> factor of $0.0125/kWh. 2022 revenue sharing in excess of $100 million shall continue to be a rate base reduction. Any amount credited to the regulatory account and not so used for EAC stabilization relief and remaining in said regulatory account at the Company's next general rate case shall be used as a rate base reduction.
> 2. When 50% of the Company's Wind PRIME retail energy benefits plus 100% of revenue sharing exceeds $100 million, the excess up to $50 million shall be credited to the EAC as needed to reach the targeted EAC factor of $0.0125/kWh. Amounts not so credited and amounts in excess of $150 million shall be used as a rate base reduction.

Mr. Specketer described the Iowa EAC and Rate Mitigation ratemaking principle as providing guaranteed benefits to Iowa customers. (MidAmerican Specketer Surrebuttal Testimony, p. 8.) Mr. Specketer testified that this clause will provide an immediate customer benefit of $100 million through lower energy adjustment costs. (*Id.*) Additionally, this provision will be utilized to buy down the energy adjustment costs. (*Id.*) In the event it is not used to buy down the energy adjustment costs, the fund will be used to provide additional rate relief. (*Id.*)

In a response to such testimony, Mr. Pollock raised the fact that MidAmerican has not fully committed to a set time frame for the EAC and that there is no set guarantee of customers benefiting from the project compared to the costs of the project. (Tech Customers Pollock Additional Testimony, p. 6; Pollock Rehearing Rebuttal Testimony, p. 7.) Additionally, Mr. Pollock testified during the rehearing proceedings that ratepayers are essentially "gambling" and "assuming that benefits will happen." (RT, p. 147.)

This proposed advance ratemaking principle is different from the proposed advance ratemaking principle that was denied in the Board's Final Order. That previous advance ratemaking principle stated:

> MidAmerican will provide Energy Adjustment Clause ("EAC") stabilization relief to a targeted amount of $0.0125/kWh through the following steps, in this order:
> 1. Include up to 50% of the Iowa allocation of any zero emission nuclear power credits ("nuclear production tax credits") associated with the Quad Cities Nuclear Station and up to 50% of any bonus production tax credit amounts (bonus production tax credit amounts are defined as related to domestic content and energy community) associated with Wind PRIME authorized in the federal Inflation Reduction Act ("IRA") in the Energy Adjustment Clause as needed to achieve the targeted EAC factor of $0.0125/kWh. All nuclear and bonus production tax credits will be recorded above the line in FERC account 409.1, or any successor account for recording such credits.
> 2. For the 2023 Energy Adjustment Clause ("EAC") Factor calculation and 2022 Reconciliation filing, 2022 revenue sharing in excess of $100 million will be credited to the EAC up to a maximum credit amount of $100 million. 2022 revenue sharing in excess of $200 million will continue to be a rate base reduction. For EAC reconciliation filings in 2024 and after, when 50% of the Company's Wind PRIME retail energy benefits plus 100% of revenue sharing exceeds $100 million, the excess up to $50 million shall be credited to the EAC if needed to reach the targeted EAC factor of $0.0125/kWh. Amounts in excess of $150 million will be used as a rate base reduction.
> 3. When the Company's excess accumulated deferred income tax ("EADIT") amortization exceeds $400 million (anticipated in 2027), the annual EADIT amortization will be available to provide additional rate relief if needed to reach the target EAC stabilization amount of $0.0125/kWh by including 50% in the TERM Rider and 50% in the EAC. If the annual EAC factor (before this adjustment) is less than or equal to $0.0125/kWh, the annual EADIT amortization will continue to be deferred as a regulatory liability.

(Final Order, p. 58.)

While the current proposed advance ratemaking principle still has a target EAC factor of $0.0125/kWh, two main differences include the removal of the nuclear PTCs and excess accumulated deferred income tax, which were concerns the Board discussed in its Final Order. (*See* Final Order, pp. 76-82.) The Board has reviewed the

record in this proceeding and has determined that the revised proposed advance ratemaking principle is reasonable in light of the record as a whole, is in line with the public interest, and is consistent with law. Based on the potential customer benefits, the Board has determined that the proposed Iowa EAC and Rate Mitigation advance ratemaking principle is reasonable.

K. Iowa Retail Energy Benefits

The Settlement Agreement includes a proposed Iowa Retail Energy Benefits advance ratemaking principle that states in part:

> The following ratemaking treatment for Wind PRIME shall remain in effect until the assets are reflected in rates in MidAmerican's next Iowa electric rate case. Each month 100% of the Iowa retail energy benefits from Wind PRIME production shall be excluded from the Iowa Energy Adjustment Clause approved in MidAmerican's 2013 rate case. Fifty percent (50%) of the Iowa retail energy benefits from Wind PRIME production shall be included in the calculation of any revenue sharing for the year. The remaining 50% of the Iowa retail energy benefits from Wind PRIME production shall be used to accelerate depreciation against the highest earning return on equity asset rate base....

The remaining portion of the proposed advance ratemaking principle includes the list of 14 projects and the order in which accelerated depreciation will be applied.

Mr. Pollock testified, "Requiring MidAmerican to use the retail energy benefits of Wind PRIME to offset the capital costs of existing rate base, rather than flow through the benefits entirely to its shareholder as additional profit, will mitigate future rate impacts, thereby benefiting Iowa retail customers." (Tech Customers Pollock Additional Direct and Rebuttal, p. 23.)

Mr. Specketer testified that this proposed advance ratemaking principle ensures customers benefits. (RT, p. 75.) Benefits of this proposed ratemaking principle include

the renewable energy credits being retired on behalf of customers and, therefore, it "buys down rate base regardless of whether or not MidAmerican is in a revenue sharing position." (RT, p. 51.)

At the rehearing, Mr. Pollock testified to his understanding that the accelerated depreciation included in this proposed advance ratemaking principle would occur regardless of revenue sharing and it is not subject to the 90/10 split in revenue sharing. (RT, p. 146.)

By allowing accelerated depreciation, the Board has determined that this proposed advance ratemaking principle is in the public interest and therefore finds it to be reasonable.

L. Revenue Sharing

The proposed Revenue Sharing advance ratemaking principle states, in part:

> As originally contemplated in Appendix 3 of the Settlement Agreement approved by the Board in Docket No. RPU-03-1, the revenue sharing calculation shall be based on Iowa electric jurisdictional values unadjusted from amounts recorded on the Company's books other than for items explicitly addressed by Board orders in Docket No. RPU-2013-0004 or advance ratemaking principles proceedings prior to this docket.
>
> The threshold for revenue sharing shall be as approved by the Board in Docket No. RPU-2018-0003. To the extent that Iowa jurisdictional electric operating income exceeds the threshold, 90% of the excess shall be credited to customers. Any revenue-sharing proceeds for the customers' benefit shall be used to reduce the investment in generation rate base....

The remaining proposed advance ratemaking principle details the order that revenue sharing will be applied to rate base assets and other necessary provisions, such as timing, filing, and revision requirements.

Mr. Specketer testified at the rehearing that under the Iowa electric jurisdictional results, repowering "would be included in revenue sharing even though a prudence determination has not been made." (RT, p. 70.) Mr. Specketer further testified that the proposed Revenue Sharing advance ratemaking principle is to "make sure that that methodology and that principle of revenue sharing is consistent with how we've done it over the last 25 years." (*Id.* at 93.) Mr. Specketer also testified that the advance ratemaking principle would allow MidAmerican to include costs associated with generation facilities not approved by the Board in a general or advance ratemaking docket in the revenue sharing calculation. (*Id.*)

While there was much testimony that referenced revenue sharing, there is a lack of record regarding the proposed Revenue Sharing advance ratemaking principle itself. (*See* Tech Customers Pollock Additional Testimony, p. 6 (discussing the significance of revenue sharing as MidAmerican's earnings being in excess of the return on equity authorized in MidAmerican's latest rate case); *see also* Tech Customers Pollock Rehearing Rebuttal, p. 10 (discussing potential items that may be included in revenue sharing).)

As previously stated, the Board has concerns about the details of the revenue sharing calculation, especially the treatment of generation projects that do not have Board approval. (*See generally* Final Order.) As stated in the original settlement establishing revenue sharing, "[t]he parties reserve the right to modify or change the methodology set forth herein in the event such party or parties deem the methodology to lead to unreasonable or unrepresentative results." (*MidAmerican Energy Co., Joint Motion for Adoption of Amended Settlement Agreement,* Docket Nos. APP-96-1 and RPU-96-8 (Consolidated), Appendix V (March 10, 1997).) Even though the Board was

not a party to the settlement, the Board has these concerns, and believes that revenue sharing should be reviewed; however, the Board has determined that this advance ratemaking docket is not the proper place to discuss those detailed and complex conversations. Therefore, the Board will approve this advance ratemaking principle as proposed.

M. Consumer Protection Plan

The Settlement Agreement includes a Consumer Protection Plan (CPP) advance ratemaking principle that is based on the annual, aggregated capacity factor for the Wind PRIME wind facilities. The CPP would run from January 1 after all Wind PRIME wind facilities are in service or January 1, 2028, and will end four calendar years after the final year of the initial PTC earning period. Penalties are then assessed on a five-year rolling average when the in-service wind facilities capacity factor is below 36%. If the capacity factor is greater than or equal to 45%, credits will be assessed. While penalties and credits are offset against one another, no payment would occur until the program ends. Further, "A negative (penalty) accumulated sharing balance at the end of the program shall be settled as a credit to MidAmerican's EAC in the next EAC reconciliation; a positive balance shall be treated as a zero balance and shall not result in any return to MidAmerican." Each individual calendar year will include a $10 million cap, with an overall program cap of $50 million.

Mr. Fehr testified that a key factor for Wind PRIME's economic success is capacity because it determines the PTCs earned, the number of Renewable Energy Credits produced and the amount of low-cost energy produced. (MidAmerican Fehr Surrebuttal, p. 7.)

Mr. Pollock testified that the Tech Customers originally opposed the CPP included in the original settlement. (Tech Customers Pollock Rehearing Rebuttal, p. 14.) Mr. Pollock testified that the proposed CPP would not protect customers from the loss of PTCs associated with any underperformance of the Wind PRIME wind facilities. (*Id.*) Mr. Pollock also testified that the CPP is limited and would not provide protection after year 10. (*Id.*)

The Board agrees that customers should receive additional protections, especially with such a large capital investment. The CPP does not include the Wind PRIME solar facilities, albeit a small portion of the overall project, and the CPP's duration is less than that of the expected life of the project. The Board finds this advance ratemaking principle provides protection to customers that has not been included in prior settlements and finds that the principle as proposed is reasonable.

N. Rate Mitigation

In its Final Order, the Board approved the Rate Mitigation principle, which stated:

> MidAmerican shall include the Wind PRIME assets in revenue sharing for purposes of calculation, and then exclude them and recalculate revenue sharing to determine the net impact of Wind PRIME on revenue sharing. The difference between the revenue sharing with Wind PRIME and the revenue sharing without Wind PRIME shall be recorded in a regulatory account. MidAmerican shall report on the status and calculation of the regulatory account annually by February 15 in Docket No. RPU-2023-0156. The amounts in the regulatory account shall accrue until the assets are fully depreciated unless earlier addressed by the Board in a general rate case. The Board will determine the ratemaking treatment of any over- or under-realization of benefits related to the Wind PRIME assets compared to no net cost projections during each contested general rate case and determine how and whether the over- or under-realization should be distributed to or recovered from customers. MidAmerican will accumulate carrying costs on the regulatory account balance at the company's annual

> weighted average cost of capital based on the approved return on equity for Wind PRIME if the regulatory account balance is a liability. If the regulatory account balance is an asset, no carrying costs will be calculated for that year.

