

17 Q So in your testimony on page 38, lines 8 through  
18 10, just to clarify this, you confirm that you do not  
19 incorporate any market to book adjustment, correct?

20 A Not in a formulistic sense; that is correct.

21 Q But just in kind of a general way you reduce the  
22 returns for market to book ratios?

23 A I don't reduce the returns. I just point out that  
24 it's not the required return. The required return is less  
25 than the indicated return.

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1           Q     And that's true for PacifiCorp, where you set a  
2 range of 9 to 9.5, but less true for PSE where you set a  
3 range of 9 to 10; is that correct?

4           A     Well, again, PacifiCorp was in the context of 2013  
5 -- actually, early 2013 time frame. And my interpretation  
6 of what was being requested in PacifiCorp was a more broad  
7 or even a wider analysis of what the potential returns could  
8 be. At least that's the approach I took to PSE --  
9 PacifiCorp instead of PSE in that prior sentence.

10                  Let me recap. In PSE I accepted my assignment as  
11 focusing on the early 2013 time period. All my analyses  
12 were as of that time period.

13                  And also, I interpreted the Commission's agreement  
14 and order to indicate that -- show us what were reasonable  
15 returns at that point in time. Therefore, as opposed to  
16 focusing just on the midpoints, I went to the lower band of  
17 the lowest return and the highest band of the highest to get  
18 a broader range.

19                  Again, the midpoint would likely be the same using  
20 and averaging two midpoints. But I took the broader range  
21 approach in that case because that was my interpretation of  
22 what was being desired.

23           Q     And wouldn't you agree that that kind of broader  
24 range look would be fairly applied to PacifiCorp, given the  
25 fact that the cases are pending concurrently and the

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1 Commission is looking at this issue at the same time?

2 A Not really, because again, PSE is in time frame of  
3 early 2013. That's almost two years ago now. And I think  
4 the latest data that I used was March 31 of 2013 in that  
5 case.

6 And I'm using data through September of 2014 in  
7 this case. So it's 18 months apart.

8 It's true the Commission is hearing them more or  
9 less back to back, but one is a remand. And the  
10 Commission's order specifically stated early 2013, which is  
11 what I did.

12 Q Let me just ask you about your CAPM results in the  
13 case.

14 A Sure.

15 Q Can you turn to page 39 of your testimony in this  
16 case?

17 A Yes. 39?

18 Q Yes.

19 A Yes, I'm there.

20 Q And there you testify that while your CAPM results  
21 are less than your DCF or CE results, the Commission should  
22 use them to support your recommendation for a low end of the  
23 range outcome; is that a fair summary of your testimony?

24 A Roughly speaking.

25 What I'm really saying here is the same thing that

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1 Mr. Gorman and Mr. Hill have already told you, which is  
2 we've been waiting for interest rates for go up for four  
3 years now. And by George, if we keep predicting, one year  
4 we're going to be right. We haven't been right yet.

5 And if an investor had thought in 2010 they're  
6 going up and you bet the farm on it, you wouldn't have the  
7 farm today.

8 And the longer they stay low, the more it becomes  
9 a norm. My 93-year-old father can't get a CD over 1 percent  
10 before two years. And that's normal for him. And people  
11 who used to get 5 percent CD's have all but forgotten that  
12 they were. That's an opportunity cost for your ratepayers.  
13 And that's the way people are reacting to this long-term low  
14 interest rate environment. It's not a novelty anymore.  
15 It's the norm now.

16 Q So Mr. Parcell, can you turn to page 30 of your  
17 PSE testimony, DCP-26CX, please?

18 A Yes.

19 JUDGE MOSS: And that's page 30 of the  
20 exhibit?

21 MS. MCDOWELL: That's correct.

22 THE WITNESS: It will be 28 of the  
23 testimony?

24 Q (By Ms. McDowell) 27 of the testimony.

25 JUDGE MOSS: It's page 27 of the testimony.

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1 THE WITNESS: Thank you.

2 Q (By Ms. McDowell) Now, it's true, isn't it, that  
3 your CAPM results in the PSE case are much lower than they  
4 are in the Pacific Power case?

5 A The PSE case, they were a midpoint of 6.7.  
6 At the current time it's 7.3. So the CAPM has  
7 gone up.

8 Q So I have the ranges here. Your PSE results, 6.5  
9 to 6.8, and your Pacific Power results 7.2 to 7.4.

10 Do you see that?

11 A Yes.

12 Q And in your PSE testimony you don't have a similar  
13 comment about the Commission considering the low CAPM  
14 results to justify a lower range outcome, correct?

15 A Correct.

16 Q So even though PSE's CAPM results are lower, you  
17 don't advocate for the Commission to consider those,  
18 correct?

19 A Right, because I'm talking two years ago in PSE.  
20 And when I came across that question and answer, I  
21 determined it would be more confusing in a historic sense  
22 that it would be as opposed to being clear in a present  
23 sense. Therefore, I made the executive decision to take  
24 that out of that PSE case because it was two years ago.

25 Q Doesn't the fact that the CAPM results are

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1 increasing in the PacifiCorp case suggest that the costs of  
2 capital are increasing and not declining, as your narrower  
3 range for PacifiCorp suggests?

4 A Well, the DCF costs are lower in the PacifiCorp  
5 vs. PSE.

6 Q But the CAPM results are higher?

7 A That's correct.

8 Q And the CE results are the same, correct?

9 A They are the same, yes.

10 Q And you ultimately rely on the CE results to  
11 justify your recommendation in the PSE case, correct?

12 A In part, yes.

13 Q That's how you get to 9.5 and to justify a 9.8 as  
14 a part of a reasonable range, correct?

15 A That's correct. If I just did DCF and CAPM I'd be  
16 below 9 percent.

17 Q So Mr. Parcell, can you turn to DCP-27, please?

18 A Sure.

19 Q And do you recognize this as the testimony of Tom  
20 Schooley filed concurrently with your testimony in the PSE  
21 case?

22 A I do.

23 Q And I just have one question to ask you on this  
24 testimony. I wanted to direct your attention to page -- the  
25 top of page 7. And --

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1 A I have that.

2 Q And this question actually begins -- there's a  
3 question that leads up to it at the bottom of page 6. The  
4 bottom of page 6 reports on PSE's earnings?

5 A Yes.

6 Q And the top of page 7 the question is: "Of what  
7 importance is this data?"

8 And the answer is, "This data implies that, since  
9 PSE is not achieving its authorized return of 7.77 percent,  
10 it is unnecessary to reduce the authorized return."

11 Do you see that testimony?

12 A Yes, ma'am, I do.

13 Q So based on this testimony, wouldn't you agree  
14 that if PacifiCorp is not achieving its authorized return,  
15 it would be unnecessary to reduce its authorized return from  
16 9.5 percent to 9.0 percent?

17 A I do disagree with that. And I'll gladly tell you  
18 why if you want to know.

19 Q So can you turn to page 23CX, please?

20 A Page 23 of what?

21 Q I'm sorry. Exhibit 23CX.

22 A Oh, sure. Yes. I have that.

23 Q Now this is your data request response to  
24 PacifiCorp's Data Request No. 50. And this data request  
25 response referred to a survey of electric utility rate



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1 decisions in 2014.

2 Do you recall responding to this data request?

3 A Yes, I do.

4 Q And in your response, you confirm that the survey  
5 found that the average ROE for the electric utility rate  
6 case decisions in 2014 was 9.9 percent?

7 A That is correct.

8 Q Do you recall that?

9 A And I'm glad you brought this schedule up, because  
10 the same information shows the prior authorized returns from  
11 the prior year, and that average was 10.14. So over that  
12 one-year period, the average return on equity for electric  
13 utilities dropped 26 basis points.

14 So that does indicate a decline in cost of equity  
15 as shown by regulators.

16 Q But it also indicates an average ROE that's 90  
17 basis points higher than your recommendation --

18 A That's right, but 26 base points lower than the  
19 year before.

20 Q So on page 2 of this cross-examination exhibit, in  
21 the article entitled "Risk Holds Sway," it quotes -- are you  
22 with me?

23 MS. WALLACE: 23CX.

24 Q (By Ms. McDowell) Sorry if I misspoke. 23CX on  
25 page 2.

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1           And there's a discussion of the ISO New England  
2 decision at FERC.

3           Do you see that, in the first part of the  
4 article?

5           And I want to ask you about one quote which is at  
6 the midcolumn on the third column over. It said that, "As  
7 FERC explained, if ROE's were tied too closely to current  
8 interest rates, investors would simply choose to put their  
9 money elsewhere."

10           Now, your recommended ROE of 9.0 percent in this  
11 case does not account for this risk of investor disinterest,  
12 correct?

13           A     Investor what?

14           Q     The loss of investment interest in utility  
15 investment if ROE's were tied too closely to current  
16 interest rates.

17           A     I'm sorry. I must have misunderstood your  
18 question, because I don't see the connection between this  
19 page and your question. So maybe I'm missing something.

20           Q     Let me rephrase my question.

21           A     Sure. Thank you.

22           Q     In this article, there's a quote saying, "As FERC  
23 explained, if ROE's were tied too closely to current  
24 interest rates, investors would simply choose to put their  
25 money elsewhere."

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1 Do you see that quote?

2 A Yes, ma'am.

3 Q And I'm asking you, did your recommendation in  
4 this case consider whether investors would continue to  
5 invest in PacifiCorp at that 9 percent?

6 A Again, interest rates are lower today than they  
7 were a year ago when the Commission gave PacifiCorp 9.5  
8 percent.

9 So -- and that part was on appeal at that time.  
10 So if 9.5 was appropriate based upon the context of your  
11 question a year ago, and interest rates are lower today,  
12 that logic would indicate on its own less than 9.5 percent.

13 Q Can you turn to page 39 of your testimony, please?

14 A You said 39?

15 Q Yes.

16 A Yes. I'm there. Thank you.

17 Q Again, lines 1 through 5. As another reason for  
18 justifying the bottom end of your range recommendation, you  
19 refer to the possible implementation of a PCAM mechanism in  
20 this case.

21 Do you see that?

22 A Yes, ma'am.

23 Q You agree that PacifiCorp currently does not have  
24 any PCAM mechanism, right?

25 A Right, as Mr. Williams points out in his

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1 testimony.

2 Q And even if the Commission adopted one in this  
3 case, wouldn't it be premature to make any risk adjustment  
4 for a PCAM at this time before there's any demonstration of  
5 an actual reduction in risk?

6 A It's not a risk adjustment.

7 What it's saying is it's something new for the  
8 company. And I'm not going outside my range. I'm just  
9 saying it's a factor to tell us where to go within the  
10 range.

11 And this company's been asking for a PCAM for  
12 years, according to my information. And the Staff is  
13 recommending one in this case.

14 So it's a new factor potentially for the company,  
15 and it's a positive factor.

16 I mean, Mr. Williams said that the rating agents  
17 have commented on the Company's lack of PCAM in Washington.  
18 It's the only state that does not have one for PacifiCorp.

19 So it's a new factor. So it's a factor to help  
20 determine where within the range to set PacifiCorp's cost of  
21 equity.

22 But I don't go beyond the range. I'm not making  
23 an adjustment per se. I'm just going within the range.

24 Q So Mr. Parcell, can you turn to DCP-28CX?

25 A Sure. I have that.

0292

1 Q And do you recognize this as testimony previously  
2 filed in a Cascade Natural Gas case in this jurisdiction?

3 A At least the first four pages of it, yes.

4 Q And on page 5 of this exhibit, which is page 3 of  
5 the testimony, you recommend that if -- that Cascade's ROE  
6 should be 25 basis points higher if it does not have a  
7 decoupling mechanism; isn't that correct?

8 A As of 2006, yes, for a gas company.

9 Q So since PacifiCorp does not have a decoupling  
10 mechanism, is it your position --

11 MS. CAMERON-RULKOWSKI: I'm going to object.  
12 Mr. Parcell has not testified to making any adjustments  
13 whatsoever based on decoupling. And so I think that this  
14 question would be outside the scope of his testimony.

15 JUDGE MOSS: I'm going to overrule the  
16 objection.

17 Go ahead with the question.

18 Q (By Ms. Wallace) So since PacifiCorp does not  
19 have a decoupling mechanism, is it your position that  
20 PacifiCorp's ROE should be 25 basis points higher than a  
21 utility that has a decoupling mechanism?

