

Rocky Mountain Power
Docket No. 07-035-93
Witness: Bruce N. Williams

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF UTAH

ROCKY MOUNTAIN POWER

Rebuttal Testimony of Bruce N. Williams

Rate of Return Phase – Cost of Capital

April 2008

1 **Q. Please state your name, business address and present position with Rocky**
2 **Mountain Power (the Company).**

3 A. My name is Bruce N. Williams. My business address is Lloyd Center Tower, 825
4 NE Multnomah, Suite 1900, Portland, Oregon, 97232. I am the Vice President
5 and Treasurer.

6 **Q. Are you the same Bruce N. Williams who previously submitted Direct and**
7 **Supplemental Direct Testimony in this proceeding?**

8 A. Yes, I am.

9 **Purpose of Testimony**

10 **Q. What is the purpose of your rebuttal testimony?**

11 A. I will respond to certain issues raised in the Direct Testimony filed by Mr. Daniel
12 J. Lawton for the Committee of Consumer Services and by Mr. Charles E.
13 Peterson for the Division of Public Utilities, Department of Commerce for the
14 state of Utah.

15 **Q. Please enumerate the issues you will address in your rebuttal testimony.**

16 A. I will comment on the following issues raised by Mr. Lawton and Mr. Peterson.

- 17 1. (Peterson and Lawton) Cost of new long-term debt.
18 2. (Peterson) Compliance with MidAmerican Energy Holdings Company
19 Acquisition Commitment No. 37.
20 3. (Lawton) Rating agency coverage ratios.
21 4. (Peterson) Rating agency business position.

22 **Cost of New Long-Term Debt**

23 **Q. Have other parties proposed adjustments to the Company's cost of long-term**
24 **debt?**

25 **A.** Yes, both Messrs. Peterson and Lawton are suggesting a reduction to the
26 Company's cost of long-term debt through adjustments to the prospective new
27 issuance rate. Mr. Peterson is proposing a 21 basis point reduction in the coupon
28 rate of the prospective new debt issuance and Mr. Lawton is recommending a 45
29 basis point reduction on the new issuance.

30 **Q. On what basis do the parties propose such a reduction?**

31 **A.** Both parties cite a decline in yields on U.S. Treasury bonds since my direct
32 testimony was originally prepared.

33 **Q. Do you agree with these proposed reductions?**

34 **A.** No. The Company cannot borrow funds at the U.S. Treasury bond rate and must
35 pay a premium or credit spread over those rates. While it is true that U.S.
36 Treasury bond rates have recently declined, it is also true there has been a nearly
37 equal and offsetting increase in the credit spread that investors are requiring when
38 purchasing corporate debt securities. Presently, the Company's estimated interest
39 rate on the new long-term debt is actually slightly higher than the rate in my
40 direct testimony.

	Direct Testimony	April 2008
Forward		
Treasury Rate	4.91%	4.47%
Credit Spread	1.52%	1.98%
Issuance Costs	0.09%	0.09%
All-in Cost	6.52%	6.53%

41 **Q. What is the Company recommending that the Commission adopt as to the**
42 **cost of debt?**

43 A. The Company disagrees with the other parties as to the cost of debt for the reason
44 cited above. The Company continues to believe that 6.30 percent is the
45 appropriate cost of long-term debt .

46 **Acquisition Commitment No. 37**

47 **Q. Please describe Acquisition Commitment No. 37.**

48 A. Mr. Peterson outlines the commitment in his Confidential Appendix to his Direct
49 Testimony on page 44. The commitment states in part:

50 MEHC believes that PacifiCorp's incremental cost of long-term debt will
51 be reduced as a result of the proposed transaction, due to the association
52 with Berkshire Hathaway. Historically, MEHC's utility subsidiaries have
53 been able to issue long-term debt at levels below their peers with similar
54 credit ratings. MEHC commits that over the next five years it will
55 demonstrate that PacifiCorp's incremental long-term debt issuance will be
56 at least a spread of ten basis points below its similarly rated peers.
57 MEHC's demonstration will include information from a third party
58 industry expert supporting its calculation and conclusion.

59 **Q. Please describe Mr. Peterson's concern.**

60 A. Mr. Peterson expresses a concern that Rocky Mountain Power's testimony
61 evidencing the achievement of the 10 basis point reduction relied upon an
62 analysis that incorporates estimates known as "new issue premiums." Mr.
63 Peterson goes on to state that the amount to include as the new issue premium is
64 based on a judgment made by the investment banker.

65 **Q. Is Rocky Mountain Power's evidence on this issue limited to judgments made**
66 **by its investment bankers?**

67 A. No. The evidence presented analyzes the Company's issuances of long-term debt

68 through several methods. Mr. Peterson is correct that under certain methods, the
69 investment bankers appropriately added a new issue premium to the quoted
70 secondary levels to make the analysis to PacifiCorp's issuance comparable. This
71 adjustment is necessitated by the fact it is common for investors to seek a new
72 issue premium in order to incentivize them to buy new bonds versus simply
73 buying existing bonds in the secondary market.