In its application for reconsideration, MidAmerican stated "the principle is simply detrimental to customers." (Application for Reconsideration or Rehearing, p. 31.) MidAmerican asserted that the Rate Mitigation ratemaking principle does not accelerate depreciation at the time when the revenue is accrued, but rather allows for a higher revenue sharing threshold later. (*Id.*) MidAmerican also stated "imposing the Board's Rate Mitigation Principle in lieu of the Settlement will result in a projected $266 million less in rate base reduction through 2035." (*Id.*)

Mr. Pollock testified that the Board should reinstate the Rate Mitigation principle. (Tech Customers Pollock Rehearing Rebuttal, p. 14.) Mr. Pollock testified that this principle would "balance the risks imposed by a capital-intensive project and to ensure that customers will realize the benefits from the project, if any materialize." (*Id.*)

OCA witness Blake Kruger testified that, due to the IRA, the PTCs are enhanced, therefore providing additional benefits. (RT, pp. 130-131.) He also referenced revenue sharing and rate mitigating principles as additional customer protections. (*Id.*) Mr. Kruger then testified that while OCA may have concerns with market energy benefits, customers still receive low-cost energy, which will protect customers [and MidAmerican] from needing to purchase higher-cost energy later. (RT, pp. 130-131.)

Based upon the Settlement Agreement as proposed, the Board will not reaffirm the need for the April 27, 2023 Board-instituted Rate Mitigation ratemaking principle.

Based upon the above-discussed proposed advance ratemaking principles in the Settlement Agreement, the Board will approve the Settlement Agreement.

REQUEST FOR WAIVER

On January 19, 2022, as part of its application, MidAmerican filed a request for waiver of the Board's rules at 199 IAC 20.9(1) and (2) with respect to the EAC, and 199 IAC 41.3(1)(c)-(g) to the extent information required is not reasonably available relating to project site locations. (Request for Waiver, p. 1.) MidAmerican states that under the proposed Iowa Retail Energy Benefits principle, MidAmerican would exclude the Wind PRIME generation from the calculation of recoverable Iowa retail fuel costs each month; this could be read as inconsistent with 199 IAC 20.9(1) and (2), which references the actual cost of fuel. (*Id.* at 2.) MidAmerican argues that 199 IAC 20.9(2)(c)(10) allows different ratemaking treatment for PTCs and therefore is not requesting a waiver of that rule. (*Id.* at 3.) MidAmerican states that the requested waiver would be temporary until its next general rate case.

Pursuant to rule 199 IAC 1.3, the Board may grant a waiver of its rules when it finds, based on clear and convincing evidence, that:

1. The application of the rule would pose an undue hardship on the person for whom the waiver is requested;
2. The waiver would not prejudice the substantial legal rights of any person;
3. The provisions of the rule subject to a petition for waiver are not specifically mandated by statute or another provision of law; and
4. Substantially equal protection of public health, safety, and welfare will be afforded by a means other than that prescribed in the rule for which the waiver is requested.

The burden of persuasion rests with the person who petitions the board for the waiver.

With respect to the waiver request of 199 IAC 20.9(1) and (2), MidAmerican contends that without the waiver, the company and its customers would bear an undue hardship because the ratemaking principles would result in an unbalanced outcome, creating a "mismatch" between the benefits provided to customers and the company's

recovery of corresponding costs. (Request for Waiver, pp. 4, 6.) MidAmerican next asserts the waiver would not prejudice the substantial legal rights of any person and would ultimately provide environmental, economic development, and tax benefits to Iowans at no additional cost to customers. (*Id.*) Further, the provisions of 199 IAC 20.9 are not required by statute or other provision of law. (*See* Iowa Code § 476.6(8).) Finally, MidAmerican claims the waiver would not adversely impact public health, safety, or welfare as Wind PRIME would be constructed and operated in accordance with the environmental policies of the state and good engineering practice. (Request for Waiver, p. 6; MidAmerican Jablonski Direct, p. 22.)

MidAmerican and its customers would suffer undue hardship if the rule was enforced in this proceeding because application of 199 IAC 20.9(1) and (2) would create an imbalance in how the EAC and revenue sharing are implemented for Wind PRIME and prior wind advance ratemaking dockets. No person's legal rights would be prejudiced by the waiver as the issues leading to the waiver have been litigated in this case. Further, the application of 199 IAC 20.9 is not mandated by statute or other provision of the law, and granting the waiver would not adversely impact public health, safety, or welfare, as MidAmerican must still comply with the applicable rules, regulations, and ordinances that would apply to the project. Accordingly, the Board finds that the waiver should be granted with respect to the EAC provisions in 199 IAC 20.9(1) and (2).

With respect to the waiver request of 199 IAC 41.3(1)(c)-(g), MidAmerican and its customers would suffer undue hardship if the rule was enforced in this proceeding because with the transition to clean energy, it is important for customers to have access to low-cost, clean energy even if it is in a different part of the state, of which the specific

location and contractors may be unknown at this time. By requiring the specific, detailed location information and contractual information that may not be in place would unnecessarily delay the proceeding. No person's legal rights would be prejudiced by the waiver. The specific provisions of 199 IAC 41.3(1)(c)-(g) are not required by statute or other provision of law. MidAmerican asserts granting the waiver will not adversely impact public health, safety, and welfare. (Request for Waiver, p. 6.) MidAmerican is requesting a temporary waiver until its next rate case. (*Id.*) Accordingly, the Board finds that the waiver should also be granted with respect to 199 IAC 41.3(1)(c)-(g).

REPORTING REQUIREMENTS

To allow the Board and other interested persons to monitor the progress of Wind PRIME, MidAmerican will be required to file construction and operation reports consistent with reporting requirements approved in prior advance ratemaking dockets. The Board will require MidAmerican to file semi-annual reports containing the following information:

1. Actual operating and capital costs;
2. Amount of customer rate relief flowed through the EAC or through revenue sharing;
3. Retail fuel cost reduction attributable to Wind PRIME; and
4. Income from PTCs, Renewable Energy Credits sales, capacity sales, and net system benefits attributed to Wind PRIME.

This information will be required to be filed on March 1 and September 1 of each year. This reporting requirement will end when Wind PRIME's assets are included in MidAmerican's rate base.

CONFIDENTIAL TREATMENT

On August 9, 2023, MidAmerican requested confidential treatment for portions of supplemental testimony from MidAmerican witnesses Adam Jablonski and Thomas Specketer. MidAmerican asserts the confidential material contains information regarding the cost cap and economic forecasts. MidAmerican is requesting confidential treatment pursuant to Iowa Code §§ 22.7(3) as a trade secret, 22.7(6) as a report to the Board that would give advantage to competitors and serve no public purpose, and 22.7(18) as a communication not required by law, rule, procedure, or contract that could threaten MidAmerican's economic interests and that of its customers. MidAmerican supported its request for confidential treatment with the affidavit of Mark Lowe, MidAmerican Vice President and General Counsel, as required by 199 IAC 1.9(6)(b).

On August 30, 2023, MidAmerican requested confidential treatment for portions of MidAmerican Energy Company's Reply to Comments on Revised Joint Stipulation and Agreement. MidAmerican asserts the confidential material is within the scope of MidAmerican's August 9, 2023 application for confidential treatment.

On September 21, 2023, MidAmerican requested confidential treatment for portions of rehearing rebuttal testimony for Mr. Specketer. MidAmerican asserts the confidential material is within the scope of MidAmerican's August 9, 2023 application for confidential treatment.

On September 28, 2023, MidAmerican requested confidential treatment for portions of its prehearing brief. MidAmerican asserts the confidential material falls within the scope of MidAmerican's August 9, 2023 application for confidential treatment.

On November 8, 2023, MidAmerican requested confidential treatment for

portions of its post-hearing brief. MidAmerican asserts the confidential material falls within the scope of MidAmerican's August 9, 2023 application for confidential treatment or a prior application for confidential treatment.

On November 14, 2023, MidAmerican requested confidential treatment for portions of its post-hearing reply brief. MidAmerican asserts the confidential material falls within the scope of MidAmerican's August 9, 2023 application for confidential treatment.

Based on the information provided by MidAmerican and the supporting affidavits, the Board finds the August 9, 2023 material qualifies as a report to a governmental agency, the release of which would give an advantage to MidAmerican's competitors and serve no public purpose. The Board will grant the application and will hold the material confidential under Iowa Code § 22.7(6). Because the Board concludes the material should be held confidential under Iowa Code § 22.7(6), the Board will not address the claims that the material should be held confidential under Iowa Code §§ 22.7(3) or 22.7(18). The Board will also hold confidential any additional information for which confidential treatment has been requested and not yet addressed that derives from material for which confidential treatment has been granted throughout this proceeding.

CONCLUSION

As provided in the Conditions Precedent section, MidAmerican has satisfied the two conditions precedent in Iowa Code § 476.53(3)(c) and is, therefore, eligible for advance ratemaking principles. As 199 IAC 7.18 requires that the Board will not approve a settlement unless it "is reasonable in light of the whole record, consistent with

law, and in the public interest," the Board has to review the Settlement Agreement as a whole.

The Board recognizes settlements are the result of extensive negotiations and compromise. Although the Board's decisions on individual issues may have been different from the resolutions reached in the settlement, the Board will approve the Settlement Agreement. This approval will allow MidAmerican to meet its future capacity needs and the needs of the greater electric grid. Iowa Code § 476.53A states:

> It is the intent of the general assembly to encourage the development of renewable electric power generation. It is also the intent of the general assembly to encourage the use of renewable power to meet local electric needs and the development of transmission capacity to export wind power generated in Iowa.

The Board, viewing the stipulation and agreement as a whole, finds the agreement "is reasonable in light of the whole record, consistent with law, and in the public interest." As these projects have been approved for advance ratemaking principles, MidAmerican is able to include these renewable energy projects, including any maintenance and repair below the 80/20 repowering threshold, within the revenue sharing calculation.

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. MidAmerican Energy Company has met the minimum statutory requirements in Iowa Code § 476.53(3)(c)(1) for approval of advance ratemaking principles.

2. MidAmerican Energy Company has met the minimum statutory requirements in Iowa Code § 476.53(3)(c)(2) for approval of advance ratemaking

principles.

3. The Request for Waiver of 199 Iowa Administrative Code 20.9(1) and (2) and 199 Iowa Administrative Code 41.3(1)(c), (d), (e), (f), and (g), filed by MidAmerican Energy Company on January 19, 2022, pursuant to 199 Iowa Administrative Code 1.3, is granted.

4. MidAmerican shall file, in this docket, semi-annual reports containing the information identified in the body of this order on March 1 and September 1 of each year. This reporting requirement shall end when Wind PRIME's assets are included in MidAmerican's rate base.

5. The August 9, 2023 settlement filed by MidAmerican Energy Company, the Office of Consumer Advocate, and the Environmental Intervenors, is approved.

6. The Application for Confidential Treatment filed by MidAmerican Energy Company on August 9, 2023, is granted.

7. The Application for Confidential Treatment filed by MidAmerican Energy Company on August 30, 2023, is granted.

8. The Application for Confidential Treatment filed by MidAmerican Energy Company filed on September 21, 2023, is granted.

9. The Application for Confidential Treatment filed by MidAmerican Energy Company filed on September 28, 2023, is granted.

10. The Application for Confidential Treatment filed by MidAmerican Energy Company filed on November 8, 2023, is granted.

11. The Application for Confidential Treatment filed by MidAmerican Energy Company filed on November 14, 2023, is granted.

12. Any additional information for which confidential treatment has been

requested and not yet addressed that derives from material for which confidential treatment has been granted throughout this proceeding is granted.

13. The materials for which the Utilities Board has granted confidential treatment shall be withheld from public inspection subject to the provisions of 199 Iowa Administrative Code 1.9(8)(b)(3).

14. Motions and objections not previously granted or sustained are denied or overruled. Any argument not specifically addressed in this order is rejected either as not supported by the evidence or as not being of sufficient persuasiveness to warrant comments.

UTILITIES BOARD

Erik M. Helland Date: 2023.12.14 14:48:13 -06'00'

Joshua Byrnes Date: 2023.12.14 15:48:22 -06'00'

ATTEST:

Keetah A Horras Date: 2023.12.14 16:14:05 -06'00'

Dated at Des Moines, Iowa, this 14th day of December, 2023.