22 A I have not addressed decoupling in the context of  
23 electric utilities such as PacifiCorp, or actually any  
24 electric company in two or three years now. So I have not  
25 run those numbers lately.

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1           Certainly in 2006 it was a big factor for a gas  
2 company like Cascade.

3           But the analysis I make is the cost of capital for  
4 a broad spectrum of publicly traded companies. Maybe some  
5 of those companies may have a subsidiary with decoupling,  
6 but other subsidiaries do not. But whatever is there is  
7 built in, and it's not a factor that I would be comfortable  
8 either adding to or subtracting from based upon the  
9 information that I've done lately and what I've done in  
10 either this or the PSE case prior testimonies.

11           So I'm sorry. I just can't help you on that. I  
12 haven't studied it.

13           Q     At least since the time you filed this testimony  
14 in 2006; is that your testimony?

15           A     I'm sorry?

16           Q     You haven't looked at this since 2006 when you  
17 filed this testimony previously?

18           A     No. I said I have not looked at the decoupling  
19 impact on an electric utility in two or three years, is what  
20 I said.

21           What I did say in '06 is that I had an indicator  
22 of the impact for a gas utility in 2006, but that was eight  
23 years ago. That may be the same today; it may not be the  
24 same. I just don't know.

25           Q     Well, you know, I was just wondering about it

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1 because you recommend a higher ROE for PSE than you did for  
2 PacifiCorp, notwithstanding the fact that PSE has a  
3 decoupling mechanism.

4 A PSE has lower bond ratings than PacifiCorp.

5 And also PSE's return on equity was as of early  
6 2013, whereas PacifiCorp's is in the second -- the fourth  
7 quarter of 2014. It's a different time period, different  
8 proxy companies.

9 And most of my recommendations are lower today  
10 than they were two years ago because the cost of equity has  
11 declined over the last two years, as indicated by the lower  
12 authorized returns by utility commissions.

13 Q And isn't that true, Mr. Parcell, that every one  
14 of the utilities in your proxy group in this case is also in  
15 one of the proxy groups in the PSE case?

16 A Repeat that, please?

17 Q Isn't it true that every one of the utilities in  
18 your proxy group in this case is in one of the proxy groups  
19 you use in the PSE case?

20 A It's probably true because in the PSE case I have  
21 my own proxy group.

22 I also do analyses of Mr. Gorman's proxy group  
23 from 2013.

24 And PSE was in Dr. Morin's proxy group as of 2013.

25 So I'm using three different proxy groups, which

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1 probably includes 75 to 90 percent of all electric utilities  
2 between the three of them. You'd almost have to follow.

3 Q So can you turn to page 46 of your testimony,  
4 please?

5 A I'm sorry; 46?

6 Q Yes, please, in this case.

7 A Sure. I'm there. Thank you.

8 Q So there you point to an Exhibit DCP-16, which you  
9 indicate states that -- or demonstrates that electric  
10 utilities had equity ratios of less than 50 percent and had  
11 single A ratings.

12 Do you see that?

13 A Yes.

14 Q Now, would you agree that in that exhibit there  
15 are 21 decisions where the utility was single A rated?

16 A I'll accept that.

17 Q And as of those 21 decisions, only one involved a  
18 utility with a single A rating that had a common equity  
19 ratio of less than 50 percent, correct?

20 A I'll accept that. But that still shows that 49  
21 percent is enough to maintain an A rating.

22 Q But it's certainly well below the average for that  
23 single A rated utility?

24 A But you don't have to be the average. You're in  
25 the game, so to speak. Companies with lower equity ratios



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1 have had A ratings and maintained A ratings.

2 Q So can you turn to page 40 of your testimony?

3 A Sure. I have that.

4 Q And I wanted to ask you about your testimony about  
5 the financial integrity test that you conducted on your  
6 recommendation. And that's contained here on lines 14  
7 through 19; is that correct?

8 A Yes.

9 Q Now you did just a single test to determine  
10 whether your recommendation would maintain PacifiCorp's  
11 financial integrity, correct?

12 A I'm sorry. I didn't hear all that.

13 Q I'm sorry. You just did a single test to verify  
14 that your recommendation would maintain PacifiCorp's  
15 financial integrity?

16 A There are two tests. There's coverage and the  
17 debt to total capital calculation. There's two tests there.

18 Q Now when we asked you about the source of your  
19 tests that you ran, you provided the information in  
20 DCP-22CX. Can you turn to that please?

21 A Sure. I have that.

22 Q And that information was provided in response to  
23 Data Request No. 49?

24 A Yes, ma'am.

25 Q And you basically provided these as the source

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1 documents for your financial analysis of your recommendation  
2 in this case; is that correct?

3 A The information in the -- DCP-15, the benchmark  
4 ratios came from DCP-22CX.

5 But the analyses were done by me. The  
6 calculations for PacifiCorp is where it shows. I think  
7 that's what you asked me.

8 Q Yes. That's a fine clarification in your  
9 response. That is what I was asking, whether this was  
10 basically the source of the framework for your analysis.

11 A That is correct, yes.

12 Q And the document that you provided on page 3 of  
13 DCP-22, that document is dated 2004, correct?

14 A Yes, ma'am.

15 Q And it's true, isn't it, that S&P no longer uses  
16 this approach to reviewing credit metrics, correct?

17 A No, not this exact metric, that is correct.

18 Q And to do this metric it requires a business  
19 profile score from Standard & Poor's, correct?

20 A Yes.

21 Q And Standard & Poor's no longer provides business  
22 profile scores, do they?

23 A Not to my knowledge.

24 Q So how is it that one can conduct this analysis  
25 when a critical input to the analysis is no longer provided

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1 by Standard & Poor's?

2 A I used the business position of 4, which is the  
3 middle business position of electric utilities. I should  
4 say was.

5 Q As of 2004?

6 A And -- well, thereafter. They didn't discontinue  
7 it in 2004, but it was published in 2004.

8 Q But it hasn't been used in some time?

9 A For some time, yes.

10 MS. MCDOWELL: That's all I have. Thank you.

11 JUDGE MOSS: Thank you. Any redirect?

12 MS. CAMERON-RULKOWSKI: Yes, your Honor.

13 RE-DIRECT EXAMINATION

14 BY MS. CAMERON-RULKOWSKI:

15 Q Mr. Parcell, Ms. McDowell had asked you about  
16 various questions about the range that you propose in this  
17 case, the PacifiCorp case. And now the basis for the low  
18 end of your range, which analysis is that?

19 I can give you a little more context. On page 38  
20 you summarize the results of your three types of analyses?

21 A Yes.

22 Q And the low end of your range, does that come from  
23 one of those particular analyses?

24 A It does. That is the midpoint of my DCF analysis.  
25 My DCF analysis is a range of 8.75 to 9.25. The midpoint of

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1 that is 9.0. So the 9.0 DCF midpoint forms the lower end of  
2 my cost of capital range.

3 MS. CAMERON-RULKOWSKI: Thank you very much.

4 That's all I have for Mr. Parcell

5 JUDGE MOSS: You may as well stay where you  
6 are.

7 THE WITNESS: Keep my chair?

8 JUDGE MOSS: It's probably the most  
9 comfortable one anybody's going to have.

10 Why don't we take a break while we get  
11 organized here, because I'm going to ask you to give up your  
12 chairs to the witnesses.

13 (Recess.)

14 JUDGE MOSS: Let's be back on the record. We  
15 have our panel seated now. And this is the opportunity to  
16 questions from the bench, so I'll ask if you have any  
17 preferences as to order.

18

19 QUESTIONS TO THE PANEL FROM THE BENCH

20 CHAIRMAN DANNER: I want to thank you all of  
21 you for being here today. It's been a very interesting day  
22 so far.

23 I guess I'll start with Mr. Parcell. There  
24 was a discussion earlier of Mr. Schooley's testimony in the  
25 other case which we are not litigating today. And he said

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1 that PSE continues to earn less than its authorized rate of  
2 return but it's getting closer, and said that that date  
3 implies since they're not achieving their authorized rate of  
4 return it's unnecessary to reduce the authorize the rate of  
5 return.

6 And I remember Ms. McDowell asked you about  
7 that, and you said no, there's a difference. And you  
8 invited her to ask to you explain the difference, and she  
9 didn't take you up on it.

10 I wanted to know why in this case that is not  
11 a factor. If they're not achieving their authorized rate of  
12 return, is it unnecessary to reduce that?

13 And then I'd ask others to weigh in.

14 MR. PARCELL: All right. I will not put  
15 words in Mr. Schooley's mouth, and I haven't discussed this  
16 with him.

17 However, my reading of the rules of conduct,  
18 so to speak, in a case is such that when you had that  
19 hearing in 2013, it was, for lack of a better term that  
20 comes to mind, an expedited rate case with no cost of  
21 capital testimony. In the remand there was no cost of  
22 capital.

23 And I think -- and it's just me thinking;  
24 I've not talked to Schooley about this -- but I think what  
25 he was saying is that in the absence of the company not

0301

1 earning its authorized return, maybe the cost of capital had  
2 less importance in that context. But again, that's my  
3 words, not his.

4 CHAIRMAN DANNER: So as a general matter, to  
5 say that if you're not achieving your authorized rate of  
6 return it's not necessary to reduce it? That's not --

7 MR. PARCELL: Or vice versa. The fact that  
8 you do or do not earn your authorized rate of return is not  
9 by itself justification for an increase or decrease in the  
10 cost of equity.

11 CHAIRMAN DANNER: Thank you.

12 Anyone else want to respond to that?

13 All right. Thank you.

14 And then I wanted to also get others' views  
15 on the effect of the PCAM, having a PCAM or not having a  
16 PCAM, what should be its effect on ROE.

17 And I'll just throw that out there to whoever  
18 wants to take it.

19 MR. STRUNK: I can take a first shot at that.

20 The companies in my proxy group use PCAMs.  
21 It's very standard practice for the industry. 42 states in  
22 the U.S. use dollar for dollar PCAM recovery. And so the  
23 effect of a PCAM is really already baked into the ROE  
24 estimates or baked into the ROE estimates for any of the  
25 proxy groups that are on the record in this case.

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1                   CHAIRMAN DANNER:  And of course one of the  
2  issues that we've have had before this Commission is the  
3  elements of a PCAM, whether the ones that you're looking at  
4  in your proxy group, for the most part do they have the same  
5  characteristics?

6                   Do they have sharing of --

7                   MR. STRUNK:  I can't speak to that directly  
8  for the -- each operating company is going to be very  
9  different.

10                  But what I can say generally is that as I  
11  said before, 42 of the states in the U.S. use dollar for  
12  dollar recovery with no sharing or deadbands.  So it would  
13  only be very rare that there would be a sharing or debt band  
14  in the beginning.

15                  MR. GORMAN:  Can I offer an opinion on that?

16                  The issue with PCAM is whether or not they're  
17  provided an opportunity to recover their cost of service.  
18  So within that there is some uncertainty about what those  
19  costs are going to be.

20                  There are many ways to manage cost  
21  uncertainty.

22                  One means is passing it on to ratepayers  
23  through an automatic adjustment cost.

24                  Another way is to negotiate supply contracts  
25  with coal suppliers and put some of that price uncertainty

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1 off on the coal suppliers, both in volume and in price.

2 So when you compare one utility to other  
3 utilities and only look at the regulatory mechanisms, you're  
4 not doing a full review of the options available to those  
5 utilities to manage that commodity risk.

6 So it is far more complicated of an issue  
7 than just questioning who has a PCAM, who doesn't, and what  
8 are the terms of PCAM; because another layer of that risk  
9 assessment is how do they buy coal, how much risk do they  
10 take, how much risk do they put back on suppliers?

11 What are their other generation mixes? Do  
12 they have hydro facilities, nuclear facilities?

13 So it's a very complicated assessment that  
14 deals not only with cost recovery risk, but what options you  
15 have available to manage that risk and how effective are you  
16 in managing that risk. So there's not one solution to  
17 manage the risk. There are many different options.

18 CHAIRMAN DANNER: That's all the questions I  
19 have for now.

20 COMMISSIONER JONES: Good afternoon,  
21 everyone. I'll start with Mr. Williams.

22 Mr. Williams, can you turn to your Exhibit --  
23 it's the Fitch Ratings. I think it's BNW-2.

24 MR. WILLIAMS: Okay.

25 COMMISSIONER JONES: This regards the PCAM.



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1                   So following up on Chairman Danner's  
2 question, ever since I've been here we've discussed the  
3 PCAM.