74 However, PacifiCorp's ability to provide the ten basis points of savings
75 required under Commitment No. 37 does not necessarily depend on including a
76 new issuance premium. For example, on page 4 of Confidential Exhibit
77 RMP___(BNW-7), Lehman Brothers provides rates at which they estimate other
78 comparably rated utilities could issue new first mortgage bonds based on trading
79 levels of similar securities by those utilities. This schedule does include the
80 investment banker's estimate of what the new issuance premium would have been
81 at the time that PacifiCorp issued its bonds. Note that PacifiCorp's \$350 million
82 issuance, including its own new issuance premium, sold at a spread to Treasury
83 bonds of approximately 20 basis points less than the spread of comparable utility
84 bonds. However, even if one were to exclude the estimated new issuance
85 premiums of the comparable bonds from the analysis, PacifiCorp's \$350 million
86 issuance still sold at a spread of 12 basis points less than its peers.

87 **Q. Is this true of the other issuances as well?**

88 A. Yes. On page 7 of Confidential Exhibit RMP___(BNW-10), Goldman Sachs and
89 BNP Paribas estimate that PacifiCorp's March 2007 issuance provided 19 basis
90 points of savings as compared to a similarly rated peer group. Again, if one were

91 to completely ignore the five basis points of new issue premium, PacifiCorp's
92 issuance still delivered 14 basis points of savings. Similarly, JPMorgan's
93 analysis (Confidential Exhibit RMP ___(BNW-12)) concludes that PacifiCorp's
94 October, 2007 issuance was 13 basis points lower than the average rate obtained
95 by a group of comparable A-rated utility issuances of 30 year first mortgage
96 bonds. This analysis includes no new issuance premium, again demonstrating
97 that Commitment No. 37 was met.

98 **Q. What should the Commission conclude from these studies?**

99 A. The Commission should conclude that the Company has appropriately met
100 Commitment No. 37 and no further action is necessary. The Company has
101 provided a number of studies on each of its debt issuances subject to Commitment
102 No. 37. These studies utilize several methods to assess whether the commitment
103 was met. In the facts before the Commission, one can exclude the new issue
104 premium from secondary levels and PacifiCorp's issuances clearly still provided
105 the savings required under Commitment No. 37.

106 However, this does not mean that new issuance premiums should be
107 ignored in determining PacifiCorp's compliance with Commitment No. 37. It is
108 necessary for the investment bankers to add a new issue premium to the
109 secondary trading levels to make a valid comparison to new-issuance levels. It is
110 a reality of the market place that during nearly all markets an issuer must offer a
111 premium on a new issuance relative to the yields on comparable secondary issues
112 in order to attract investors. Therefore, in nearly all circumstances the investment
113 bankers will need to estimate a new issuance premium and PacifiCorp will

114 continue to provide documentation of its compliance with Commitment No. 37 by
115 providing several methods of determining if the 10 basis point spread was
116 achieved.

117 **Rating Agency Ratios**

118 **Q. Is Mr. Lawton's statement accurate that his recommended overall cost of**
119 **capital provides coverage ratios sufficient for the Company to maintain**
120 **financial integrity?**

121 A. No. The major rating agencies have moved away from relying on pre-tax interest
122 coverage as a key credit ratio. They focus more on cash flow measures rather
123 than income as a determinant of credit worthiness. Standard & Poor's has gone as
124 far as to eliminate pre-tax interest coverage as a key credit ratio. (June 2, 2004
125 S&P Research Report).

126 Even if interest coverage ratios were still used by the rating agencies as
127 primary credit metrics, Mr. Lawton's calculation is inappropriate. The rating
128 agencies make numerous adjustments to the financial statements of a utility
129 before calculating their credit metrics. For instance, my direct testimony
130 described the adjustments made to account for purchase power agreements. Mr.
131 Lawton's calculations simply ignore these adjustments and other realities of the
132 rating agencies credit procedures. Secondly, Mr. Lawton has assumed the ratios
133 he obtains are within the range of acceptable coverage ratios for the credit rating
134 that PacifiCorp carries. He provides no evidence whether this is true or not.
135 Unfortunately, since the rating agencies rely on cash flow metrics (funds from
136 operations coverage ratios), Mr. Lawton's ratios are simply irrelevant.

137 **Rating Agency Business Position**

138 **Q. In footnote 7 on page 8 of his testimony, Mr. Peterson states that Standard &**
139 **Poor's assigns a risk profile grade between 1 to 10 depending on its**
140 **evaluation of the company's business and regulatory environment. Do you**
141 **agree?**

142 A. No. Standard & Poor's continues to assign a business position to a utility, but
143 they no longer use the 1 to 10 scoring system. Standard & Poor's now employs a
144 rating of Excellent, Strong, Satisfactory, Weak and Vulnerable to represent its
145 opinion of the utility's business risk. These Business Risk Profiles are contrasted
146 with Financial Risk Profiles that include Minimal, Modest, Intermediate,
147 Aggressive and Highly Leveraged. While these measures form a matrix of
148 business and financial risk, Standard & Poor's cautions that they do not assign
149 credit ratings strictly based on what part of the matrix a utility finds itself in.
150 Standard & Poor's indicates that the matrix is merely a guide and there are many
151 other positives and negatives that affect credit quality and could result in a credit
152 rating different from that implied by the matrix.

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

154 A. Yes, it does.