CONCURRENCE

I join with my colleagues in approving the Settlement Agreement for the reasons stated in the order. I write separately to include additional thoughts surrounding this decision.

The Settlement Agreement approved with this order is compelling for the fact that it represents a compromise between settling parties, and that all but one intervening party has not objected to the Settlement Agreement. OCA Witness Blake Kruger testified in hearing that the settlement provides a "fair and balanced outcome for both MidAmerican and for ratepayers." (RT, p. 125.) Over the 22 years that advance ratemaking has been in effect, the utility industry has evolved and continues to evolve significantly, leading to a more complex set of factors than could have been contemplated at the time the law was enacted. Reconciling current circumstances with the statute is not straightforward and with that in mind, the successful compromise warrants recognition.

A. ROE

I do have concerns about the continued practice of granting premium ROE's for advance ratemaking projects, and testimony in the case points toward ending that practice. (*See* OCA Munoz Direct, p. 4 (stating recommendation of 10% ROE, midpoint between 9.3% and 10.12%); IBEC Walters Direct, p. 51 (stating recommendation of 9.50%, midpoint between 9.20% and 9.80%).)

The effect of small changes in a granted ROE, especially on a project of this magnitude, are significant, and directly affect the amounts that will be recovered from MidAmerican's customers by potentially hundreds of millions of dollars over the life of the project.

The ROE granted for Wind PRIME also raises the threshold for revenue sharing, which means that MidAmerican's earnings must be even higher before MidAmerican will be required to provide benefits via the revenue sharing mechanism.

However, MidAmerican (in testimony) and OCA (in hearing cross-examination) argue that the settlement in whole is still fair and balanced. (*Id.*; *see also,* MidAmerican Specketer Rehearing Rebuttal.) OCA points out that, in particular, the Retail Energy Benefits provision results in accelerated depreciation of assets each year, regardless of MidAmerican's position in Revenue Sharing that year. (RT, pp. 125-126.) This does alleviate my concerns, at least in part, and as the Board is to look at the Settlement Agreement as a whole, I will approve the Settlement Agreement with a 10.75% ROE while retaining my overall concern on the appropriateness of higher ROE's established through advance ratemaking.

B. Cost Cap

The cost cap for the wind portion of the project has been increased from $1.890 million/MW to $2.106 million/MW, an 11% jump. For an approximately $4 billion project, this has real and significant implications for Iowans. OCA witness Kruger testified at hearing that the higher cost cap is a detriment to customers. (*Id.* at 126.) MidAmerican states that the increased cost cap is necessary due to changing market conditions, which includes increased costs for material and labor. (MidAmerican Jablonski Rehearing Direct (Supplemental), pp. 3-4.) Again, this represents a significant increase in the amount that will be recovered from customers, in the hundreds of millions of dollars.

Mr. Kruger testified that while the increased cost cap is a detriment, this impact is somewhat reduced by the delayed implementation of Wind PRIME. (*Id.* at 127.)

According to Mr. Kruger's testimony, more operating income will likely lead to more revenue sharing prior to Wind PRIME being fully in service, which could help reduce the impact of the increased cost cap. (*Id.*)

Out of respect for the settlement process, the trade-offs and compromises necessary to reach that settlement, and the extent to which agreement was reached, I will approve the Settlement Agreement with the proposed Cost Cap advance ratemaking principle, but I caution that we should not lose sight of the significance of this cost increase. The difference in costs from when this project was proposed to the amount reached in settlement would constitute one of the largest ratemakings in Board history, on its own. Such cost impacts to customers are not lightly considered nor easily approved.

UTILITIES BOARD

Sarah Martz Date: 2023.12.14 14:50:12 -06'00'

Sarah Martz, Board Member

ATTEST:

Keetah A Horras Date: 2023.12.14 16:13:37 -06'00'

Dated at Des Moines, Iowa, this 14th day of December, 2023.

STATE OF IOWA

DEPARTMENT OF COMMERCE

IOWA UTILITIES BOARD

IN RE:	)	
MIDAMERICAN ENERGY COMPANY	)	**DOCKET NO. RPU-2023-0001**

DIRECT TESTIMONY

OF

ANN E. BULKLEY

June 2023

TABLE OF CONTENTS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Ann E. Bulkley. My business address is One Beacon Street, Suite 2600, Boston, Massachusetts 02108. I am employed by The Brattle Group ("Brattle") as a Principal.

Q. On whose behalf are you submitting this Prepared Direct Testimony?

A. I am submitting this testimony before the Iowa Utilities Board ("IUB" or "Board") on behalf of MidAmerican Energy Company ("MidAmerican" or "Company").

Q. Please describe your education and experience.

A. I hold a Bachelor's degree in Economics and Finance from Simmons College and a Master's degree in Economics from Boston University, with more than 25 years of experience consulting to the energy industry. I have advised numerous energy and utility clients on a wide range of financial and economic issues with primary concentrations in valuation and utility rate matters. Many of these assignments have included the determination of the cost of capital for valuation and ratemaking purposes. I have included my resume and a summary of testimony that I have filed in other proceedings as MidAmerican Bulkley Direct Testimony-Appendix 1.

Q. Please describe the purpose of your testimony.

A. The purpose of my Direct Testimony is to present evidence and provide a recommendation regarding the appropriate return on equity ("ROE") for the Company and to assess the reasonableness of its proposed capital structure for ratemaking purposes.

Q. Are you sponsoring any schedules in support of your Direct Testimony?

A. Yes. My analysis and recommendations are supported by the data presented in MidAmerican Bulkley Direct Exhibits 2 through 12, which were prepared by me or under my direction.

Q. Please provide a brief overview of the analyses that led to your ROE recommendation.

A. I estimated the Company's Cost of Equity ("COE") by applying several traditional COE estimation methodologies to a proxy group of comparable utilities including, Discounted Cash Flow ("DCF"), Capital Asset Pricing Model ("CAPM"), Empirical CAPM ("ECAPM"), and Bond Yield Risk Premium ("BYRP" or "Risk Premium") analysis. My recommendation also takes into consideration: (1) the Company's small size, relative to the proxy group, (2) the Company's actual and anticipated capital expenditure requirements, and (3) the Company's regulatory risk as compared with the proxy group. Finally, I considered the Company's capital structure as compared with the capital structures of the proxy companies.[1] While I did not make any specific adjustments to the ROE recommendation for any of these factors individually, I did take them into consideration in aggregate when determining where the Company's ROE falls within the range of analytical results.

Q. How is the remainder of your Direct Testimony organized?

A. Section II provides a summary of my analyses and conclusions. Section III reviews the regulatory guidelines pertinent to the development of the cost of capital. Section IV discusses current and projected capital market conditions and the effect of those conditions on the cost of equity. Section V explains the selection of a proxy group of natural gas distribution

[1] The selection and purpose of developing a group of comparable companies will be discussed in detail in Section V of my Direct Testimony.

utilities. Section VI describes the analyses and analytical basis for the recommendation of an appropriate ROE for the Iowa natural gas operations of MidAmerican. Section VII provides a discussion of specific regulatory, business and financial risks that directly affect the ROE to be authorized for the Company in this case. Section VIII addresses the Company's capital structure as compared with the capital structures of the utility operating company subsidiaries of the proxy group companies. Section IX presents my conclusions and recommendations.

II. SUMMARY OF ANALYSIS AND CONCLUSIONS

Q. Please summarize the key factors considered in your analyses and upon which you base your recommended ROE.

A. In developing my recommended ROE for MidAmerican, I considered the following:

- The United States Supreme Court's *Hope* and *Bluefield* decisions that established the standards for determining a fair and reasonable allowed ROE, including consistency of the allowed return with the returns of other businesses having similar risk, adequacy of the return to provide access to capital and support credit quality, and the requirement that the result lead to just and reasonable rates.[2]
- The effect of current and projected capital market conditions on ROE estimation models and on investors' return requirements.
- The results of several analytical approaches that provide estimates of the Company's COE. Because the Company's required COE should be a forward-looking estimate,

[2] Fed. Power Comm'n. v. Hope, 320 U.S. 591 (1944); Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of West Virginia, 262 U.S. 679 (1923).

these analyses rely on forward-looking inputs and assumptions (e.g., projected analyst growth rates in the DCF model, forecasted risk-free rate and Market Risk Premium in the CAPM analysis, etc.).

- The Company's regulatory, business and financial risks relative to the proxy group of comparable companies, and the implications of those risks in determining an appropriate ROE for the Company over the period during which rates will be in effect.

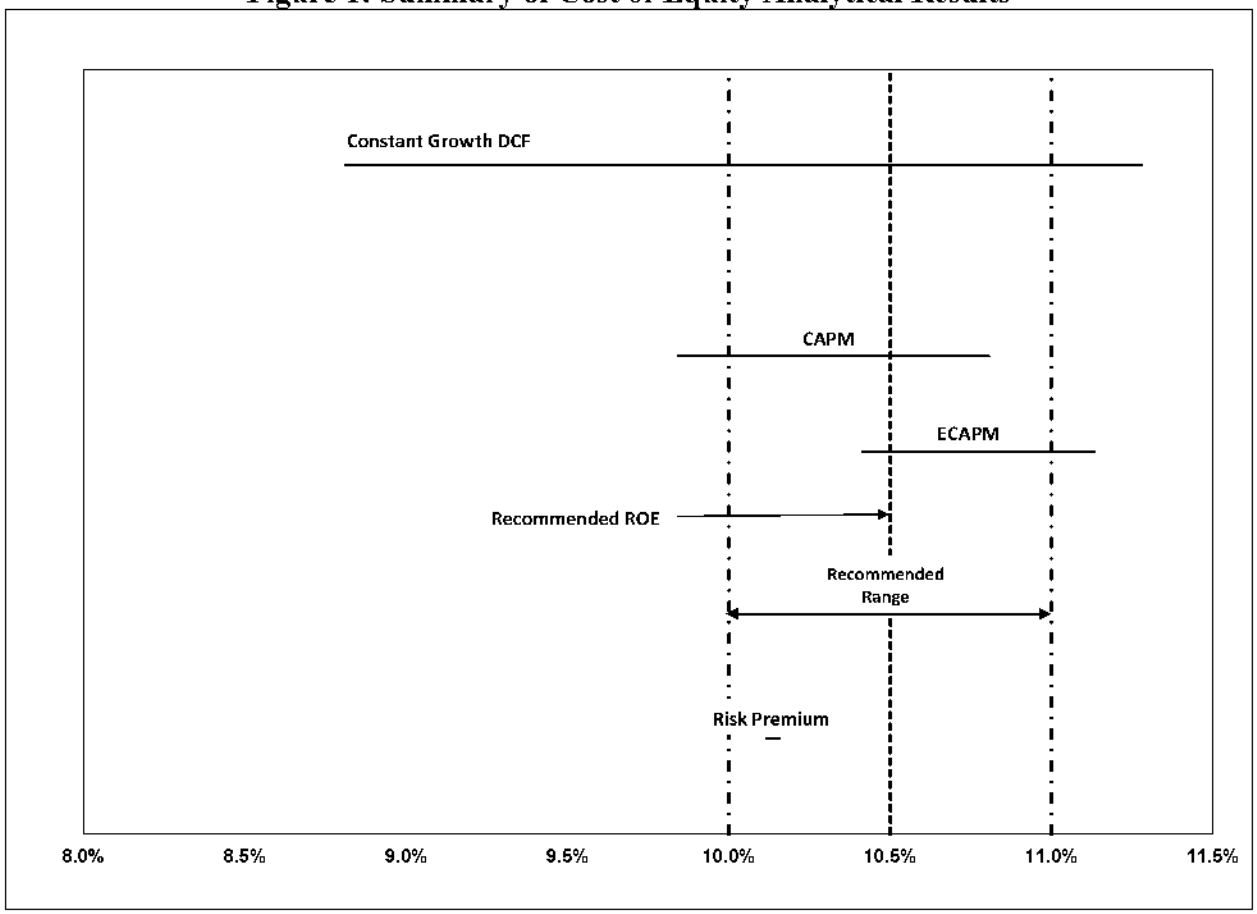
Q. Please explain how you considered those factors.