4                   MR. WILLIAMS: For quite a while, I believe  
5 we have.

6                   COMMISSIONER JONES: I went back to the  
7 acquisition in '06. And there was a rate case after that.

8                   Staff and the parties were supposed to enter  
9 into a collaborative and come up with a PCAM and submit it  
10 to the Commission. Didn't happen. So this has been before  
11 us for a long time.

12                   So my question to you is in that second  
13 paragraph from the bottom, it says Fitch would expect PPW to  
14 pursue a power cost mechanism in a future rate filing.

15                   So why didn't you do it in this case?

16                   Why didn't you submit something?

17                   Because now we're faced with a Staff proposal  
18 in responsive and the Company hasn't proposed anything.

19                   MR. WILLIAMS: I think the Company has made a  
20 proposal for the renewable portion of it. Mr. Duvall will  
21 be talking more about that, I believe, tomorrow. And I  
22 think he can address why he thinks that's a better vehicle  
23 for the company than the full PCAM.

24                   I know we proposed one in the last case. And  
25 I guess the structure of it or arrangements was not

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1 acceptable by the Staff.

2                   So I think we're proposing a renewable  
3 mechanism as maybe a midpoint, trying to meet their concerns  
4 and still provide some protection for the Company.

5                   So I would say we have proposed maybe the  
6 substance of a PCAM, but not maybe calling it a PCAM.

7                   COMMISSIONER JONES: Well, do you think the  
8 burden should be on the Company or the Staff or any  
9 responsive party to file an appropriate PCAM?

10                   MR. WILLIAMS: Well, I think it's the  
11 Company's responsibility. And we did try that in the last  
12 case and it wasn't acceptable.

13                   So I think what we're proposing now is  
14 something that we think hopefully will be more acceptable to  
15 the parties and give the Company some protection on the  
16 variability of the renewable resources.

17                   COMMISSIONER JONES. I don't have the order  
18 in front of me.

19                   And I acknowledge your point on the renewable  
20 resources. But that, in my view, is just one small portion  
21 of fuel costs. As Mr. Gorman says, you have coal and  
22 wholesale purchases.

23                   So I guess the follow-up question is I think  
24 the Commission has given you pretty clear guidance in the  
25 past in orders about things like a sharing band and a dead

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1 band, haven't we?

2 MR. WILLIAMS: That's my understanding, yes.

3 COMMISSIONER JONES: Okay. The next series  
4 of questions regards Berkshire Hathaway debt to BHE.

5 I think earlier this morning -- I'd just like  
6 to explore this a little bit. It gets to this question that  
7 Mr. Hill mentions in his testimony about holding company cap  
8 structure vs. the operating company.

9 And I fully realize that the Commission has  
10 never imposed a double leverage adjustment, and I'm not  
11 going in that direction.

12 But I'm just trying to understand. This  
13 morning you said the Berkshire Hathaway debt to BHE is made  
14 to look like equity. So what does that mean?

15 Is that an intracompany loan? If you could  
16 briefly describe to the Commission?

17 MR. WILLIAMS: Sure. I'll use some technical  
18 terms. I'll try to explain, and if it doesn't make sense  
19 please let me know.

20 But the securities that Berkshire Hathaway  
21 purchases from BHE in exchange for cash are called junior  
22 subordinated debentures. And they're a form of debt.  
23 They're typically very long-lived, 30 or 40 years.

24 And they're subordinated. So in terms of  
25 security they rank behind all the other creditors. So in



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1 numbers in the exhibits. If I had the Berkshire Hathaway  
2 10-K I could determine that quickly, but I don't.

3 COMMISSIONER JONES: That's not necessary.

4 Mr. Hill or Mr. Gorman, do you have any  
5 comment on that issue of the holding company leverage vs.  
6 the operating company leverage?

7 Mr. Hill, I think you had mentioned that in  
8 your testimony.

9 MR. HILL: Yes, I mentioned it in the context  
10 of looking at the published capital time structure in the  
11 10-K; not Berkshire Hathaway, but BHE.

12 COMMISSIONER JONES: Right.

13 MR. HILL: BHE's published 10-K common equity  
14 ratio was in the 30's, 32 to 33 percent. They still had a  
15 relatively high bond rating. That was my point.

16 And it was countering Mr. Williams saying  
17 that a 2 percent drop in common equity ratio would cause the  
18 bond rating to go down. Well, here was BHE with a much  
19 lower common equity ratio than PacifiCorp, but still  
20 maintaining a similar bond rating ratio.

21 His explanation that a good percentage of it  
22 -- and I'm not sure what the percentage is -- is  
23 subordinated debt to Berkshire Hathaway would make -- would  
24 provide some explanation for that.

25 COMMISSIONER JONES: Okay. Mr. Williams, my

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1 next questions are regarding the credit rating of A minus,  
2 which is what you've enjoyed since 2006.

3 MR. WILLIAMS: On the unsecured debt yes.

4 COMMISSIONER JONES: Right, on the senior  
5 unsecured.

6 So in that time period, as I recall the  
7 acquisition, one of the merger commitments was for the  
8 equity layer not to go below 44 percent.

9 And I frankly forget where the equity of  
10 PacifiCorp started at that time. My sense was it was in the  
11 mid to high 40's.

12 Then BHE, or Berkshire Hathaway, made quite a  
13 substantial equity injection into the company, and then it's  
14 been -- it was that way until about 2011, and then you  
15 started to make dividend payments back to BHE.

16 Is that kind of an accurate summary of since  
17 2006?

18 MR. WILLIAMS: Yes. Let me clarify a little  
19 bit, though. The equity contributions were really begun  
20 under Scottish Power.

21 They did continue under MidAmerican, or BHE  
22 ownership, through I believe 2008 or 2009.

23 There was a period of time where there was no  
24 contributions.

25 And then you're correct. I think beginning

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1 in 2011 we began to pay dividends back to or pay dividends  
2 to BHE.

3 The acquisition commitment I think you're  
4 referring to was a dividend test. And it had a threshold, I  
5 think initially requiring 48 percent common equity for  
6 PacifiCorp to pay dividends. And that threshold then  
7 stepped down over time to 44 percent, where it's at  
8 currently and stays at that level kind of going forward.

9 COMMISSIONER JONES: And my recollection is  
10 that that lower equity layer has never been tested?

11 MR. WILLIAMS: No. We've never had an issue  
12 with that test when we're paying dividends.

13 COMMISSIONER JONES: But would you agree the  
14 equity layer, at least for the Washington jurisdiction, has  
15 varied a bit for that period from 2006 to 2013, but -- I  
16 think Mr. Hill states in his testimony -- the credit rating  
17 has stayed constant at an A minus during that entire period,  
18 correct?

19 MR. WILLIAMS: Yes, I think -- as I remember,  
20 in 2006 we requested, I think, a 49 percent common equity  
21 level. And rates were set at 47. And then over time that's  
22 risen to the 49.1 that's currently the authorized rate here  
23 in Washington.

24 I guess my point is that the ratings have  
25 been maintained because the company has capitalized itself

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1 at a higher equity level and not at the 47 or 49 percent  
2 authorizing rates.

3 So to answer your question, yes, we have  
4 maintained the ratings of A minus, but that's because the  
5 capitalization has not followed the authorized levels.

6 COMMISSIONER JONES: Mr. Gorman, in your  
7 testimony relating to cap structure, you do make an issue of  
8 these dividend payments which began, as Mr. Williams says, I  
9 think in 2011, about 500 million per year according to the  
10 10-K's. So I think Mr. Williams admits in his rebuttal that  
11 that could equate to a 50 basis point reduction in the cap  
12 structure.

13 So my question so you is A), do you think  
14 that this -- these dividends will continue over time; and  
15 B), what is going to be the impact in the future in the rate  
16 year and beyond, if these dividend payments continue.

17 MR. GORMAN: It's my understanding, based on  
18 credit analyst reports -- and I'm assuming they're getting  
19 this information from PacifiCorp -- that they do plan to  
20 make large dividend payments at least over the next three  
21 years through 2016. As they're paying large dividends,  
22 they're not growing their equity base. And they are issuing  
23 debt.

24 So over that time period I would expect that  
25 the common equity ratio will continue to decline down



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1 towards the hypothetical common equity ratio used by this  
2 jurisdiction.

3                   And I would note that the S&P credit report  
4 recognizing those large dividend payments and the climb in  
5 the common equity ratio has not noted that to be a concern.  
6 They have a stable bond rating outlook. They have a strong  
7 regulatory ranking. They have strong financial ranking.  
8 There is no apparent concern in the published debt rating  
9 reports that PacifiCorp's actual common equity ratio is  
10 declining.

11                   It's declining quite significantly, and  
12 coming closer to the hypothetical capital structure used by  
13 this Commission.

14                   COMMISSIONER JONES: And you've testified  
15 before us quite a few times. And you are aware that we use  
16 hypothetical capital structures frequently for the three  
17 companies we regulate, correct?

18                   MR. GORMAN: That is my understanding, yes.

19                   And I think the credit analysts know that the  
20 hypothetical capital structure can be a common equity ratio  
21 that's above the actual level and below the actual level.

22                   I think the credit rating agencies understand  
23 that the hypothetical capital structure is instruction for  
24 company management, but what this regulatory commission  
25 expects them -- how they are expected to manage their

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1 capital in providing service to retail customers in this  
2 state.

3 To the extent regulation is a surrogate for  
4 competition, I think that meets that objective. In the  
5 competitive marketplace a company takes market prices and  
6 they have to adjust their actual cost structure in order to  
7 profitably operate at these market prices. That produces an  
8 incentive for them to have a competitive cost structure.

9 In setting rates we can't use market prices  
10 because they're not available. So we have to set prices  
11 based on a competitive cost structure. So that creates a  
12 tie between a regulated price setting scheme and a  
13 market-based price setting scheme.

14 COMMISSIONER JONES: Mr. Strunk, I think on  
15 page 3 of your testimony when you discuss hypothetical  
16 capital structures you -- well, let me ask you. Are you  
17 aware of the hypothetical capital structures that we have  
18 used for our three companies going back to the western  
19 energy crisis?

20 MR. STRUNK: Yes, I'm generally familiar with  
21 the use of hypothetical capital structures in this  
22 jurisdiction. And my understanding is that it's been used  
23 both to increase the equity ratio --

24 COMMISSIONER JONES: Correct.

25 MR. STRUNK: -- and to decrease --

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1                   COMMISSIONER JONES: You're going where I was  
2 going. I came on this Commission in 2005. And I think in  
3 some important cases prior to that and even when I became a  
4 Commissioner, by order we established what was called an  
5 EBM, an equity building mechanism, in which we established a  
6 capital structure with more equity than necessary, or then  
7 actual at the time, because as you may recall in those days,  
8 in order to make wholesale power purchases to serve native  
9 load, our utilities were in dire straits. So we used an  
10 equity building mechanism to strengthen and set them above  
11 what we thought the actuals were.

12                   And we did not adjust the ROE at all, either  
13 up or down.

14                   And so that's why I'm a little bit curious  
15 about the symmetry of an ROE adjustment mechanism with a  
16 hypothetical capital structure. You and the company argue  
17 that we should make this 28 basis point adjustment. And to  
18 the best of my knowledge, we've never done this.

19                   Is that your understanding as well?

20                   MR. STRUNK: That's my understanding of the  
21 Washington state precedent.

22                   It is practice in other jurisdictions to  
23 adjust the ROE up. NERA was involved in a case in Texas  
24 where the Texas commission imputed a higher debt ratio and a  
25 lower equity ratio. And when it did that, it adjusted the

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1 ROE up by 50 basis points.

2 COMMISSIONER JONES: Okay.

3 MR. STRUNK: So while it's not practice in  
4 Washington, it is necessary from a financial theory  
5 perspective and is consistent with that other regulatory  
6 practice that was described.

7 COMMISSIONER JONES: Mr. Williams, do you  
8 have any further comments on that, or are you going to rely  
9 on Mr. Strunk?

10 MR. WILLIAMS: I'm going to rely on Mr.  
11 Strunk.

12 I would like to comment on what Mr. Gorman  
13 said, if I may.

14 COMMISSIONER JONES: Yes.

15 MR. WILLIAMS: I do agree that we share our  
16 plan and our projections with the rating agencies. So they  
17 are well aware of our dividend and our financing plans and  
18 expectations.

19 But our current plan has the common equity  
20 level declining a little bit more, but not getting anywhere  
21 near the hypothetical level. So currently we expect the  
22 common equity level will bottom out about 51.4 percent.

23 The other point I would like to address  
24 quickly -- and I'm sorry if I'm running long -- the cost  
25 that Mr. Gorman spoke of, to me that's really the overall

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1 rate of return. And I don't think you can -- you should  
2 focus so much on the capital structure component, but how  
3 all those, the capital structure and the costs, interplay  
4 and the resulting overall rate of return that that produces.

5 MR. GORMAN: Can I respond to that?

6 There is some differences in the overall rate  
7 of return, even if you hold most of the components constant.  
8 For example, PacifiCorp has a lot of variable cost debt in  
9 their capital structure. So right now that's cheap. That  
10 helps reduce their overall rate of return.

11 But there's risk associated with it. If  
12 short-term interest rates go back up, that cost of debt is  
13 going to go back up and customers are going to pay a higher  
14 rate of return to support that level of variable cost debt.

15 Other utilities don't have as much variable  
16 cost debt in their capital structure. That's not a  
17 criticism of PacifiCorp. I think it's a good thing. But it  
18 is an a explanation why you can't target on the rate of  
19 return because they're not apples to apples comparison  
20 between utilities.

21 JUDGE MOSS: Mr. Hill, did you have  
22 something?

23 MR. HILL: Just briefly on the balance  
24 between ROE and capital structure, those two things actually  
25 work against each other. If you raise the common equity



0318

1 clarify the 49.1 percent cap structure again, summarize the  
2 adjustments. I think you mentioned this on page 48 and 49  
3 of your testimony.

4 But this is basically the same cap structure  
5 that you recommended and we accepted in the last case. So  
6 you did make some adjustments for leases, operating leases,  
7 and PPA's; but you did exclude other pension, other  
8 post-retirement benefits, did you not?

9 MR. GORMAN: In developing the credit metrics  
10 you've got to judge whether the rate of return I was  
11 recommending was not only fair, but whether or not it helped  
12 support credit metrics that would support their  
13 investment-grade bond rating.

14 So it was a test of the reasonableness of my  
15 rate of return recommendation. In doing that test, there  
16 are certain financial obligations the utility is going to  
17 take on that are off balance sheet that are recognized as  
18 debt obligations by credit rating agencies. Not all of them  
19 are outside management's control.

20 Pensions and OPEB's, for example, the amount  
21 of cash contributions they make to those trusts determines  
22 how much debt-like characteristics those obligations have.  
23 And they have discretion to determine how much cash  
24 contribution they're going to make.

25 And I haven't done it, but you could go back

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1 and see what have customers been paying in rates; for  
2 example, if it's an accrual pension contribution, accrual  
3 OPEB expense, to verify whether or not the company actually  
4 deposited that amount of money in the pension trust.  
5 There's a way of gauging whether or not that debt obligation  
6 or meeting their commitment to their employees has been  
7 satisfied in line with what customers have actually paid the  
8 utility to meet that obligation.

9                   So it gets far more complicated than  
10 determining whether or not a utility entered into a purchase  
11 power agreement and now they have to meet the financial  
12 obligations of that contract; the utility enters into a  
13 leasing agreement and now they have to meet that financial  
14 obligation. Those are clearly contracts that allow them to  
15 meet their service obligation to customers going forward.

16                   The OPEB and the pension obligations are a  
17 little different because there's some give and take in the  
18 regulatory treatment, the discretion of management, and  
19 other factors, which, if they're ignored, could result in  
20 awarding a higher rate of return in order to meet that off  
21 balance sheet debt obligation when customers have already  
22 made a pretty strong commitment to meeting that financial  
23 obligation already. So that's the bottom line basis of it.

24                   There are also some other issues. And one of  
25 them deals with whether or not you look at it on a total



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1 company basis or a jurisdictional retail basis.

2 The credit rating agencies look at it total  
3 company basis. There's no question there.

4 But in this case we're trying to answer the  
5 question whether or not the rate of return we're asking  
6 customers to pay is just and reasonable.

7 So in answering that question, it's necessary  
8 to focus on the financial obligations the utility incurs to  
9 provide that retail service. Customers in this jurisdiction  
10 shouldn't be asked to pay higher rates to support financial  
11 obligations outside of this jurisdiction.

12 So my analysis focuses on retail operations,  
13 which is not what the credit rating agencies do. They look  
14 at total company. And that's one of the ongoing  
15 disagreements that Mr. Williams and I have had in presenting  
16 these credit metrics for many of our cases now.

17 The second one is how you deal with some of  
18 these other off balance sheet obligations, which credit  
19 rating agencies recognize, but it's kind of a long story in  
20 determining whether or not it should be used to determine  
21 whether or not customers should pay higher rates to support.

22 COMMISSIONER JONES: So this is not anything  
23 new to Mr. Williams as well. It sounds like the two of you  
24 see each other in Utah, Wyoming, and in other jurisdictions.  
25 Okay.

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1                   CHAIRMAN DANNER: I just want to ask  
2 Mr. Williams to respond. You heard Mr. Hill say that the  
3 cap structure here, we're splitting hairs, and the  
4 difference really at this point is in the noise.

5                   And Commissioner Jones mentioned only 7  
6 percent of the territory.

7                   This is obviously, though, something the  
8 Company feels very strongly about in the way you've done the  
9 hypothetical cap structure. It's a big issue in the case  
10 before us. It's being litigated from the last case.

11                   So is this an argument over principle or is  
12 this actual numbers?

13                   Can you clarify that for us? What is the  
14 dispute over?

15                   MR. WILLIAMS: Well, I think it's about  
16 fairness. And we're asking our customers in Washington to  
17 pay the same capital structure and cost of capital that we  
18 ask customers in every other state, whether it's California,  
19 Idaho, Utah, Wyoming, Oregon. All the other states are on  
20 an actual capital structure and actual capital cost of debt  
21 and preferred and no adjustment to the equity.

22                   And I know for historical reasons it's  
23 different here in Washington. And I know I've testified  
24 many times that the Company would like to have the actual  
25 cost.

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1                   I think in this case we did present the  
2 alternative, the hypothetical capital structure that is the  
3 fully hypothetical with the cost of debt I know that other  
4 parties disagree with. But I think it makes sense for the  
5 reasons I outlined earlier.

6                   So to me, I think it's fairness. We're just  
7 asking Washington customers to pay on the same basis that  
8 all the other states are.

9                   And if I was one of the other states, and  
10 seeing how Washington is setting rates a level below actual,  
11 I would wonder why customers in that state should not do the  
12 same. And I think at that point you would kind of be in a  
13 spiral downwards about who could get to the lowest level the  
14 quickest. And I don't think that's good for the customers  
15 or good for the Company. So that's why we would like  
16 everybody on the actual capital structure.

17                   CHAIRMAN DANNER: So it's more of a slippery  
18 slope argument than there will be an actual downgrade on the  
19 basis of anything our state did?

20                   MR. WILLIAMS: Well, I'm just speaking off  
21 the top of my head right now. But if all the other states  
22 went to a hypothetical 49, I don't think the Company would  
23 have any choice but to then finance itself at that 49  
24 percent level. We wouldn't make that much of a sacrifice or  
25 adjustment to maintain the ratings if people aren't going to

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1 pay for the equity that supports the ratings.

2 I understand Washington is small. It's only  
3 7 percent. But every state is important. And all the  
4 states provide diversification, which is a benefit from the  
5 ratings perspective. They all balance each other out in  
6 terms of maybe weather or customer load issues or  
7 distribution issues, things like that. So every state is  
8 important, but at least to me I think it's a matter of  
9 fairness.

10 CHAIRMAN DANNER: Okay. Anyone else want to  
11 comment on that?

12 MR. HILL: I'd like to make the comment that  
13 the slippery slope can go both ways.

14 We have to remember the subsidiary capital  
15 structure can be changed by the parent. The parent company  
16 can get another infusion from Berkshire Hathaway, infuse  
17 that then to Pacific Power as equity capital, and suddenly  
18 they're -- if you -- if all you do is base rates on what the  
19 booked capital structure for the subsidiary is, that allows  
20 the parent company to set the capital structure for  
21 ratemaking.

22 And because common equity is three times the  
23 cost of debt, it becomes very expensive if the capital  
24 structure gets to 52, 55 percent equity, 58 percent equity,  
25 at what point does it become untenable? That's a problem.

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1                   I think it's a problem that FERC has on their  
2 hands. They allow up to 60 percent equity ratio. And so  
3 the ITC capitalizes all of its subsidiaries at 60 percent  
4 equity, while the parent company has 30 percent equity. So  
5 they borrow money, infuse that into their subsidiaries, and  
6 then rates are based on 60 percent equity. So it's very bad  
7 for ratepayers in my view.

8                   So I think we have to be concerned certainly  
9 about what Mr. Williams is saying for the health of the  
10 company.

11                   But also, for the benefit of ratepayers, I  
12 think the Commission is wise in using a limit on the upper  
13 end of capital structure, ratemaking capital structures. I  
14 think it's dangerous to say that we're only going to rely on  
15 book value capital structure. Then you're forced to use  
16 that for ratemaking, and then it allows the parent company  
17 to sort of set their own rates. It's a bad incentive.

18                   MR. GORMAN: Just quickly, I agree that the  
19 objective should be fairness. But in establishing  
20 appropriate capital structure, the entity that should be  
21 making that determination are the regulatory commissions,  
22 not PacifiCorp senior management.

23                   In this case, I appreciate Mr. Williams  
24 having conversations with credit analysts. But we're not  
25 privy to those conversations. We don't know what they said

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1 or what response they were given or what question might have  
2 been asked.

3 But in the public disclosures, the suggestion  
4 that there would be a drop in the bond rating by coming down  
5 to a 49 percent common equity ratio is a pretty iffy  
6 assertion. In fact, I'm confident it's not accurate.

7 I would also suggest that even though  
8 authorized returns on equity have come down more recently,  
9 the spread to marginal cost of debt is quite wide. So to  
10 the extent the utility management sees an opportunity for an  
11 unusually large spread for equity capital relative to debt  
12 capital, that's a good investment opportunity for them.  
13 That would give them the incentive to fatten up their common  
14 equity ratio to a level that's really higher than necessary  
15 to support their bond rating.

16 And because of that uncertainty, I think the  
17 determination of who should set an appropriate ratemaking  
18 capital structure should be the regulatory commissions, not  
19 PacifiCorp management.

20 CHAIRMAN DANNER: Mr. Strunk?

21 MR. STRUNK: If I could just clarify for the  
22 record, the analysis that I've done in my testimony, both  
23 direct and rebuttal, looks at this issue from the  
24 perspective of what if this were applied to the whole  
25 company. And that's the right regulatory policy question,

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1 because unlike the other analyses that have been put on  
2 here, those analyses just focus on the 7 percent.

3 But the right question for this Commission  
4 is, is this a reasonable capital structure for a utility.  
5 And that's the analysis that has been done with respect to  
6 the credit rating and the cost of capital.

7 CHAIRMAN DANNER: All right. Thank you.  
8 Anyone else wish to opine on that?

9 All right. Thank you.

10 COMMISSIONER JONES: Mr. Parcell, I'm not  
11 ignoring you. You're kind of sitting comfortably back  
12 there.

13 MR. PARCELL: So far.

14 COMMISSIONER JONES: So far. But just most  
15 of my questions have dealt with cap structure. And I'm  
16 going to come back to you on CAPM and CE.

17 But I'm turning it over to Commissioner  
18 Goltz.

19 COMMISSIONER GOLTZ: So starting with capital  
20 structure, in following up on the combination of -- first  
21 Mr. Gorman mentioned about the conversations I think  
22 Mr. Williams and other members of the company have had with  
23 rating agencies.

24 Can you, Mr. Williams, turn to your Exhibit  
25 BNW-6?

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1 MR. WILLIAMS: All right. I'm there.

2 COMMISSIONER GOLTZ: So on page 3 of that  
3 exhibit, there's a heading toward the bottom of the page  
4 that says "Benefits from Berkshire Hathaway affiliation."  
5 And it talks about the dividends paid to then MEHC in 2012  
6 and 2011.