A. I relied on the range of results produced by the Constant Growth DCF model, the CAPM and ECAPM, and a Risk Premium analysis. As shown in Figure 1, these COE estimation models produce a wide range of results. My conclusion as to the appropriate ROE for MidAmerican within that range of results is based on MidAmerican's natural gas distribution operations business in Iowa and financial risk relative to the proxy group and my assessment of market conditions. Although the companies in my proxy group are generally comparable to MidAmerican, each company is unique, and no two companies have the exact same business and financial risk profiles. Accordingly, I considered the Company's natural gas distribution operations business, financial and regulatory risk in aggregate relative to that of the proxy group companies when determining where the Company's ROE should fall within the reasonable range of analytical results to appropriately account for any residual differences in risk.

Q. Please summarize the results of the COE estimation models that you considered to establish the range of the COE for MidAmerican.

A. Figure 1 summarizes the range of results produced by the Constant Growth DCF, CAPM, ECAPM, and Bond Yield Risk Premium analyses.

Figure 1: Summary of Cost of Equity Analytical Results



As shown in Figure 1 (and in Bulkley Direct Exhibit 2), the range of results produced by the COE estimation models is wide. While it is common to consider multiple models to estimate the cost of equity, it is particularly important when the range of results varies considerably across methodologies. As a result, my ROE recommendation considers the range of results of the Constant Growth DCF model, as well as the results of the CAPM, ECAPM, and Bond Yield Plus Risk Premium analyses. My ROE recommendation also considers MidAmerican's company-specific risk factors and current and prospective capital market conditions.

Q. Are prospective capital market conditions expected to affect the results of the cost of equity for MidAmerican during the period in which the rates established in this proceeding will be in effect?

A. Yes. Capital market conditions are expected to affect the results of the cost of equity estimation models. Specifically:

- Inflation is expected to persist over the near-term, which increases the operating risk of the utility during the period in which rates will be in effect.
- Long-term interest rates have increased substantially in the past year and are expected to remain relatively high at least over the near-term in response to inflation.
- Since utility dividend yields are now less attractive than the risk-free rates of government bonds, and interest rates are expected to remain near current levels over the next year, and since utility stock prices are inversely related to changes in interest rates, it is likely that utility share prices will decline.
- Rating agencies have responded to the risks of the utility sector, with Moody's Investors Service ("Moody's") most recently indicating its outlook for the industry in 2023 is "negative", citing increasing interest rates, inflation and high natural gas prices, all of which create pressures for customer affordability and prompt rate recovery.
- Similarly, equity analysts have noted the increased risk for the utility sector as a result of increases in interest rates and expect the sector to underperform over the near-term.
- Consequently, the results of the DCF model, which relies on current utility share prices, is likely to understate the cost of equity during the period that the Company's rates will be in effect.

It is appropriate to consider all of these factors when estimating a reasonable range of the investor-required cost of equity and the recommended ROE for MidAmerican.

Q. What is your conclusion regarding the appropriate authorized ROE for MidAmerican in this proceeding?

A. Based on the analytical results presented in Figure 1, my assessment of current and anticipated capital market conditions, and the Company's business, financial and regulatory risk relative to proxy group companies, I conclude that a ROE in the range of 10.00 percent to 11.00 percent is reasonable. Considering underlying market conditions and the business, financial and regulatory risk factors facing MidAmerican's Iowa natural gas distribution operations, including the Company's small size compared to proxy group, significant capital expenditures and lack of any mechanism to provide for recovery of equity costs or capital investments other than those to replace or modify infrastructure to meet state or federal natural gas pipeline safety regulations between rate cases, I believe an ROE of 10.50 percent is reasonable and appropriate.

Q. Please summarize your analysis of the appropriate ratemaking capital structure for the Company.

A. Based on the analysis presented in Section VIII of my testimony, I conclude that MidAmerican's proposed 55.00 percent common equity ratio is reasonable. To determine if MidAmerican's requested capital structure was reasonable, I reviewed the capital structures of the utility subsidiaries of the proxy companies. As shown in Bulkley Direct Confidential Exhibit 11, the results of that analysis demonstrate that the three-year average equity ratios for the utility operating companies of the proxy group range from 48.73 percent to 61.47 percent, with an average of 56.39 percent. Comparing the recommended equity ratio to the

proxy group demonstrates that the Company's requested equity ratio is well below the average equity ratio for the utility operating subsidiaries of the proxy group companies.

III. REGULATORY GUIDELINES

Q. Please describe the guiding principles to be used in establishing the cost of equity for a regulated utility.

A. The United States Supreme Court's precedent-setting *Hope* and *Bluefield* cases established the standards for determining the fairness or reasonableness of a utility's allowed ROE. Among the standards established by the Court in those cases are: (1) consistency with other businesses having similar or comparable risks; (2) adequacy of the return to support credit quality and access to capital; and (3) the principle that the result reached, as opposed to the methodology employed, is the controlling factor in arriving at just and reasonable rates.[3]

Q. Has the IUB provided similar guidance in establishing the appropriate return on common equity?

A. Yes. The Board follows the precedents of the *Hope* and *Bluefield* cases and acknowledges that utility investors are entitled to a fair and reasonable return. This position was set forth by the Board as follows:

> [i]n setting an allowed rate of return on equity investment, the Board is to balance investor and consumer interests. For example, if rates produce earnings that are below a fair and reasonable level, they may be unjust or confiscatory to the owners of the utility property; if rates produce earnings

[3] *Hope*, 320 U.S. 591 (1944); *Bluefield*, 262 U.S. 679 (1923).

> that are above a fair and reasonable level, the rates may be oppressive to the utility's ratepayers. Davenport Water Co., v. Iowa State Commerce Comm'n, 190 N.W.2d 583, 604-605 (Iowa 1971). In addition, the U.S. Supreme Court in Federal Power Commission v. Hope Natural Gas Company, 320 US 591 (1944), held that "the return to the equity owner [the utility] should be commensurate with returns on investments in other enterprises having corresponding risks. The return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain credit and attract capital...."
>
> In determining the allowed return, the various models generally produce a range for the Board to consider. There is no precise return on equity that is accurate or only one that is appropriate, but a range of reasonable returns. Within that range, the Board determines the most appropriate return, balancing the interests of shareholders and ratepayers.[4]

Based on these standards, the authorized ROE should provide the Company with a fair and reasonable return and should provide access to capital on reasonable terms in a variety of market conditions.

[4] "Order Approving Settlement, With Modifications, and Requiring Additional Information," *In RE: MidAmerican Energy Company*, Iowa Utils. Bd. Docket No. RPU-2013-0004, Mar. 17, 2014), at 20-21.

Q. Why is it important for a utility to be allowed the opportunity to earn an ROE that is adequate to attract capital at reasonable terms?

A. An ROE that is adequate to attract capital at reasonable terms enables the Company to continue to provide safe, reliable natural gas service while maintaining its financial integrity. That return should be commensurate with returns expected elsewhere in the market for investments of equivalent risk. If it is not, debt and equity investors will seek alternative investment opportunities for which the expected return reflects the perceived risks, thereby inhibiting the Company's ability to attract capital at reasonable cost.

Q. Is a utility's ability to attract capital also affected by the ROEs that are authorized for other utilities?

A. Yes. Utilities compete directly for capital with other investments of similar risk, which include other natural gas and electric utilities. Therefore, the ROE awarded to a utility sends an important signal to investors regarding whether there is regulatory support for financial integrity, dividends, growth, and fair compensation for business and financial risk. The cost of capital represents an opportunity cost to investors. If higher returns are available for other investments of comparable risk, investors have an incentive to direct their capital to those investments. Thus, an authorized ROE that is not in line with authorized ROEs for other natural gas and electric utilities, on a risk adjusted basis, can inhibit the utility's ability to attract capital for investment in Iowa.

Q. Are you aware of any utilities that have experienced either a credit rating downgrade or negative market response related to the financial effects of a rate case decision?

A. Yes. Pinnacle West Capital Corporation ("PNW") received a credit rating downgrade following a 2021 rate case decision for its operating subsidiary, Arizona Public Service

Company, that included a below average authorized ROE. The PNW stock price experienced a 24 percent loss in value, and equity analysts reducing their earnings growth projections from 6.5 percent prior to the decision to 0.1 percent following the decision. Guggenheim Securities LLC, an equity analyst that follows PNW informed its clients that:

> [T]he "Arizona Corporation Commission is now confirmed to be the single most value destructive regulatory environment in the country as far as investor-owned utilities are concerned."[5]

S&P Global Market Intelligence (Regulatory Research Associates or RRA) noted that this decision was "among the lowest ROEs RRA had encountered in its coverage of vertically integrated electric utilities in the past 30 years."[6] Finally, at its 3Q 2021 earnings call, PNM announced changes to its capital plan saying that it would defer equity issuances until the conclusion of its next rate case to limit shareholder dilution.[7]

Q. What are your conclusions regarding regulatory guidelines?

A. The ratemaking process is premised on the principle that a utility must have the opportunity to recover the return of, and the market-required return on, its invested capital. Because utility operations are capital-intensive, regulatory decisions should enable the utility to attract capital at reasonable terms under a variety of economic and financial market conditions; doing so balances the long-term interests of the utility and its customers.

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[5] S&P Global Market Intelligence, "Pinnacle West shares tumble after regulators slash returns in rate case," October 7, 2021.

[6] S&P Global Market Intelligence, RRA Regulatory Focus, "Commission accords Arizona Public Service Company a well below average ROE," October 8, 2021.

[7] S&P Global Market Intelligence, "Pinnacle West Capital Corporation NYSE:PNW FQ3 2021 Earnings Call Transcripts," November 5, 2021, p. 7.

The financial community carefully monitors the current and expected financial condition of utility companies and the regulatory frameworks in which they operate. In that respect, the regulatory framework is one of the most important factors in both debt and equity investors' assessments of risk. The Board's order in this proceeding, therefore, should provide the Company with the opportunity to earn an ROE that is: (1) adequate to attract capital at reasonable terms under a variety of economic and financial market conditions over the period of time that this asset will be recovered; (2) sufficient to ensure good financial management and firm integrity; and (3) commensurate with returns on investments in enterprises with similar risk. Providing the opportunity to earn a market-based cost of capital supports the financial integrity of the Company, which is in the interest of both customers and shareholders.

Q. What is the standard for setting the ROE in any jurisdiction?

A. The stand-alone ratemaking principle is the foundation of jurisdictional ratemaking. This principle requires that the rates that are charged in any operating jurisdiction be for the costs incurred in that jurisdiction. The stand-alone ratemaking principle ensures that customers in each jurisdiction only pay for the costs of the service provided in that jurisdiction, which is not influenced by the business operations in other operating companies. In order to maintain this principle, the COE analysis is performed for an individual operating company as a stand-alone entity. As such, I have evaluated the investor-required return for MidAmerican's natural gas operations in Iowa.

IV. CAPITAL MARKET CONDITIONS

Q. Why is it important to analyze capital market conditions?

A. The COE estimation models rely on market data that are either specific to the proxy group, in the case of the DCF model, or to the expectations of market risk, in the case of the CAPM. The results of the COE estimation models can be affected by prevailing market conditions at the time the analysis is performed. While the ROE that is established in a rate proceeding is intended to be forward-looking, the analyst uses current and projected market data, specifically stock prices, dividends, growth rates and interest rates, in the COE estimation models to estimate the required return for the subject company. As a result, it is important to consider the effect of these conditions on the COE estimation models when determining the appropriate range and recommended ROE for a future period.