7 And by the way, this document is dated May,  
8 2013.

9 But then the second full sentence says that  
10 the dividends were intended to manage PacifiCorp's equity  
11 ratio -- and then skipping a parenthetical -- around 50  
12 percent after it, meaning the ratio, had accreted to 53  
13 percent as of year end 2010.

14 Now, I gather that they make these analyses  
15 after conversations with the company. And I read that as  
16 indicating similar to what Mr. Gorman was saying, that the  
17 equity ratio is being managed toward, around, 50 percent.  
18 And am I reading that wrong?

19 And some of you may want to comment on that  
20 as well.

21 MR. WILLIAMS: I think you're reading that  
22 exactly right. I guess it depends on --

23 COMMISSIONER GOLTZ. The other panel members  
24 don't have to comment.

25 MR. WILLIAMS: -- what they mean by 50



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1 percent. And I think 51.4, 51.7, at least in my mind, is  
2 around 50 percent.

3 COMMISSIONER GOLTZ: Meaning it's 1.4 percent  
4 above, and 49.1 is nine-tenths of a cent below?

5 MR. WILLIAMS: Well, the fact that they're  
6 starting from 53 to around 50 makes me think it's in the  
7 range above it.

8 But as to the matter of what we're talking to  
9 the agencies about, I think in our responses to data  
10 requests we do share the presentation to the rating  
11 agencies. So it's in there on a confidential basis.

12 But you can see what we're telling the rating  
13 agencies. And it's wholly consistent with what we've told  
14 you here and what we've told you in the past in terms of  
15 dividends and financing plans. So it's available in the  
16 data requests on a confidential basis.

17 COMMISSIONER GOLTZ: These rating agency  
18 reports, I mean, they're like Department of State cables.  
19 Every word seems to be chosen carefully. And it's not  
20 sloppy writing at all. And they use terms, manage the  
21 equity to around 50 percent after it had accreted.

22 And "accreted" certainly means it just sort  
23 of got away from you, just sort of slipped up to that 53  
24 percent mark, as sort of being not managed.

25 And I'm reading that as being a reflection, I

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1    assume, of a conversation that says yeah, 53 percent is too  
2    high; it's really got to be around, quote/unquote, 50  
3    percent.

4                   MR. WILLIAMS: I think maybe it will help if  
5    I explain a little bit how we do our financing plan. But  
6    when we do our annual plan and budget, we look at how we can  
7    finance the company in terms of amount of debt and dividends  
8    to produce the financial metrics and ratios that will meet  
9    the targets that the agencies have laid out for us. And  
10   those are the targets in their published reports, so we know  
11   what those are.

12                   And maybe we start running scenarios at 53  
13   percent common equity. And we see that based on that, given  
14   the capital spending and the regulatory recovery and the  
15   cash flows the company's expecting to receive, we don't need  
16   53 percent, where maybe in the past we did.

17                   So as capital spending maybe has come down,  
18   the company then is able to reduce the common equity  
19   component, still mindful of where the ratios are resulting  
20   from that scenario.

21                   And as we get down to 51.7 or 52.1 last time,  
22   51.7 now and actually 51.4, that level of common equity will  
23   produce financial metrics that the agencies are looking for  
24   to maintain their rating.

25                   So I wouldn't say it's unmanaged. It's very

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1 well managed through the planning process, trying to have  
2 just enough equity that will produce the financial ratios  
3 that the rating agencies are looking for.

4 So we're not looking to have excess equity in  
5 the company. That wouldn't really make financial sense  
6 given the returns. So we're trying to have just the minimum  
7 necessary to maintain the ratings.

8 COMMISSIONER GOLTZ: Anyone else have a  
9 comment on that?

10 MR. GORMAN: I'm just going to repeat  
11 Mr. Hill's comment that 49.1 is kind of 50 percent, just  
12 like 51.4 is kind of 50 percent.

13 But we don't see those metrics in rate cases  
14 supporting their capital structure. We just hear about  
15 them.

16 I've looked at the confidential presentation  
17 of credit analysts, and I didn't see any report that said 49  
18 percent would cause you to get a BBB bond rating.

19 If these are legitimate benchmarks, or  
20 whether or not they're benchmarks with some range, that's  
21 what is necessary to determine whether or not you're setting  
22 up appropriate cost structures in setting hypothetical  
23 capital structure.

24 And I believe that the 49.1 is reasonable  
25 based on what I've seen in this case and what you see for

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1 industry data, both equity analysts and credit analysts.  
2 All of it indicates that it is capable of supporting  
3 PacifiCorp's current bond rating.

4 COMMISSIONER GOLTZ: So I have a different  
5 topic for Mr. Strunk. I heard you say in response, I  
6 believe to questions from Chairman Danner about the PCAM,  
7 that looking at your proxy group, many of which -- most of  
8 which have the power of cost adjustment mechanism of a PCAM,  
9 and so therefore, the presence of one is baked into that  
10 analysis.

11 So my question is: Can I assume from that  
12 that the -- you aren't saying that the absence of such a  
13 mechanism for the company suggests a higher ROE?

14 MR. STRUNK: No. PCAMs have become so common  
15 in the industry that they really don't affect -- it's not  
16 something that investors look at when they determine the  
17 cost of capital for a utility. And that's because they are  
18 so common.

19 And in my proxy group, the entities that are  
20 there mostly operate outside of Washington state. And  
21 outside of Washington state, the existence of debt bands and  
22 sharing mechanisms is quite rare. So you generally would  
23 see, for all of these companies, a dollar for dollar PCAM.

24 COMMISSIONER GOLTZ: I guess you aren't  
25 saying -- you are saying that -- strike that.

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1                   We've seen some evidence in the credit  
2 reports that the credit agencies, rating agencies, are  
3 proponents of power cost adjustment mechanisms.  
4 Commissioner Jones read from one.

5                   But Pacific Power doesn't have one. But so  
6 is it your testimony that because of that absence the return  
7 on equity should be increased?

8                   MR. STRUNK: No, it's not my testimony.

9                   Although it may be a big concern for  
10 bondholders, it's not something that we see a lot in the  
11 equity analyst reports.

12                   COMMISSIONER GOLTZ: And for Mr. Williams, is  
13 it the same question as opposed to for capital structure?

14                   Is the fact that -- I mean, in your testimony  
15 you talk about the absence of a PCAM. But does that have  
16 any relevance to the capital structure as you see it?

17                   MR. STRUNK: Yes. Sorry.

18                   COMMISSIONER GOLTZ: I assume you agree.

19                   MR. STRUNK: Yes. I think the PCAM has a  
20 very important effect on cash flows. And so it would be  
21 very relevant to capital structure and managing the -- from  
22 a Treasury perspective, which Mr. Williams can speak to.

23                   MR. WILLIAMS: Yes, I would agree with that.

24                   From the bondholder perspective, they don't  
25 have the upside that the equity holders might have. They

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1 just have the downside. So the PCAM to them is an important  
2 instrument, an important vehicle.

3 And then as well as managing for the  
4 company's liquidity, capital structure, you know, I was here  
5 during the power crisis. So I remember how painful that can  
6 be and what can happen quickly in terms of capital structure  
7 and borrowing costs and just liquidity. And so from a  
8 Treasury perspective it is important too.

9 COMMISSIONER GOLTZ: So I gather, then, that  
10 you would advocate for a PCAM, correct, full PCAM?

11 MR. WILLIAMS: Well, I'm not the power cost  
12 or PCAM witness.

13 But Mr. Duvall is. And I think he can talk  
14 to you about the renewable resource mechanism.

15 I think in an ideal world, yeah, we'd love a  
16 dollar for dollar cost recovery mechanism. And I understand  
17 that's not the direction the Commission or Staff wants to go  
18 here. So we're trying to find an alternative that makes  
19 sense for all the parties.

20 COMMISSIONER GOLTZ: Right. And in the Fitch  
21 Report that Mr. Jones read from, where it was an admonition  
22 or a suggestion that the Company apply for one in the next  
23 rate case, they had just recited in that excerpt the fact  
24 that we didn't require debt bands or sharing bands.

25 So is it then Mr. Duvall is the witness we

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1 should ask as to why that was not proposed by the Company in  
2 this rate case?

3 MR. WILLIAMS: Yes.

4 COMMISSIONER GOLTZ: Okay. So I have a  
5 question, then, for Mr. Strunk and the others if you want to  
6 comment.

7 In your rebuttal testimony, on pages 36 and  
8 37, you mention a new risk. That's the Clean Power Plan  
9 under Section 111(d) of the Clean Air Act. And that would  
10 increase the risk for utilities.

11 Is the implication there that -- well, first  
12 let me ask, is that really a new risk or is it just an old  
13 risk in different clothes; meaning that in 2008-2009, there  
14 was the so-called Waxman-Markey cap and trade legislation in  
15 Congress that was cited as increasing costs of coal-fired  
16 generation. And so that was a risk.

17 That sentiment for that kind of waned as we  
18 had the great recession. But at least in this state there  
19 was still a fair amount of legislative activity pushing for  
20 a cleaner energy supply and getting off coal. We had that a  
21 couple years ago in legislative session.

22 So is that really a new risk, or is it just  
23 the same risk in a different format?

24 And my next question is going to be what is  
25 the impact of all that on ROE?

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1                   MR. STRUNK: I think you're absolutely right  
2 to recognize that that was a risk that was out there before.

3                   And what we've seen however, is the  
4 realization of the risk. There's a concrete plan put on the  
5 table by the EPA that would have utilities comply with this  
6 for existing generation units by 2020. And to comply with  
7 that is going to require a lot of changes. It's going to  
8 require a lot of investments. And it's not going to be --  
9 it's going to be an expensive transformation.

10                   And in the context of that transformation  
11 which has newly been actually formalized, the state,  
12 Washington state, really needs a financially strong utility.  
13 And that financially strong utility will then be able to  
14 contract with generators to develop facilities, will be able  
15 to build its own replacement facilities.

16                   And the importance and the value of the A  
17 credit rating that Mr. Williams has described in his  
18 testimony will be borne out as that transformation takes  
19 place.

20                   COMMISSIONER GOLTZ: So is it your testimony  
21 that all other things being equal, a utility that's more  
22 dependent upon coal should have a higher ROE than other  
23 utilities?

24                   MR. STRUNK: No. I wouldn't say it that way.  
25 I have not -- that is not my view.



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1                   My view is that this is a particular issue  
2 that PacifiCorp faces. And that should be an issue that's  
3 taken into consideration when the ROE is set, when the  
4 capital structure is set for rate making purposes.

5                   COMMISSIONER GOLTZ: Let me just ask also,  
6 you say that you compare PacifiCorp, all of PacifiCorp, with  
7 your proxy utilities. And you have that on your Exhibit  
8 KGS-17T at the bottom of page 37 and the top of page 38.

9                   But you make reference to an Exhibit KGS-25  
10 that presents the comparison. And I don't see that in  
11 KGS-25.

12                   MR. STRUNK: I'm sorry. That should be a  
13 reference to KGS-24. That's the exhibit right before there.

14                   And so what we've seen in the analysis that  
15 has come out so far on the Clean Power Plan is that there  
16 are potential credit issues. And the credit issues will be  
17 more severe if there are not adequate mechanisms to flow  
18 through the increased dispatch costs of higher marginal cost  
19 generation and if there are not adequate mechanisms to  
20 facilitate the construction of new facilities to replace the  
21 facilities that will be retired.

22                   So there's really a focus to make this  
23 transition work in a way that preserves the utility's  
24 financial strength. It really requires a regulatory  
25 framework that is accommodating and recognizes the changes

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1 that are taking place.

2 COMMISSIONER GOLTZ: I was afraid that, you  
3 know, you were implicitly saying that a utility, as I  
4 mentioned, more dependent on coal, their investors were  
5 entitled to a higher ROE than the others. And that would be  
6 somewhat ironic to make that argument, I think.

7 MR. STRUNK: No, that's not my testimony.

8 COMMISSIONER GOLTZ: That's all I have.

9 MR. HILL: Commissioner, could I comment?

10 I just want to say I don't disagree with Mr.  
11 Strunk particularly.

12 But I just want to note that we're in a  
13 situation that for a type of company for which building rate  
14 base is a key factor, here with the EPA mandate, here you  
15 have a governmental body requiring building of a certain  
16 sort of plant.

17 And I'm not aware of any regulatory body  
18 across the U.S. that's disallowed environmental construction  
19 when it's required by the government. So here you have a  
20 government entity saying yes, you have to build a plant.