Q. What factors are affecting the cost of equity for regulated utilities in the current and prospective capital markets?

A. The COE for regulated utility companies is being affected by several factors in the current and prospective capital markets, including: 1) relatively high inflation, 2) changes in monetary policy, and 3) increased interest rates that are expected to remain relatively high over the next few years. These factors affect the assumptions used in the COE estimation models. In this section, I discuss each of these factors and how they affect the models used to estimate the cost of equity for regulated utilities.

Q. What effect do current and prospective market conditions have on the COE for MidAmerican?

A. As is discussed in more detail in the remainder of this section, the combination of persistently high inflation and the Federal Reserve's changes in monetary policy contribute to an

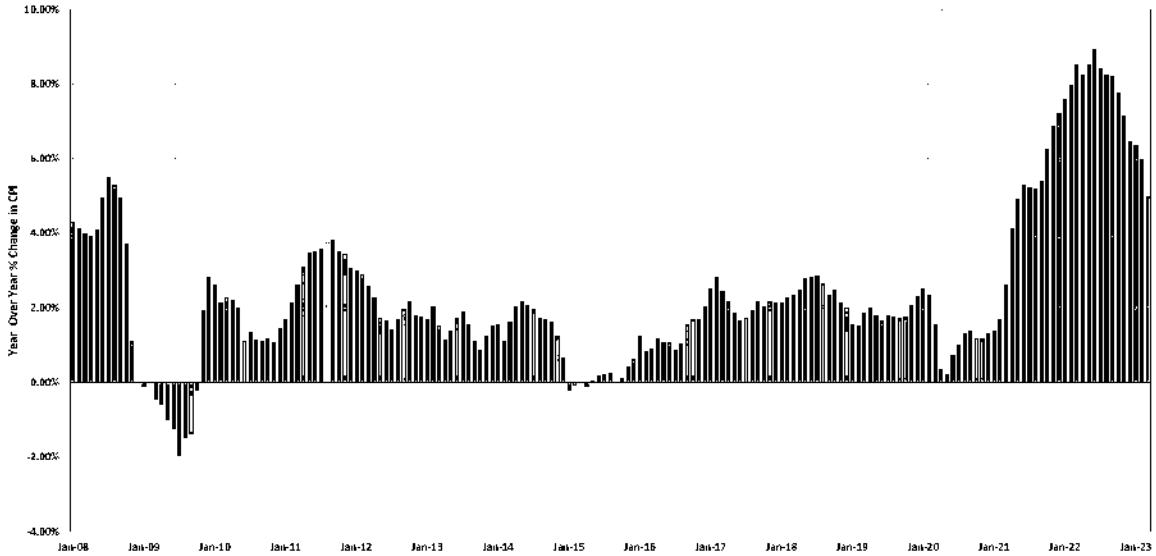
expectation of increased market risk and an increase in the cost of the investor-required return. It is essential that these factors be considered in setting a forward-looking ROE. Inflation has recently been at some of the highest levels seen in approximately 40 years. Interest rates, which have increased from the pandemic lows seen in 2020, are expected to remain elevated over the near term in direct response to the Federal Reserve's monetary policy. Since there is a strong historical inverse correlation between interest rates and the share prices of utility stocks (share prices of utility stocks typically fall when interest rates rise), it is reasonable to expect that investors' required return for utility companies will also increase. Therefore, cost of equity estimates based solely on current market conditions will understate the cost of equity required by investors during the future period that the Company's rates determined in this proceeding will be in effect.

A. Inflationary Expectations in Current and Projected Capital Market Conditions

Q. Has inflation increased significantly over the past year?

A. Yes. As shown in Figure 2, the year-over-year ("YOY") change in the Consumer Price Index ("CPI") published by the Bureau of Labor Statistics has increased steadily since the beginning of 2021, rising from 1.37 percent in January 2021 to a high of 9.0 percent in June 2022, which was the largest 12-month increase since 1981 and significantly greater than any level seen since January 2008. As shown in Figure 2, since that time, while inflation has declined in response to the Federal Reserve's monetary policy, inflation continues to remain elevated.

Figure 2: Consumer Price Index—YOY Percent Change January 2008–April 2023[8]



Q. What are the expectations for inflation over the near-term?

A. The Federal Reserve has indicated that it expects inflation will remain elevated above its target level over at least the next year and that it will continue to increase short-term interest rates to reduce inflation. For example, Federal Reserve Chair Powell at the Federal Open Market Committee ("FOMC") meeting in February 2023 anticipated further increases in the federal funds rate, and observed that while inflation is off of its recent highs, it remains significantly above the Federal Reserve's long-term target:

> We continue to anticipate that ongoing increases will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time.
>
> .....
>
> Inflation remains well above our longer-run goal of 2 percent. Over the 12 months ending in December, total PCE prices rose 5.0 percent; excluding the volatile food and energy categories, core PCE prices rose 4.4 percent.

[8] Source: Bureau of Labor Statistics, shaded area indicates a recession.

> The inflation data received over the past three months show a welcome reduction in the monthly pace of increases. And while recent developments are encouraging, we will need substantially more evidence to be confident that inflation is on a sustained downward path.
>
> .....
>
> With today's action, we have raised interest rates by 4-1/2 percentage points over the past year. We continue to anticipate that ongoing increases in the target range for the federal funds rate will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time.
>
> .....
>
> At the December meeting, we all wrote down our best estimates of what we thought the ultimate level would be [of the federal funds rate], and that's obviously back in December. And the median for that was between five and five and a quarter percent. At the March meeting, we're going to update those assessments. We did not update them today. We did, however, continue to say that we believe ongoing rate hikes will be appropriate to attain a sufficiently restrictive stance of policy to bring inflation back down to 2 percent. We think we've covered a lot of ground, and financial conditions have certainly tightened. I would say we still think there's work to do there. We haven't made a decision on exactly where that will be. I think, you know, we're going to be looking carefully at the incoming data between now and the March meeting and then the May meeting. I don't feel a lot of certainty about where that will be. It could certainly be higher than we're writing down right now. If we come to the view that we need to write down to -- you know, to move rates up beyond what we said in December we would certainly do that. At the same time, if the data come in, in the other direction then we'll -- you know, we'll make data-dependent decisions at coming meetings, of course.[9]

Most recently, on May 3, 2023, the Federal Reserve again raised interest rates by one quarter of a percentage point, which is the third Federal Funds rate increase in 2023.[10] In addition, the Federal Reserve reiterated its long-term target of 2 percent inflation and its commitment

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[9] Transcript, Chair Powell Press Conference, February 1, 2023; clarification added.

[10] Federal Reserve, "Implementation Note issued March 22, 2023," March 22, 2023, Federal Reserve Board - Implementation Note issued March 22, 2023 , Transcript of Chair Powell's Press Conference May 3, 2023 (federalreserve.gov)

to get to this target.[11] The Federal Reserve believes that there is significant progress that needs to be made to bring inflation to its long-term target of 2 percent. Indeed as Chair Powell stated in his most recent press conference, "Reducing inflation is likely to require a period of below-trend growth and some softening in labor market conditions."[12]

B. The Use of Monetary Policy to Address Inflation

Q. What policy actions has the Federal Reserve enacted to respond to increased inflation?

A. The dramatic increase in inflation has prompted the Federal Reserve to pursue an aggressive normalization of monetary policy, removing the accommodative policy programs used to mitigate the economic effects of COVID-19. Beginning in March 2022 and through May 3, 2023, the Federal Reserve increased the target federal funds rate through a series of increases from 0.00 – 0.50 percent to 4.75 percent to 5.25 percent.[13] The Federal Reserve anticipates the continued need to maintain the Federal Funds rate at a restrictive level in order to achieve its goal of 2 percent inflation over the long-run.[14]

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[11] Transcript, Chair Powell Press Conference, May 3, 2023, Transcript of Chair Powell's Press Conference May 3, 2023 (federalreserve.gov). Federal Reserve, Press Release, "Federal Reserve issues FOMC Statement," March 22, 2023, https://www.federalreserve.gov/newsevents/pressreleases/monetary20230322a.htm ("In determining the extent of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in its previously announced plans. The Committee is strongly committed to returning inflation to its 2 percent objective").

[12] Federal Reserve, Transcript of Chair Powell's Press Conference, May 3, 2023, p. 4, Transcript of Chair Powell's Press Conference May 3, 2023 (federalreserve.gov).

[13] Federal Reserve, Press Releases, March 16, 2022, May 4, 2022, June 15, 2022, September 22, 2022, November 2, 2022, February 1, 2023, March 22, 2023 and May 3, 2023.

[14] Federal Reserve, Press Release, "Federal Reserve issues FOMC statement," March 22, 2023, https://www.federalreserve.gov/newsevents/pressreleases/monetary20230322a.htm.

C. The Effect of Inflation and Monetary Policy on Interest Rates and the Investor-Required Return

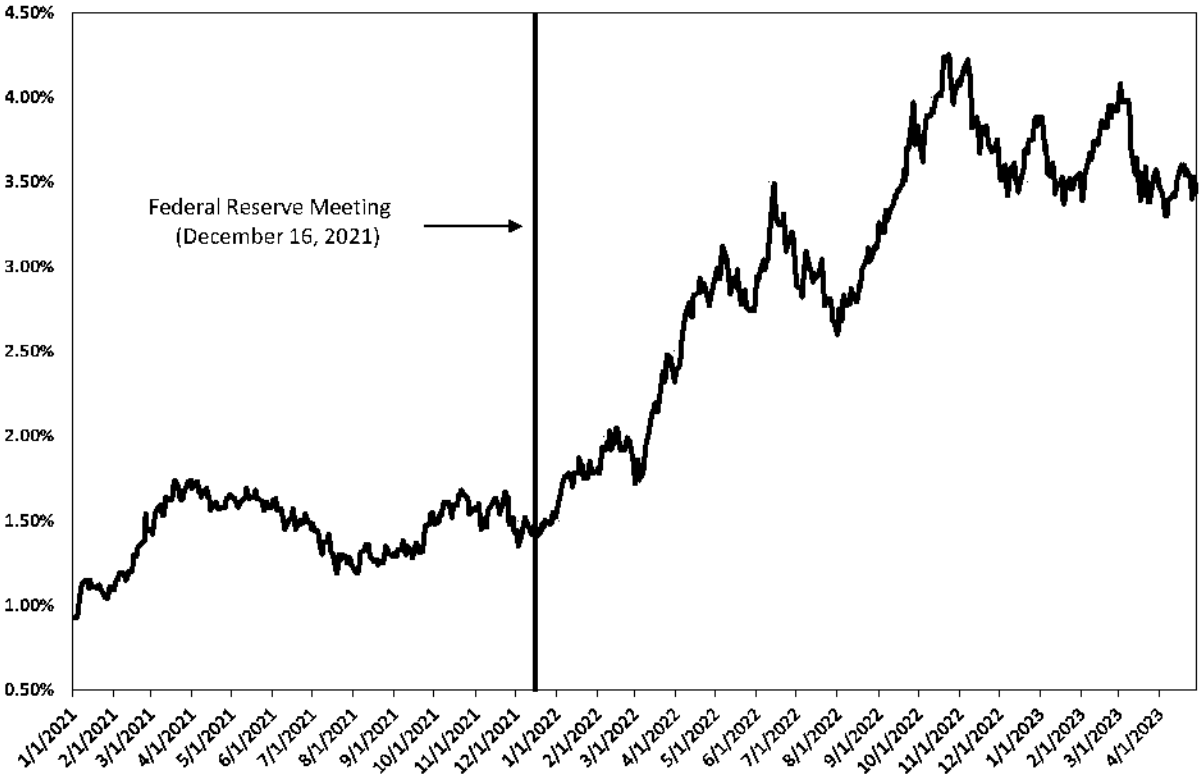
Q. What effect will inflation and Federal Reserve's normalization of monetary policy have on long-term interest rates?

A. Inflation and the Federal Reserve's normalization of monetary policy will likely result in increases in long-term interest rates. Specifically, inflation reduces the purchasing power of the future interest payments an investor expects to receive over the duration of the bond. This risk increases the longer the duration of the bond. As a result, if investors expect increased levels of inflation, they will require higher yields to compensate for the increased risk of inflation, which means interest rates will increase.