21 You're in almost a fairyland of financial  
22 opportunity with interest rates being lower than they have  
23 been since 1968. And so it's really almost not a risk, but  
24 an opportunity to build rate base in a very favorable cost  
25 of capital environment for utilities to expand their

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1 operations with a government mandated buildout.

2 So I mean, my point simply is there's other  
3 ways to look at it, like oh, this is more risk and we need  
4 another tracker. There's other ways to look at it. I think  
5 this could be a favorable thing for utilities.

6 I started in this business in '81 when  
7 interest rates were 21 percent and everyone was building a  
8 nuclear plant. That was a bad deal, a serious bad deal.  
9 That's not the case now. It's just the opposite now.

10 COMMISSIONER GOLTZ: I have no further  
11 questions.

12 COMMISSIONER JONES: And Mr. Hill, you also  
13 come from West Virginia, right?

14 MR. HILL: There's a --

15 COMMISSIONER JONES: -- coal-fired  
16 generation?

17 Just to follow up on Commissioner Goltz --  
18 and I am going to get to you, Mr. Parcell. You're still  
19 sitting there with no questions.

20 So is it the investor expectations, both on  
21 the buy side as well as debt, that 111(d) is going to happen  
22 and they're baking that in there into their expectations  
23 over the next five to ten years?

24 Is that your testimony?

25 MR. STRUNK: Yes. From the reports that I

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1 reviewed, there's a general expectation that 111(d) will  
2 happen in some form or another.

3           There have been some comments that challenge  
4 it or seek to roll it back. But -- or limit its scale. But  
5 the reports I've read have generally accepted it as  
6 something that's going to happen in some way or form in some  
7 period of time.

8           COMMISSIONER JONES: And it follows that it's  
9 your testimony that because PacifiCorp is 60 percent  
10 dependent on baseload generation of coal, it will have a  
11 fairly significant impact on Pacific Power -- PacifiCorp;  
12 excuse me.

13           MR. STRUNK: Yes, it will happen.

14           And I don't agree with Mr. Hill's  
15 characterization of a fairyland cost of capital environment.  
16 The only way you can get to that conclusion is by fussing  
17 with the objective market indicators that we see.

18           It doesn't matter, from an ROE perspective,  
19 whether the expected higher interest rates have realized. I  
20 mean, these witnesses characterize waiting for the interest  
21 rate rise as like waiting for Godot. But in fact it doesn't  
22 matter whether or not they've been realized. What matters  
23 is investor expectations. And we have objective indicators  
24 that show increases over time.

25           COMMISSIONER JONES: That was my question,

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1 was investor expectations. And I think you've answered that  
2 question.

3 And in response to Commissioner Goltz, you  
4 are not arguing that there's a direct relationship to ROE,  
5 because there are many tools in the toolbox that regulators  
6 can use, would you not agree, whether it's securitization of  
7 stranded assets or formula rates or trackers, there are many  
8 things that state commissions can do if we move in a certain  
9 direction that could hurt a utility like PacifiCorp,  
10 right?

11 MR. STRUNK: Absolutely. And I think those  
12 mechanisms are going to be necessary, and you've hit on  
13 quite a few of them. There would be capital trackers or if  
14 there are stranded assets.

15 COMMISSIONER JONES: Right.

16 MR. STRUNK: And securitization and  
17 mechanisms to flow through higher dispatch costs.

18 COMMISSIONER JONES: So Mr. Parcell, finally,  
19 why is your CAPM so low? Let's start there.

20 MR. PARCELL: It starts at the risk-free  
21 rate.

22 COMMISSIONER JONES: But compared to even  
23 Mr. Hill and Mr. Gorman, I think, you derive a CAPM of --  
24 what is it? What is your average CAPM?

25 MR. PARCELL: 7.3, I believe.

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1 COMMISSIONER JONES: 7.3.

2 And what is yours, Mr. Gorman?

3 MR. GORMAN: High 8's.

4 COMMISSIONER JONES: High 8's?

5 MR. HILL: Eight and a half for me.

6 COMMISSIONER JONES: So just walk through. I  
7 think it relates both to the risk-free rate and the market  
8 risk premium, right, the MRP --

9 MR. PARCELL: Yes.

10 COMMISSIONER JONES: -- and how you did that.

11 MR. PARCELL: The first thing that comes to  
12 mind is I use the actual recent yields in Treasury bonds, 20  
13 years.

14 And the reason I use 20 years is the  
15 Sinquefield-Ibbotson studies, which go back to 1926, they  
16 use 20 years as the government bond rate.

17 And I use actual yields. And Mr. Gorman and  
18 I believe Mr. Hill -- and he can correct me if I'm wrong --  
19 they use a blend of actual and projected interest rates.

20 And I don't use projected interest rates  
21 because the mechanisms used to develop the risk premiums use  
22 actual interest rates, not projected.

23 So I think that's a big one right there, the  
24 fact I use actual recent interest rates and they use, in  
25 addition to that, or maybe exclusive of that, projected

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1 interest rates.

2                   And I don't recall that our risk premiums are  
3 that much different. Mine is about 5.85, and I think  
4 they're about in that ballpark aren't they? We both use  
5 Value Line data.

6                   COMMISSIONER JONES: Does it relate to the  
7 source of data?

8                   I thought your MRP, market risk premium, was  
9 forward looking and you used Bloomberg Finance EPS analyst  
10 estimates.

11                  MR. PARCELL: Not me.

12                  COMMISSIONER JONES: That's not you?

13                  MR. PARCELL: No. For my risk premiums, I  
14 use three things. I looked at the S&P 500 Industrial, or  
15 combination, S&P 500, you can calculate with trends on  
16 equity market ratios for them going back to 1978.

17                  So I looked at achieved returns on equity for  
18 the S&P 500 for each year from 1978 to 2013, and I compared  
19 those to the level of 20-year Treasury bonds over the same  
20 period. And that gave me an average of 6.75 percent.

21                  COMMISSIONER JONES. Okay.

22                  MR. PARCELL: That's returns on equity and  
23 yields on Treasury bonds.

24                  Then I moved from there to the  
25 Sinquefield-Ibbotson studies, which were from 1926. And

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1 those use total returns; which in other words, for the S&P  
2 500, in any given year the return would be a combination of  
3 dividends paid and change in stock price or capital gains.  
4 And compare those to total returns only.

5 And I look at the arithmetic basis.

6 And I average those three, and I get 5.85  
7 percent as the risk premium. And that's ballpark with those  
8 two gentlemen.

9 COMMISSIONER JONES: And then you also use  
10 the CE, what we've referred to as CE, the comparable  
11 earnings analysis, right?

12 MR. PARCELL: That is correct.

13 COMMISSIONER JONES: But none of the other  
14 witnesses uses that, right?

15 MR. PARCELL: Mr. Gorman does not. As a  
16 matter of fact, he makes it clear that he doesn't even like  
17 it.

18 COMMISSIONER JONES: I think Mr. Gorman may  
19 want to respond to that.

20 MR. PARCELL: Is that fair?

21 Mr. Hill uses a version of comparable  
22 earnings. But he goes a step beyond me. He calls it the  
23 market to book. He take returns on equity and applies a  
24 formula which includes market to book. So that's a form of  
25 comparable earnings. But it's a formulistic form, where I



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1 use more of a -- not formulistic.

2                   And the way I do it, that's the least  
3 sensitive measure that I use with regard to interest rates,  
4 because as interest rates change, the CE changes much more  
5 slowly. But I use returns over a business cycle as opposed  
6 to a given year.

7                   COMMISSIONER JONES: So which of the three  
8 methods should we give more weight to, Mr. Parcell?

9                   I think in your testimony you come up with a  
10 recommendation of 9.0. And you have a CAPM of 7.3, you have  
11 a CE of 9.5, and a DCF constant growth of 9.0.

12                   So I think this is always a dilemma, a  
13 challenge for the Commission when we make our decisions.  
14 And I'll get to this interest rate environment in a minute.

15                   But in the environment that we're in now,  
16 which of those three methods should we give more weight to?

17                   MR. PARCELL: Well, I would give less weight  
18 in this environment to CAPM.

19                   And that leaves more weight to comparable  
20 earnings and DCF. And I hope you're not pinning me to one.  
21 Are you pinning me to one?

22                   COMMISSIONER JONES. No.

23                   MR. PARCELL: Okay. Good.

24                   COMMISSIONER JONES: I would never do that.

25                   MR. PARCELL: I've always liked to use three

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1 and rely upon two. They give me a comfort level.

2 COMMISSIONER JONES: So what would be your  
3 number two; DCF constant growth or DCF sustainable growth?

4 MR. PARCELL: Sustainable growth can be a  
5 version of constant growth, the two versions of constant  
6 growth in multistage. And I use constant growth.

7 I use sustainable growth as one growth rate  
8 indicator.

9 COMMISSIONER JONES: Mr. Hill, let's --  
10 before we get to that question, let me go to Mr. Gorman  
11 because I think you raised this today. The interest rate  
12 projections are terribly difficult to make in this  
13 environment, right?

14 MR. GORMAN: Yes.

15 COMMISSIONER JONES: Very difficult. I mean,  
16 what were your projections of the ten-year Treasury bond a  
17 year ago, probably at 3 percent, right, or high 2's?

18 MR. GORMAN: Yes. To qualify that, they're  
19 always difficult to make, because analysts' projections  
20 almost always project increases in interest rates, and they  
21 almost always overstate what the actual interest rate turns  
22 out to be.

23 COMMISSIONER JONES: Right.

24 MR. GORMAN: Particularly right now they're  
25 overstating changes in interest rates.

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1                   COMMISSIONER JONES: So the testimony as well  
2 as financial literature indicate that the -- as you said,  
3 the Federal Reserve discontinued the QE, the quantitative  
4 easing policy sometime this year.

5                   MR. GORMAN: Yes.

6                   COMMISSIONER JONES: All analysts expected  
7 interest rates to go up, at least on the ten-year bond,  
8 maybe close to 3 percent.

9                   MR. GORMAN: All the projections I saw in the  
10 editorials I read support that, yes.

11                  COMMISSIONER JONES: And what happened?

12                  MR. GORMAN: They went down.

13                  COMMISSIONER JONES: What's it today, 2.1,  
14 2.0?

15                  MR. GORMAN: That area, yes.

16                  COMMISSIONER JONES: So this is kind of the  
17 dilemma that we face. I'd like to hear from all of you on  
18 this. How should we grapple with this for this particular  
19 company at this particular time?

20                  I think there were some questions earlier  
21 today about when interest rates might rise. And we have the  
22 70/30 weighting or the 75/25 rating or whatever.

23                  But just give us some guidance on what we  
24 should be looking at, because we're dealing with rates for a  
25 company for a rate-effective period that's going to be in

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1 2015, when supposedly the Federal Reserve is going to start  
2 to tighten or at least eliminate the phrase "liquidity" for  
3 a considerable period of time, right?

4 MR. GORMAN: Yes. And this predicament was  
5 considered in my testimony and in developing my rate of  
6 return. And we talked a little bit about this in my cross  
7 this morning.

8 One model specifically is a risk premium  
9 model. And a risk premium, when debt securities are more  
10 risky in relationship to equity securities, the risk premium  
11 goes up. Conversely -- or I'm sorry; goes down.

12 Conversely, when equity risk premiums are  
13 lower risk than debt, then the opposite happens.

14 I found debt securities to be above average  
15 risk, where equity securities seemed to be relatively stable  
16 in their outlooks. Therefore, I gave above average equity  
17 risk premium in estimating what a risk premium return on  
18 equity should be. That gives consideration to projected  
19 interest rates as well as current observable interest rates,  
20 and also gives a little margin on the equity cost because  
21 there's uncertainty about what those interest rates are  
22 going to be going forward.

23 I think I also tended to round up most of the  
24 interpretation of my models.

25 COMMISSIONER JONES: I think you did.



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1 It's a three-legged stool. I think Dr. Morin has described  
2 it in his book.

3 And the reason you want to do more than one  
4 study is because in any market you can get a model result  
5 that makes sense; you can do it again six months later and  
6 it's not going to make sense. That's why it's necessary to  
7 do more than one measurement of current market cost of  
8 equity.

9 Based on my results of my study today, I gave  
10 more consideration to the DCF model and the risk premium  
11 model; whereas my CAPM model was closer to what I felt to be  
12 comfortably recommending for a return on equity range in  
13 this case.