Q. Have the yields on long-term government bonds increased in response to inflation and the Federal Reserve's normalization of monetary policy?

A. Yes, they have. At the FOMC meetings throughout 2022 and thus far into 2023, the Federal Reserve has continued to note its concerns over the sustained increased levels of inflation and has continued to accelerate the process of normalizing monetary policy to combat inflation. As shown in Figure 3, since the Federal Reserve's December 2021 meeting, the yield on 10-year Treasury bond has more than doubled, increasing from 1.47 percent on December 15, 2021 to 3.44 percent at the end of April 2023. The increase is due to the Federal Reserve's announcements at each of the meetings since December 2021 and the continued elevated levels of inflation. Further, since the settlement was approved in the Company's last rate proceeding in February 2022, the 30-day average yield on the 10-year Treasury bond has increased from 1.87 percent to 3.72 percent, or 185 basis points.

Figure 3: 10-Year Treasury Bond Yield—Janaury 2021– April 30, 2023[15]



Q. What have equity analysts said about long-term government bond yields?

A. Leading equity analysts have noted that they expect the yields on long-term government bonds to remain elevated through at least the end of 2023. According to the March 2023 *Blue Chip Financial Forecasts* report, the consensus estimate of the average yield on the 10-year Treasury bond is approximately 3.40 percent through the third quarter of 2024.[16]

[15] S&P Capital IQ Pro.

[16] Blue Chip Financial Forecasts, Vol. 42, No. 4, March 31, 2023, p. 2.

Q. Do recent changes in GDP affect the current outlook for inflation and interest rates?

A. No. While FOMC participants have recently reduced their projections for economic activity for real GDP growth to 0.5 percent in 2023,[17] which is well below the median estimate for the longer-run normal GDP growth rate, the Federal Reserve has highlighted that the labor market continues to be extremely tight, and in fact, the unemployment rate reached 3.4 percent in January 2023, the lowest it has been in over 50 years.[18] Therefore, with a tight labor market and persistently high inflation, the Federal Reserve has indicated its need to continue a restrictive monetary policy to moderate demand to better align it with supply.[19]

D. Expected Performance of Utility Stocks and the Investor-Required Return on Utility Investments

Q. Are utility share prices correlated to changes in the yields on long-term government bonds?

A. Yes. Interest rates and utility share prices are inversely correlated which means, for example, that an increase in interest rates will result in a decline in the share prices of utilities. For example, Goldman Sachs and Deutsche Bank examined the sensitivity of share prices of different industries to changes in interest rates over the past five years. Both Goldman Sachs and Deutsche Bank found that utilities had one of the strongest negative relationships with bond yields (i.e., increases in bond yields resulted in the decline of utility share prices).[20]

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[17] FOMC, Summary of Economic Projections, March 22, 2023.

[18] Mutikani, Lucia. "U.S. reports blowout job growth; unemployment lowest since 1969." Reuters, February, 3, 2023.

[19] Transcript. Chair Powell, Press Conference, February 1, 2023.

[20] Lee, Justina. "Wall Street Is Rethinking the Treasury Threat to Big Tech Stocks." Bloomberg.com, 11 Mar. 2021, www.bloomberg.com/news/articles/2021-03-11/wall-street-is-rethinking-the-treasury-threat-to-big-tech-stocks.

Q. How do equity analysts expect the utilities sector to perform in an increasing interest rate environment?

A. Equity analysts project that utilities will underperform the broader market given the increases in interest rates. Fidelity classifies the utility sector as underweight,[21] and *Morningstar* recently noted that many of the market conditions that supported the premium valuation of utilities over the last decade mainly low inflation, interest rates and energy prices are currently reversing:

> Utilities' relative outperformance in 2022 while the market frets about the economy suggests that utilities remain a defensive haven. Utilities also outperformed ahead of the 2001 and the 2007-09 recessions. However, we think utilities' weak total returns in 2022 should concern investors. For the first time in a decade, the tailwinds supporting utilities' earnings growth and premium valuations (low inflation, low interest rates, and low energy price) are reversing.

> Utilities' growth prospects are our biggest concern going into 2023. Utilities no longer offer a yield premium as bond yields climbed to their highest level in 15 years. Without that yield premium, the only advantage utilities offer investors is earnings growth. This is why high inflation and rising interest rates loom large for utilities in 2023. Inflation, including higher energy prices, will raise customer bills and could force utilities to re-evaluate their growth plans. Higher interest costs will sap cash flow and make infrastructure investments more expensive.[22]

Additionally, the *Wall Street Journal* noted that the S&P Utilities Index was down 14 percent between September and October 2022, attributing the decline to the recent increase in long-term treasury yields:

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[21] Fidelity. "First Quarter 2023 Investment Research Update." February 8, 2023.

[22] Miller, Travis. "Can Utilities Maintain Growth Against Macroeconomic Headwinds?" Morningstar, January 3, 2023.

> A big draw of utility stocks has become less attractive as interest rates have climbed. Utility stocks are known for their sizable dividends, offering investors a regular stream of income. Companies in the S&P 500 utilities sector offer a dividend yield of 3.3%, among the highest payout percentages in the index, according to FactSet.
>
> But the outsize dividends of utility stocks are no match for climbing bond yields. The yield on the benchmark 10-year Treasury note finished above 4% on Monday for a second consecutive session. Friday marked the 10-year yield's first close above the 4% level since 2008 and 11 straight weeks of gains. Treasurys are viewed as essentially risk-free if held to maturity.
>
> "The 10-year is repricing everything. I've got something that's even safer and yields even more," said Kevin Barry, chief investment officer at Summit Financial, comparing Treasurys and utility stocks.[23]

Similarly, Barron's noted that the decline in share prices can be attributed to the relatively high valuations and low dividend yields of utilities as compared to other asset classes such as Treasuries.[24] According to Barron's, even after the recent decline in share prices, the Utilities Select ETF was yielding 2.85 percent, which is a yield that will not "lure in buyers when the ultrasafe 10-year Treasury note yields close to 4%."[25] Therefore, Barron's currently recommends not buying utility stocks.

Q. Do standard market indicators support analysts' position that utilities will underperform over the near-term?

A. Yes. As discussed, the utility sector is considered a "bond proxy" or a sector that investors view as a "safe haven" alternative to bonds, and changes in utility stock prices are therefore

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[23] Miao, Hannah. "Utility Stock stumble as treasury yields climb." The Wall Street Journal, October 18, 2022.

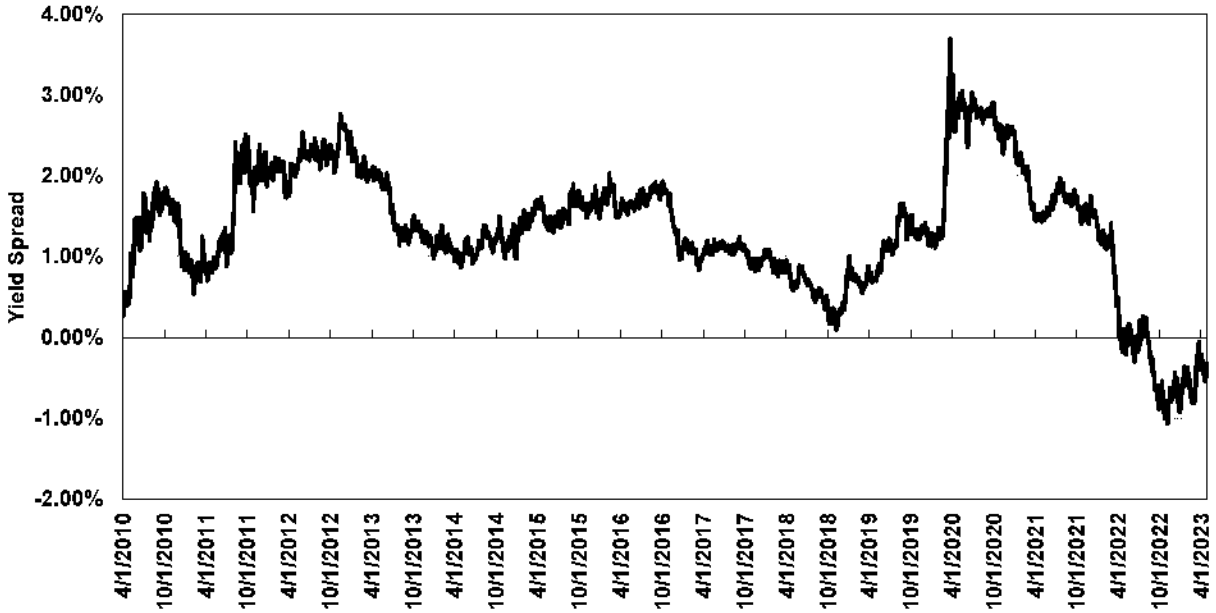
[24] Sonenshine, Jacob. "Utilities Stocks Have Fallen off a Cliff. They Just Got Downgraded, Too." Barron's, October 17, 2022.

[25] Id.

inversely related to changes in interest rates. For example, the utility sector tends to perform well when interest rates are low since the dividend yields for utilities offer investors the prospect of higher returns when compared to the yields on long-term government bonds. Therefore, I examined the difference between the dividend yields of utility stocks and the yields on long-term government bonds (*i.e.*, the "yield spread"). I selected the dividend yield on the S&P Utilities Index as the measure of the dividend yields for the utility sector and the yield on the 10-year Treasury bond as the estimate of the yield on long-term government bonds.

As shown in Figure 4, the yield spread as of April 30, 2023 was negative 0.36 percent, meaning that the yield on the 10-year Treasury bond exceeds the dividend yield for the S&P Utilities Index. Furthermore, the current negative yield spread is well below the long-term average yield spread since 2010 of 1.34 percent. Given that the yield spread is currently well below the long-term average, as well as the expectation that interest rates will remain relatively high through at least the next year, it is reasonable to conclude that the utility sector will most likely underperform over the near-term. This is because investors that purchased utility stocks as an alternative to the lower yields on long-term government bonds would otherwise be inclined to rotate back into government bonds, particularly as the yields on long-term government bonds remain elevated, thus resulting in a decrease in the share prices of utilities.

Figure 4: Spread between the S&P Utilities Index Dividend Yield and the 10-year Treasury Bond Yield, April 2010 – April 2023[26]



Q. What is the significance of the inverse relationship between interest rates and utility share prices in the current market?

A. If interest rates remain relatively high as expected, then the share prices of utilities, which have been strong in 2022 relative to the market, would be expected to decline. If the prices of utility stocks decline, then the DCF model, which relies on historical averages of share prices to calculate the dividend yield, is likely to understate the dividend yield and thus the cost of equity.

[26] S&P Capital IQ Pro and Bloomberg Professional.

Q. Have regulatory commissions acknowledged that the DCF model might understate the COE given the current capital market conditions of high inflation and increasing interest rates?

A. Yes. For example, in its May 2022 decision in establishing the cost of equity for Aqua Pennsylvania, Inc., the Pennsylvania Public Utility Commission ("PPUC") specifically concluded that the current capital market conditions of high inflation and increasing interest rates has resulted in the DCF model understating the utility cost of equity, and that weight should be placed on risk premium models, such as the CAPM, in the determination of the ROE:

> To help control rising inflation, the Federal Open Market Committee has signaled that it is ending its policies designed to maintain low interest rates. Aqua Exc. at 9. Because the DCF model does not directly account for interest rates, consequently, it is slow to respond to interest rate changes. However, I&E's CAPM model uses forecasted yields on ten-year Treasury bonds, and accordingly, its methodology captures forward looking changes in interest rates.
>
> Therefore, our methodology for determining Aqua's ROE shall utilize both I&E's DCF and CAPM methodologies. As noted above, the Commission recognizes the importance of informed judgment and information provided by other ROE models. In the 2012 PPL Order, the Commission considered PPL's CAPM and RP methods, tempered by informed judgment, instead of DCF-only results. We conclude that methodologies other than the DCF can be used as a check upon the reasonableness of the DCF derived ROE calculation. Historically, we have relied primarily upon the DCF methodology in arriving at ROE determinations and have utilized the results of the CAPM as a check upon the reasonableness of the DCF derived equity return. As such, where evidence based on other methods suggests that the DCF-only results may understate the utility's ROE, we will consider those other methods, to some degree, in determining the appropriate range of reasonableness for our equity return determination. In light of the above, we shall determine an appropriate ROE for Aqua using informed judgement based on I&E's DCF and CAPM methodologies.[27]

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[27] Penn. Pub. Util. Comm'n et.al. v. Aqua Penn. Wastewater Inc., Pennsylvania Public Utility Commission, Docket Nos. R-2021-3027385 and R-2021-3027386, Opinion and Order, May 12, 2022, pp. 154–155.