14 That hasn't been the case over the last few  
15 cases because I've been setting my CAPM analysis aside  
16 because I thought the result was unreasonably low also.

17 But in terms of endorsing a methodology, I  
18 think in every case it's necessary to do the three studies  
19 and to use the information available at that point in time  
20 to interpret those study results to produce what is a  
21 reasonable range.

22 COMMISSIONER JONES: In your opinion,  
23 Mr. Gorman, you deal with a lot of commissions across the  
24 country. Is there any magic to a round even number like  
25 9.50 for an equity return?

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1                   That's where we are now with this company.  
2   Is there any magic to that, going below that or going above  
3   that?

4                   MR. GORMAN: Well, the magic, you know, we  
5   talked a little bit about risk and all the risks the utility  
6   faces. A lot of these risks will likely result in some sort  
7   of regulatory filing, which means there's going to be impact  
8   on customer rates.

9                   So this environmental risk, all this capital  
10   investment risk, these are risks to the utility. But a lot  
11   of it is being transferred to customers because they're  
12   going to have to pay those rates. So another risk to the  
13   utility is whether or not customers can afford to pay those  
14   rates, because if they can't there's going to be a  
15   degradation in the utility's credit standing.

16                   So with all these other costs pushing the  
17   cost of service up, you have one opportunity to reflect a  
18   decline in cost of service. And it seems to be fair and  
19   balanced to recognize that decline in cost of service in  
20   setting a fair and reasonable estimate for the overall cost  
21   of service.

22                   COMMISSIONER JONES: For the Company,  
23   Mr. Strunk, Mr. Williams, do you have any comment, Mr.  
24   Strunk, on the methodologies that we should put more weight  
25   on, or any weighting, your top two or top one?

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1                   MR. STRUNK: Yes. And let me just preface my  
2 comments on that question with the notion that what's  
3 important there is the end result, right?

4                   The end result must be a number that the  
5 investment community can live with.

6                   And the recommendations that are before the  
7 Commission from the other parties are ROE's that are clearly  
8 unacceptable to the investment community.

9                   And I can give you two examples. One, the  
10 only vertically integrated utilities in the country that  
11 have been awarded ROE's of 9.3 or 9.0 have been -- in the  
12 last two years have been Entergy Arkansas and Maui Electric.

13                   And those are numbers that the investment  
14 community just can't live with. And let me tell you why.

15                   In the Entergy Arkansas case, the company  
16 took the ROE back to the Commission and requested rehearing.  
17 It was reheard, and the Commission brought the number up.

18                   In the case of Maui Electric, there were a  
19 number of other very difficult orders for the company and  
20 its affiliates, and that ended up in a transfer of ownership  
21 of the utility, which is currently being purchased by FPL,  
22 now NextEra.

23                   So I think that's pretty objective evidence  
24 that the recommendations that are before this Commission are  
25 numbers that they can't -- that the investment community



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1 won't live with. As for the --

2 CHAIRMAN DANNER: Wait. I want to make sure  
3 we've established some sort of causation here, because what  
4 I hear is that in Arkansas the utility didn't like the  
5 result, went back for reconsideration and got a better  
6 result from their point of view; and in Hawaii, NextEra came  
7 in.

8 How is that -- where is the causation that  
9 the investor community said, "We can't live with those  
10 results?"

11 MR. STRUNK: Well, I think you can see it in  
12 the fact that FPL is paying a fairly reasonable price for  
13 HECO.

14 And the fact that the company went back for  
15 reconsideration is, I think, a pretty good sign that it  
16 wasn't an acceptable ROE.

17 MR. GORMAN: Can I comment on that?

18 CHAIRMAN DANNER: Yes, please.

19 MR. GORMAN: I think we haven't seen ROE's  
20 drop into the low 9 percent area, although I think there's a  
21 good chance they will if capital market costs stay low on an  
22 industry-wide basis.

23 But we have seen them pretty consistently  
24 drop into the high 9 basis. And two years ago that would  
25 have been an unheard of rate of return on common equity.

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1 When we got down to 11, down to 10, it's just how far are  
2 they going to keep going, was the question.

3 But even though the authorized returns on  
4 equity were declining, we still saw utilities invest  
5 significant amounts of common equity in utility planned  
6 equipment.

7 Is it a lower ROE? Yes, it is.

8 But is it in any way creating an economic  
9 impediment to investment? No, it's not.

10 We've seen utility rate bases grow  
11 significantly over the last five years. We've seen utility  
12 common equity ratios grow over the last five years.

13 All of that is an indication that the  
14 authorized returns on equity are at least at market, if not  
15 still above market.

16 So I disagree with Mr. Strunk on that issue.  
17 I think authorized returns on equity, the evidence shows  
18 that they're at or above market, and that there is room to  
19 reduce the ROE's and still create incentive for reinvestment  
20 in utility planned equipment.

21 CHAIRMAN DANNER: So even at the low 9's?

22 MR. GORMAN: Based on current fair market  
23 capital cost, yes. I think a fair return on equity is in  
24 the low 9 region, area, now.

25 JUDGE MOSS: Mr. Hill, do you have a comment

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1 on that?

2 MR. STRUNK: If I could respond to that?

3 CHAIRMAN DANNER: Mr. Strunk?

4 MR. STRUNK: Effectively, Mr. Gorman is  
5 referring to a hypothetical. He's saying that the  
6 authorized ROE's, which are upwards of 10 percent, are  
7 supporting capital investment.

8 But we don't know whether or not a low 9  
9 would support that capital investment.

10 So I think the evidence I put forward would  
11 show that they don't.

12 CHAIRMAN DANNER: Well, I guess I'm kind of  
13 taking issue with the fact that every time a utility seeks  
14 reconsideration on an order or seeks any kind of review of  
15 the order that that's necessarily signs of a rebellion in  
16 the investor community. It could just be a strategy or a  
17 better argument or other factors.

18 So I was just questioning the fact that  
19 you're saying that this is direct evidence of investors  
20 getting cold feet. And I just don't see that.

21 MR. STRUNK: Right. And that's a fair point.

22 But the opportunity for FPL to buy HECO at an  
23 attractive price is --

24 MR. HILL: That aspect right there, FPL, or  
25 NextEra Energy's recent announcement that it intended to

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1 acquire Hawaiian Electric indicates to me that at 9 percent  
2 ROE for Maui -- not for everybody; it's 9 and a half for the  
3 other subsidiaries -- FPL is ready to buy. They said,  
4 "That's a return I can live with. I'm buying this company."

5 So to me it doesn't show that the investment  
6 community is not interested. It shows that they are  
7 interested.

8 So I think I disagree with Mr. Strunk on that  
9 issue. That's enough.

10 COMMISSIONER JONES: Mr. Strunk, you didn't  
11 finish answering my question on which methodology we should  
12 put more weight on. Could we address that?

13 MR. STRUNK: Sure. I've given weight to all  
14 of the methodologies.

15 And I think that the more important issue is  
16 what are the inputs?

17 To what extent are we looking at objective  
18 inputs that haven't been fussed with and haven't been  
19 subject to decisions of the experts that are subjective?

20 And so my recommendation would be to look at  
21 all of the models. It's an approach that the Commission has  
22 taken in the past, that they're always interested in looking  
23 at a variety of models. And I'll give weight to each of  
24 them.

25 COMMISSIONER JONES: So you're being wishy

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1 washy as well. All of you are.

2 MR. HILL: Commissioner, I'll give you an  
3 answer.

4 COMMISSIONER JONES: Mr. Hill from the great  
5 state of West Virginia.

6 MR. HILL: West Virginia votes for DCF. DCF  
7 has always been my primary methodology. The others are  
8 supporting.

9 I agree that we ought to do them all because  
10 we find different information.

11 But I think quite frankly, the DCF  
12 methodology is tried and true. It's been around a very long  
13 time. It's hard to mess with.

14 And the others are easier to mess with, if  
15 you know what I'm saying. You can pick a risk premium by  
16 changing the time period you study, by changing the aspects  
17 of the time period, or are you going to look at utility bond  
18 yields or Treasury bond yields. You can almost pick and  
19 choose from a variety of opportunities with the risk  
20 premium. So I'm not as favorable to that.

21 And CAPM falls within the risk premium  
22 models. So I'm not as favorable to those.

23 DCF seems to be tried and true to me. I rely  
24 primarily on that.

25 COMMISSIONER JONES: Thank you for answering

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1 my question.

2                   So my next question -- you'll probably forgo  
3 on this -- but what is the interest rate on the ten-year  
4 Treasury going to be at the end of next year?

5                   MR. HILL: You know, weirdly, at a national  
6 financial conference last year, they asked that question of  
7 all the smarty pants financial analysts.

8                   And I was one of the few that said interest  
9 rates will be lower this year than last year. So I was  
10 right. But that doesn't happen very often, you know. If I  
11 was right very often, I wouldn't have any need to be here.  
12 I'd be on my yacht in Bimini someplace.

13                   I think that -- and I forget who said this  
14 today, but I think we are in for a long haul. I've said  
15 this here before. I don't see where the suggested increase  
16 is coming from. I don't see the inflation pressure. I  
17 don't see the commodity price pressure.

18                   I would agree that there will be  
19 international things we don't count on: the banking thing  
20 you mentioned, Greece going down the tubes. There could be  
21 shocks. Something in the Middle East, that's always a  
22 possibility. It would be a shock to the system. I'm not  
23 sure, after the initial furor was over, that they would add  
24 to the long-term capital cost because people are worried  
25 about getting their return.

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1                   People are trading billions of dollars of  
2 bonds every day, and they're taking 3 percent on 30-year  
3 Treasury bonds. They're buying it every day. If they  
4 thought the yield was going to be 4 percent next week, they  
5 wouldn't pay for the 3 percent. They'd wait. But they're  
6 not. They're buying it every day.

7                   So my financial professor told me a long time  
8 ago the best indication of what the interest rate's going to  
9 be in the future is where it is right now.

10                  JUDGE MOSS: Does that complete questions  
11 from the bench, then?

12                  Okay. Then this looks like we have time,  
13 perhaps, for any followup from counsel or an early dinner.

14                  MS. DAVISON: I have a couple of questions.

15                  JUDGE MOSS: Anything from the Company?

16                  MS. MCDOWELL: I don't think so.

17                  JUDGE MOSS: Nothing from the Company,  
18 apparently.

19                  Ms. Davison, you have something?

20                  CROSS-EXAMINATION

21                  BY MS. DAVISON:

22                  Q    I have a couple of follow-up questions just to  
23 make the record clear.

24                  Mr. Strunk, you referred to a Texas case in your  
25 testimony on the panel. Can you tell us the name of the

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1 Texas case and the year it was decided?

2 JUDGE MOSS: Lonestar Transmission?

3 MR. STRUNK: No. It was the one that was --  
4 Mr. Hill, maybe you can help me here.

5 It was at the outset of restructuring when  
6 the distribution utilities were -- I think it was '06, 2006.  
7 I'd have to get the docket number. I don't have it off the  
8 top of my head.

9 Q (By Ms. Davison) What was the company name  
10 again?

11 A It was all of the distributors in Texas.

12 Q So it was a generic broad order?

13 A Yes.

14 Q All right. Thank you.

15 And then, Mr. Strunk, you made the statement that  
16 with regard to a power cost adjustment mechanism that having  
17 dead bands and sharing mechanisms is rare; is that correct?

18 A Yes, that's correct.

19 Q Are you aware that PacifiCorp has dead bands and  
20 sharing mechanisms in its power cost adjustment mechanism in  
21 Oregon?

22 A Yes. I am aware of that.

23 When I said "rare," I was speaking at the national  
24 level.

25 I understand that they are in place in Washington



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1 and in Oregon. But those are two of the eight states that  
2 do some sort of dead band or sharing mechanism. The other  
3 42 states do not do it. They do dollar for dollar.

4 Q And so you're aware that Portland General Electric  
5 also has dead bands and sharing mechanisms in their power  
6 cost adjustment mechanism?

7 A Yes.

8 MS. DAVISON: That's it.

9 JUDGE MOSS: All right. Anything else? Mr.  
10 ffitch?

11 MR. FFITCH: Nothing, your Honor. Thank you.

12 JUDGE MOSS: Ms. Rulkowski?

13 MS. CAMERON-RULKOWSKI: Nothing from Staff,  
14 your Honor.

15 JUDGE MOSS: Looks like early dinner is on.

16 I really don't think it's worthwhile to go on  
17 to another witness, even though we could.

18 (Multiple voice cross-talk.)