> .....
> We have previously determined, above, that we shall utilize I&E's DCF and CAPM methodologies. I&E's DCF and CAPM produce a range of reasonableness for the ROE in this proceeding from 8.90% [DCF] to 9.89% [CAPM]. Based upon our informed judgment, which includes consideration of a variety of factors, including increasing inflation leading to increases in interest rates and capital costs since the rate filing, we determine that a base ROE of 9.75% is reasonable and appropriate for Aqua.[28]

E. Conclusion

Q. What are your conclusions regarding the effect of current market conditions on the cost of equity for the Company?

A. Investors expect long-term interest rates to remain relatively high through 2023, in response to continued elevated levels of inflation and the Federal Reserve's normalization of monetary policy. Because the share prices of utilities are inversely correlated to interest rates, and government bond yields are already substantially greater than utility stock dividend yields, the share prices of utilities will likely decline, which is the reason a number of equity analysts have classified the sector as either underperform or underweight. The expected underperformance of utilities means that DCF models using recent historical data likely underestimate investors' required return over the period that rates will be in effect. Therefore, this expected change in market conditions supports consideration of the higher end of the range of cost of equity results produced by the DCF models. Moreover, prospective market conditions warrant consideration of forward-looking cost of equity estimation models such as the CAPM and ECAPM, which better reflect expected market conditions.

[28] *Id.*, Opinion and Order, May 12, 2022, pp. 177–178.

V. PROXY GROUP SELECTION

Q. Please provide a brief profile of MidAmerican.

A. MidAmerican is a wholly owned indirect subsidiary of Berkshire Hathaway Energy Company. The company serves 0.8 million retail electric customers in portions of Iowa, Illinois and South Dakota and 0.8 million retail and transportation natural gas customers in portions of Iowa, South Dakota, Illinois and Nebraska.[29] MidAmerican is currently rated A/Stable by Standard & Poor's[30] and A1/Stable by Moody's.[31]

Q. Why have you used a group of proxy companies to estimate the cost of equity for MidAmerican?

A. In this proceeding, we focus on estimating the cost of equity for a natural gas utility company that is not itself publicly traded. Because the cost of equity is a market-based concept and because MidAmerican's operations do not make up the entirety of a publicly traded entity, it is necessary to establish a group of companies that is both publicly traded and comparable to the Company in certain fundamental business and financial respects to serve as its "proxy" in the ROE estimation process.

Even if MidAmerican was a publicly traded entity, it is possible that transitory events could bias its market value over a given period. A significant benefit of using a proxy group is that it moderates the effects of unusual events that may be associated with any one company. The proxy companies used in my analyses all possess a set of operating and risk characteristics that are substantially comparable to the Company, and thus provide a

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[29] S&P Global Market Intelligence.

[30] Source: S&P Capital IQ Pro, (accessed April 06, 2023).

[31] Source: Moodys.com (accessed April 12, 2023).

reasonable basis to derive and estimate the appropriate ROE for MidAmerican's natural gas distribution operations in Iowa.

Q. How did you select the companies included in your proxy group?

A. I began with the group of 10 publicly traded companies that Value Line classifies as Natural Gas Distribution Utilities and applied screening criteria to select a group of risk-comparable companies as follows:

- Because certain of the models used in my analysis assume that earnings and dividends grow overtime, I excluded companies that do not consistently pay quarterly cash dividends;
- All companies in my proxy group have investment grade long-term issuer ratings from S&P and/or Moody's;
- To ensure that the growth rates used in my analysis are not biased by an individual analyst, all companies in the proxy group are covered by at least two utility industry analysts;
- Because certain of the models used in my analysis require positive growth, all companies in my proxy group have positive long-term earnings growth forecasts from at least two utility industry equity analysts;
- To establish a proxy group that consists primarily of regulated natural gas distribution utilities, I included only those companies that derive more than 60.00 percent of their total operating income from regulated natural gas distribution operations;

- I eliminated companies that were known to be parties to a merger or transformative transaction during the analytical periods relied on.

Q. What is the composition of your proxy group?

A. The screening criteria discussed above resulted in a proxy group consisting of the companies shown in Figure 5 below.

Figure 5: Natural Gas Utility Proxy Group

Company	Ticker
Atmos Energy Corporation	ATO
NiSource	NI
Northwest Natural Gas Company	NWN
ONE Gas, Inc.	OGS
Spire, Inc.	SR

Q. Do your screening criteria result in a proxy group that is risk comparable to MidAmerican?

A. Yes, they do. The overall purpose of developing a set of screening criteria is to select a proxy group of companies that align with the financial and operational characteristics of MidAmerican's natural gas operations in Iowa and that investors would view as comparable to the Company. I developed the screens and thresholds for each screen based on judgment with the intention of balancing the need to maintain a proxy group that is of sufficient size with establishing a proxy group of companies that are comparable in business and financial risk to MidAmerican. This resulted in the group of five companies shown in Figure 5, which have business and financial risks that are comparable to MidAmerican.

VI. COST OF EQUITY ESTIMATION

Q. Please briefly discuss the ROE in the context of the regulated rate of return ("ROR").

A. The ROE is the cost rate applied to the equity capital in the ROR. The ROR for a regulated utility is the weighted average cost of capital, in which the costs of the individual sources of capital are weighted by their respective proportion (i.e. book values) in the utility's capital structure. While the costs of debt and preferred stock can be directly observed, the COE is market-based and, therefore, must be estimated based on observable market data.

Q. How is the required COE determined?

A. The required COE is estimated by using analytical techniques that rely on market-based data to quantify investor expectations regarding equity returns, adjusted for certain incremental costs and risks. Informed judgment is then applied to determine where the company's COE falls within the range of results produced by multiple analytical techniques. The key consideration in determining the COE is to ensure that the methodologies employed reasonably reflect investors' views of the financial markets in general, as well as the subject company (in the context of the proxy group), in particular.

Q. What methods did you use to establish your recommended ROE in this proceeding?

A. I considered the results of the Constant Growth DCF model, the CAPM, the ECAPM and a Bond Yield Plus Risk Premium analysis. As discussed in more detail below, a reasonable ROE estimate appropriately considers alternative methodologies and the reasonableness of their individual and collective results.

A. Importance of Multiple Analytical Approaches

Q. Why is it important to use more than one analytical approach?

A. Because the COE is not directly observable, it must be estimated based on both quantitative and qualitative information. When faced with the task of estimating the COE, analysts and investors are inclined to gather and evaluate as much relevant data as reasonably can be analyzed. Several models have been developed to estimate the COE, and I use multiple approaches to estimate the COE. As a practical matter, however, all the models available for estimating the COE are subject to limiting assumptions or other methodological constraints. Consequently, many well-regarded finance texts recommend using multiple approaches when estimating the COE. For example, Copeland, Koller, and Murrin[32] suggest using the CAPM and Arbitrage Pricing Theory model, while Brigham and Gapenski[33] recommend the CAPM, DCF, and Bond Yield Plus Risk Premium approaches.

Q. Do current market conditions increase the importance of using more than one analytical approach?

A. Yes. As previously discussed, interest rates have increased substantially from the lows during the COVID-19 pandemic, and upward pressure is expected to continue as the Federal Reserve continues to combat persistently high inflation. Given the inverse relationship between interest rates and utility share prices, the dividend yields of utilities are expected to increase over the near-term. Therefore, the current low dividend yields for utilities result in

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[32] Tom Copeland, Tim Koller and Jack Murrin, Valuation: Measuring and Managing the Value of Companies, 3rd Ed. (New York: McKinsey & Company, Inc., 2000), at 214.

[33] Eugene Brigham, Louis Gapenski, Financial Management: Theory and Practice, 7th Ed. (Orlando: Dryden Press, 1994), at 341.

DCF cost of equity estimates that are understating the forward-looking cost of equity. The CAPM and Bond Yield Plus Risk Premium method offer some balance through the use of projected interest rates. Therefore, it is important to use multiple analytical approaches to ensure that the COE results reflect the market conditions that are expected during the period that Company's rates will be in effect. Given the expectation that interest rates will increase, it is important to moderate the impact that the current lower interest rates are having on the COE estimates, especially the DCF analysis, and where possible consider using projected market data in the models to estimate the return for the forward-looking period.

Q. Has the Board made similar findings regarding the reliance on multiple models?

A. Yes. In a 2014 decision for MidAmerican, the Board noted that the various models presented produced a range for the Board to consider. Further, the Board noted that there is no precise return on equity that is accurate or only one that is appropriate, but a range of reasonable returns. Within that range, the Board determines the most appropriate return, balancing the interests of shareholders and ratepayers. Further, the Board noted that it normally considers the DCF, risk premium and CAPM in determining the appropriate ROE.[34]

Q. Are you aware of any other regulatory commissions that have recognized the importance of considering the results of multiple models?

A. Yes, regulatory commissions routinely consider the results of multiple COE estimation methodologies such as the DCF, CAPM, ECAPM and Risk Premium in determining the

[34] State of Iowa Department of Commerce Utilities Board, In Re: MidAmerican Energy Company, Docket No. RPU-2013-0004, Order Approving Settlement, With Modifications, and Requiring Additional Information, March 17, 2014, at 8-9.

authorized ROE for utilities in jurisdictional rate proceedings, including the IUB,[35] the Minnesota Public Utilities Commission ("Minnesota PUC"),[36] the Michigan Public Service Commission ("Michigan PSC"),[37] the Washington Utilities and Transportation Commission ("Washington UTC"),[38] and the New Jersey Board of Public Utilities ("NJBPU").[39] For example, the Washington UTC has repeatedly emphasized that it "places value on each of the methodologies used to calculate the cost of equity and does not find it appropriate to select a single method as being the most accurate or instructive."[40] The Washington UTC has also explained that "[f]inancial circumstances are constantly shifting and changing, and we welcome a robust and diverse record of evidence based on a variety of analytics and cost of capital methodologies."[41]

Additionally, in its recent order for DTE Gas Company ("DTE Gas") in Case No. U-18999, the Michigan PSC considered the results of each of the models presented by the ROE witnesses which included the DCF, CAPM, ECAPM and Risk Premium in the determination of the authorized ROE.[42] The Commission also considered authorized ROEs in other states, increased volatility in capital markets and the company-specific business risks of DTE Gas.

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35 Docket RPU-2021-0002, Order Approving Settlement, Approving Compliance Filings, and Granting Confidential Treatment Requests; at 10; Docket RPU-2019-0002, Order Regarding Settlement and Requiring Compliance Filings; at 12-13

36 Docket No. G011/GR-17-563, Findings of Fact, Conclusions and Order, at 27; Docket No. E015/GR-16-664, Findings of Fact, Conclusions and Order, at 60-61

37 Michigan Public Service Commission Order, DTE Gas Company, Case No. U-18999, at 45-47 (Sept. 13, 2018).

38 *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-130043, Order 05, n. 89 (Dec. 4, 2013); *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-100749, Order 06, ¶ 91 (March 25, 2011).

39 NJBPU Docket No. ER12111052, OAL Docket No. PUC16310-12, Order Adopting Initial Decision with Modifications and Clarifications, at 71 (March 18, 2015).