19 JUDGE MOSS: We'll see you tomorrow.

20 I think today has gone as efficiently as I  
21 could have hoped, and I appreciate your efforts in that  
22 regard.

23 I think tomorrow we can expect will go with  
24 equal efficiency, if not even greater efficiency, so we may  
25 very well finish our proceedings tomorrow. So we'll keep

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1 that in mind overnight as counsel hone their  
2 cross-examination to those essential questions.

3 MS. CAMERON-RULKOWSKI: Your Honor I do have  
4 something. Of the three exhibits I initially had objections  
5 to, I believe where I did object to questions, that they  
6 were overruled, all of them.

7 And I don't believe that they were offered  
8 for admission. So I don't know if they're in yet.

9 JUDGE MOSS: We'll deem them to have been  
10 offered for admission, and I will admit them as marked.

11 (Exhibits DCP26CX-28CX admitted.)

12 JUDGE MOSS: Why don't we start tomorrow at  
13 9:00 to buy a little insurance on my inclinations.

14 (Pause in proceedings.)

15 (Commissioners depart.)

16 JUDGE MOSS: All right. I think we can get  
17 back on the record and get this resolved fairly quickly. I  
18 see there are certain advantages to having a former  
19 administrative law judge in the counsel role who can build  
20 even more efficiency into our progress here.

21 So the question is really fundamentally if  
22 there will be any -- if counsel anticipate objections to any  
23 of the remaining exhibits. We've admitted all of those for  
24 the cost of capital folks today.

25 MR. OSHIE: No objections from Staff, your

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1 Honor.

2 MR. FFITCH: Your Honor, we've agreed with  
3 Ms. McDowell for the Company. We do not object to any of  
4 their cross exhibits, and I believe it's mutual. I believe  
5 they didn't object to any of our cross exhibits to the  
6 Company.

7 JUDGE MOSS: All right. Very well.

8 Mr. Purdy, we're to you.

9 MR. PURDY: We have none. No problems.

10 JUDGE MOSS: Ms. Davison?

11 MS. DAVISON: We have one exhibit we're  
12 objecting to. And that is Mr. Dean's testimony being used  
13 as a cross exhibit for Mr. Mullins.

14 And we believe that based on previous rulings  
15 we've received in previous cases that it's not appropriate  
16 to ask a witness about testimony that is not their testimony  
17 and does not understand the work papers or all the  
18 complexities associated with that particular testimony.

19 I don't see any relevance whatsoever to Mr.  
20 Mullins having to answer questions about Mr. Dean's  
21 testimony that he has no familiarity with at all.

22 JUDGE MOSS: Have you tried to work this out  
23 between yourselves?

24 MS. MCDOWELL: We've worked it out to the  
25 extent we've stipulated on pretty much everything except

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1 that piece of testimony on their end.

2 And then we have one exhibit on our end.

3 So I think the answer is yes, we have tried.

4 JUDGE MOSS: How about if I just boot them  
5 both out? No, I'm just kidding.

6 Actually, I will say that it has always been  
7 -- I have always been reluctant to allow into a case  
8 testimony from someone who is not appearing as a witness in  
9 the case before me. So that is sort of the baseline.

10 Now I do allow it. I've allowed it in this  
11 case already. In the face of an objection it can be another  
12 matter.

13 So I'll need to know why the company feels  
14 it's important or imperative that we should refer to  
15 Mr. Dean's testimony.

16 MS. MCDOWELL: So Mr. Dean was Boise's power  
17 cost witness in the preceding case.

18 Mr. Mullins is their power cost witness in  
19 this case.

20 JUDGE MOSS: Okay.

21 MS. MCDOWELL: With respect to the one  
22 particular issue, market caps, they've re-raised the issue  
23 in this case. And in data request responses, Mr. Mullins  
24 specifically pointed to the testimony of Mr. Dean as being  
25 illustrative of the position.

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1                   So there's a strong connection here. This is  
2 not like some other witness for some other party. This is  
3 Boise's witness in the last case on power cost issues that  
4 have some relation to this case.

5                   The questioning is very limited. But it does  
6 have some -- the questioning would be about the position in  
7 the previous case as compared to the position in this case.  
8 And because the witness is different, the testimony is  
9 required, I think, to be able to reference that.

10                   But it's limited. It's really more a coming  
11 in as a prior statement of a party as opposed to an  
12 inconsistent statement of an individual subject to  
13 impeachment, if that makes sense.

14                   JUDGE MOSS: Ms. Davison?

15                   MS. DAVISON: Your Honor, I'd just reiterate,  
16 that Mr. Mullins -- I'm not sure which data response Ms.  
17 McDowell is referring to, but my recollection is that it was  
18 just simply saying that that issue had been raised  
19 previously.

20                   I don't believe that Mr. Mullins has any  
21 ability to know what the position and thinking of Mr. Dean  
22 is or was as it relates to market caps.

23                   And I think the Company is free to ask Mr.  
24 Mullins lots of questions about market caps, but I don't  
25 think that any -- asking him to speculate about what

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1 Mr. Dean's position was, why he took it, what his analysis  
2 was, is going to be beneficial to the record at all.

3 JUDGE MOSS: Have you indicated as a cross  
4 exhibit the data request response to which you just  
5 referred?

6 MS. MCDOWELL: I have not, your Honor.

7 JUDGE MOSS: I think under the circumstances,  
8 then, I will sustain the objection and not allow that  
9 exhibit.

10 Now you have one, right?

11 MS. MCDOWELL: Oh, I'm sorry. I'm wrong. It  
12 is in the cross exhibits. It's 16-CX.

13 JUDGE MOSS: It is in the cross exhibits?

14 MS. MCDOWELL: Mm-hm. I'm sorry.

15 JUDGE MOSS: In that case, my ruling is  
16 slightly different. I will reserve judgment until the  
17 witness is on the stand.

18 And you may question the witness about these  
19 matters and you may ask him whether and to what extent he  
20 relied on the testimony of this other witness. And if I  
21 become persuaded that it is in some fashion important to our  
22 record that we have it for a point of reference, then I may  
23 allow it in for that limited purpose.

24 But that's the best I can do at this point.  
25 I can't -- I don't think I can rule definitively on it since

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1 you have represented that he does refer to it in his data  
2 request response. And so I'll wait and see how that  
3 develops.

4 Ms. Davison, we'll take it up again at that  
5 point. All right?

6 MS. DAVISON: Thank you.

7 JUDGE MOSS: All right.

8 So you have one as well, right, an  
9 objection?

10 MS. MCDOWELL: We do. We have an objection  
11 to an Exhibit 13-CX for Mr. Duvall. It's the CAISO answer  
12 filed with FERC regarding the CAISO PacifiCorp EIM  
13 agreement.

14 JUDGE MOSS: Okay. What's your objection?

15 MS. MCDOWELL: Our objection is that it's a  
16 document filed by the CAISO, not by PacifiCorp.

17 It doesn't have any apparent connection to  
18 Mr. Duvall's testimony.

19 So it's a relevancy question, but it's also a  
20 question that there's no foundation or connection to this  
21 witness. It's generally about the EIM, which Mr. Duvall  
22 does testify to, but the fact that there's -- it's a CAISO  
23 document; it's not a PacifiCorp document.

24 JUDGE MOSS: That may be. It doesn't  
25 necessarily have to be a PacifiCorp document to be fair

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1 game. Particularly with respect to the EIM, we're getting  
2 into some relatively uncharted territory in this case.

3 So I think it best again, and particularly  
4 since your objection is in part relevance, as I discussed  
5 earlier today, it's difficult if not impossible to rule on a  
6 relevance objection absent knowing what the question is.

7 MS. MCDOWELL: And difficult for me to argue  
8 that it's completely irrelevant. We just can't imagine what  
9 the relevance is at this point.

10 JUDGE MOSS: Right. But counsel may have a  
11 very good idea about what that is and develop it to my  
12 satisfaction.

13 So again, I think I'll have to reserve  
14 judgment on that. But except as to those two exhibits, 13CX  
15 -- and what's the exhibit number, Ms. Davison, that you're  
16 objecting to?

17 MS. WALLACE: It's GND-13CX.

18 JUDGE MOSS: GND-13CX.

19 MS. WALLACE: And it's actually BGM-13CX.

20 JUDGE MOSS: BGM?

21 MS. WALLACE: No, that's the one that we're  
22 objecting to.

23 JUDGE MOSS: Oh, the other one.

24 Okay. GND13-CX and BGM-13CX.

25 I will reserve judgment on those until the



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1 appropriate time in our hearing. And as all other  
2 exhibits--

3 MS. WALLACE: There's two more things.  
4 They're not objections, though.

5 JUDGE MOSS: Let's go ahead and get this  
6 taken care of, then, unless it has something to do with this  
7 part.

8 MS. WALLACE: It's relative to adding things  
9 to the cross exhibits.

10 JUDGE MOSS: We'll take that up in a moment.

11 MS. DAVISON: Your Honor, excuse me. It's  
12 actually 14CX.

13 JUDGE MOSS: BGM-14CX?

14 MS. DAVISON: Yes, thank you.

15 JUDGE MOSS: So with the exception of Exhibit  
16 Nos. GND13-CX and BGM-14CX, marked for identification, I  
17 should say, all of the exhibits currently on the exhibit  
18 list will be admitted as marked.

19 (All remaining exhibits with the  
20 exception of GND-13CX and BGM-14CX  
21 admitted.)

22 And I'll provide that exhibit list to the  
23 court reporter.

24 And so then is there some question of  
25 supplementation, then, a separate question about

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1 supplementing exhibits?

2 MS. WALLACE: We've agreed to it.

3 There's an exhibit -- there's one  
4 supplementation and then there's one moving the witness --  
5 moving the exhibit to a different witness and then  
6 supplementing it.

7 So for the supplementation, we're still on  
8 GND, Mr. Duvall. It's GND-15CX. Actually, sorry; it's  
9 14CX. I'm not doing well with my numbers. 14CX. And it's  
10 our response to PC-2 and the hydro deferral docket.

11 And they've included the first supplemental  
12 response. But there are actually six supplemental  
13 responses. So they've agreed that we could add the other  
14 supplemental responses.

15 JUDGE MOSS: You're going to have those  
16 available for us?

17 MS. WALLACE: We have them right here. We  
18 can keep them here until tomorrow or go ahead and pass them  
19 out.

20 JUDGE MOSS: You can go ahead and distribute  
21 them this evening.

22 What's the other one?

23 MS. WALLACE: And just one note on that. The  
24 fifth supplemental response is actually GND-8C. So it's not  
25 repeated in this cross exhibit.

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1 JUDGE MOSS: Okay.

2 MS. WALLACE: And then the other one is a  
3 cross exhibit that's currently designated for Ms. Natasha  
4 Siores. And it's NCS-18CX. And it has several different  
5 responses to data requests.

6 And just the response to PC-130 is being  
7 redirected to Mr. Dalley.

8 And we're adding the first supplemental  
9 response to that data request as well.

10 JUDGE MOSS: All right. What's the next  
11 number for Mr. Dalley?

12 MS. WALLACE: The next number is 10CX.  
13 RBD-10CX.

14 JUDGE MOSS: All right. That will be fine.  
15 The parties have agreed, so I don't have to make any  
16 rulings. And I'm okay with that.

17 If you've got them to distribute this  
18 evening, that will be fine.

19 MS. WALLACE: Okay. Great.

20 JUDGE MOSS: So we're squared away on the  
21 rest of the pre-filed material, it would seem.

22 Mr. Ffitch?

23 MR. FFITCH: Your Honor, just as a reminder,  
24 we did have that substitute at Exhibit DKS-3CX which I  
25 passed out this morning that added a missing attachment.

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1 It's Public Counsel Data Request 17.

2 JUDGE MOSS: It's my understanding that  
3 there's no objection to that either. So that will be fine.

4 All right. Is there any other business we  
5 should take up this evening?

6 All right. We'll still get you out of here a  
7 bit early. Thank you all for staying a little bit late to  
8 take care of that. And we'll see you tomorrow at 9:00 in  
9 the morning.

10 Let's go off the record.

11 (Whereupon, the proceedings were  
12 adjourned at 4:45 p.m.)

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