40 *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-130043, Order 05, n. 89 (Dec. 4, 2013).

41 *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-100749, Order 06, ¶ 91 (March 25, 2011).

42 Michigan Public Service Commission Order, DTE Gas Company, Case No. U-18999, at 45-47 (Sept. 13, 2018).

B. Constant Growth DCF Model

Q. Please describe the DCF approach.

A. The DCF approach is based on the theory that a stock's current price represents the present value of all expected future cash flows. In its most general form, the DCF model is expressed as follows:

$$P_0 = \frac{D_1}{(1+k)} + \frac{D_2}{(1+k)^2} + \cdots + \frac{D_{(\infty)}}{(1+k)^{\infty}} \qquad [1]$$

Where P_0 represents the current stock price, $D_1 \ldots D_\infty$ are all expected future dividends, and k is the discount rate, or required ROE. Equation [1] is a standard present value calculation that can be simplified and rearranged into the following form:

$$k = \frac{D_0(1+g)}{P_0} + g \qquad [2]$$

Equation [2] is often referred to as the Constant Growth DCF model in which the first term is the expected dividend yield and the second term is the expected long-term growth rate.

Q. What assumptions are required for the Constant Growth DCF model?

A. The Constant Growth DCF model requires the following four assumptions: (1) a constant growth rate for earnings and dividends; (2) a stable dividend payout ratio; (3) a constant price-to-earnings ("P/E") ratio; and (4) a discount rate greater than the expected growth rate. To the extent that any of these assumptions are violated, considered judgment and/or specific adjustments should be applied to the results.

Q. What market data did you use to calculate the dividend yield in your Constant Growth DCF model?

A. The dividend yield in my Constant Growth DCF model is based on the proxy companies' current annualized dividend and average closing stock prices over the 30-, 90-, and 180-trading days ended March 31, 2023.

Q. Why did you use 30-, 90-, and 180-day averaging periods?

A. In my Constant Growth DCF model, I use an average of recent trading days to calculate the term P_0 in the DCF model to reflect current market data while also ensuring that the ROE is not skewed by anomalous events that may affect stock prices on any given trading day. However, as discussed above, recent market data is not representative of expected market conditions over the long-term. Therefore, the results of my Constant Growth DCF model using historical data may underestimate the forward-looking COE.

Q. Did you make any adjustments to the dividend yield to account for periodic growth in dividends?

A. Yes, I did. Because utility companies tend to increase their quarterly dividends at different times throughout the year, it is reasonable to assume that dividend increases will be evenly distributed over calendar quarters. Given that assumption, it is reasonable to apply one-half of the expected annual dividend growth rate for purposes of calculating the expected dividend yield component of the DCF model. This adjustment ensures that the expected first-year dividend yield is, on average, representative of the coming twelve-month period, and does not overstate the aggregated dividends to be paid during that time.

Q. Why is it important to select appropriate measures of long-term growth in applying the DCF model?

A. In its Constant Growth form, the DCF model (*i.e.*, Equation [2]) assumes a single growth estimate in perpetuity. To reduce the long-term growth rate to a single measure, one must assume that the payout ratio remains constant and that earnings per share, dividends per share and book value per share all grow at the same constant rate. Over the long run, however, dividend growth can only be sustained by earnings growth. Therefore, it is important to incorporate a variety of sources of long-term earnings growth rates into the Constant Growth DCF model.

Q. Which sources of long-term earnings growth rates did you use?

A. My Constant Growth DCF model incorporates three commonly referenced sources of long-term earnings growth rates: (1) Zacks Investment Research; (2) Yahoo! Finance; and (3) Value Line Investment Survey.

Q. How did you calculate the range of results for the Constant Growth DCF Models?

A. I calculated the low result for my DCF model using the minimum growth rate (*i.e.*, the lowest of the Value Line, Yahoo! Finance, and Zacks earnings growth rates) for each of the proxy group companies. Thus, the low result reflects the minimum DCF result for the proxy group. I used a similar approach to calculate the high results, using the highest growth rate for each proxy group company.

Q. What were the results of your Constant Growth DCF analyses?

A. Figure 6 (see also Bulkley Direct Exhibit 2 and 3) summarizes the results of my DCF analyses. As shown in Figure 6, the median and mean DCF results range from 9.97 percent to 10.18 percent, and the median high and mean high results are in the range of 10.67 percent

to 11.29 percent. While I also summarize the low DCF results, given the expected underperformance of utility stocks and thus the likelihood that the DCF model is understating the COE, I do not believe it is appropriate to consider the low DCF results at this time.

Figure 6: Constant Growth Discounted Cash Flow Results

Constant Growth DCF - Mean

	Min Growth Rate	Mean Growth Rate	Max Growth Rate
30-Day Average	8.82%	10.00%	11.28%
90-Day Average	8.80%	9.97%	11.26%
180-Day Average	8.82%	10.00%	11.29%

Constant Growth DCF - Median

	Min Growth Rate	Mean Growth Rate	Max Growth Rate
30-Day Average	8.44%	10.17%	10.74%
90-Day Average	8.41%	10.12%	10.67%
180-Day Average	8.47%	10.18%	10.68%

Q. What are your conclusions about the results of the DCF models?

A. As discussed previously, one primary assumption of the Constant Growth DCF model is a constant P/E ratio. That assumption is heavily influenced by the market price of utility stocks. Since utility stocks are expected to underperform the broader market over the near-term as interest rates increase, it is important to consider the results of the DCF models with caution.

This means that the results of the current DCF models are below where they would otherwise be under more normal market conditions. Therefore, while I have given weight to the results of the Constant Growth DCF model, my recommendation also gives weight to the results of other COE estimation models.

C. CAPM Analysis

Q. Please briefly describe the CAPM.

A. The CAPM is a risk premium approach that estimates the COE for a given security as a function of a risk-free return plus a risk premium to compensate investors for the non-diversifiable, systematic risk of that security. Systematic risk is the risk inherent in the entire market or market segment—which cannot be diversified away using a portfolio of assets. Unsystematic risk is the risk of a specific company that can, theoretically, be mitigated through portfolio diversification.

The CAPM is defined by four components, each of which must theoretically be a forward-looking estimate:

$$K_e = r_f + \beta(r_m - r_f) \quad [3]$$

Where:

K_e = the required market COE;

β = Beta coefficient of an individual security;

r_f = the risk-free rate of return; and

r_m = the required return on the market.

In this specification, the term ($r_m - r_f$) represents the market risk premium. According to the theory underlying the CAPM, because unsystematic risk can be diversified away, investors should only be concerned with systematic or non-diversifiable risk. Systematic risk

is measured by Beta. Beta is a measure of the volatility of a security as compared to the market as a whole. Beta is defined a:

$$\beta = \frac{Covariance(r_e, r_m)}{Variance(r_m)} \quad [4]$$

The variance of the market return (i.e., Variance (r_m)) is a measure of the uncertainty of the general market, and the covariance between the return on a specific security and the general market (i.e., Covariance (r_e, r_m)) reflects the extent to which the return on that security will respond to a given change in the general market return. Thus, Beta represents the risk of the security relative to the general market.

Q. What risk-free rate did you use in your CAPM analysis?

A. I relied on three sources for my estimate of the risk-free rate: (1) the current 30-day average yield on 30-year U.S. Treasury bonds, which is 3.81 percent;[43] (2) the average projected 30-year U.S. Treasury bond yield for the third quarter of 2023 through the third quarter of 2024, which is 3.78 percent;[44] and (3) the average projected 30-year U.S. Treasury bond yield for 2024 through 2028, which is 3.90 percent.[45]

Q. What Beta coefficients did you use in your CAPM analysis?

A. As shown Bulkley Direct Exhibit 4, I used the Beta coefficients for the proxy group companies as reported by Bloomberg and Value Line. The Beta coefficients reported by Bloomberg were calculated using ten years of weekly returns relative to the S&P 500 Index.

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[43] Bloomberg Professional as of March 31, 2023.

[44] Blue Chip Financial Forecasts, Vol. 42, No. 4, at 2 (March 31, 2023).

[45] Blue Chip Financial Forecasts, Vol. 41, No. 12, at 14 (December 2, 2022).

Value Line's calculation is based on five years of weekly returns relative to the New York Stock Exchange Composite Index.

Additionally, as shown in Bulkley Direct Exhibit 5, I also considered an additional CAPM analysis which relies on the long-term average utility Beta coefficient for the companies in my proxy group. As shown in Bulkley Direct Exhibit 5, the long-term average utility Beta coefficient was calculated as an average of the Value Line Beta coefficients for the companies in my proxy group from 2013 through 2022.

Q. How did you estimate the market risk premium in the CAPM?

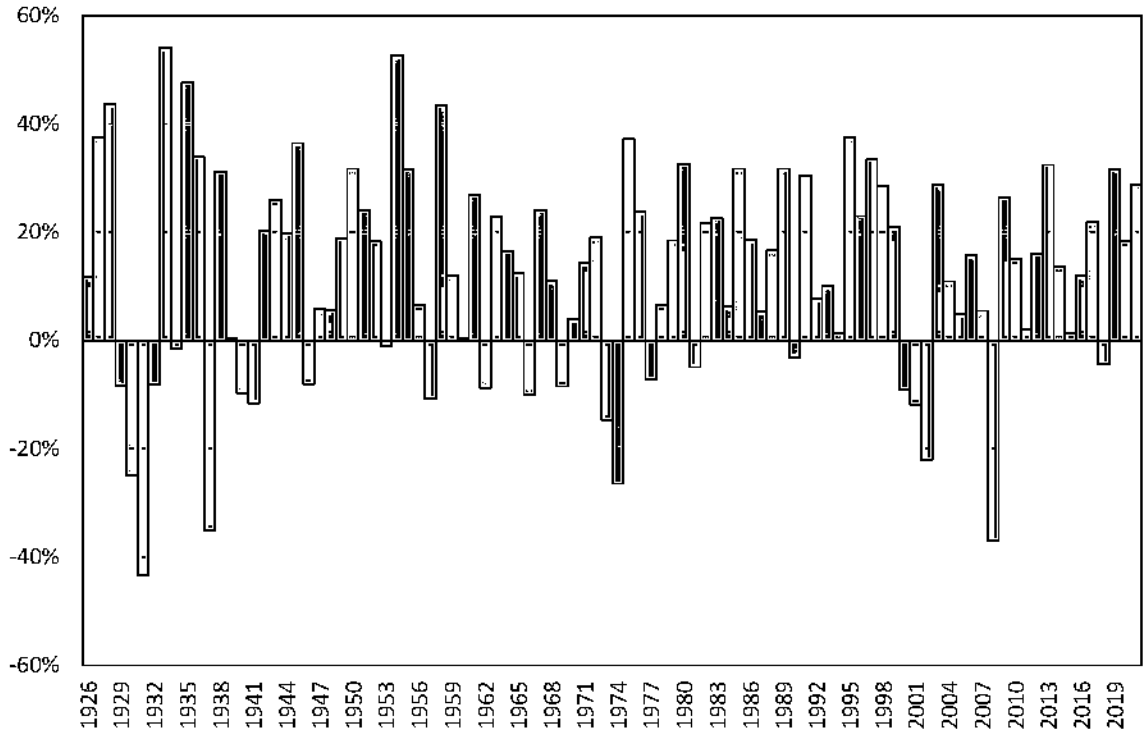
A. I estimated the Market Risk Premium ("MRP") as the difference between the implied expected equity market return and the risk-free rate. As shown in Bulkley Direct Exhibit 6, the expected return on the S&P 500 Index is calculated using the Constant Growth DCF model discussed earlier in my testimony for the companies in the S&P 500 Index. In my calculation of the market return, I included companies in the S&P 500 that: 1) had either a dividend yield or Value Line long-term earnings projections; and 2) had a Value Line long-term earnings growth rate that was greater than 0 percent and less than or equal to 20 percent. Based on an estimated market capitalization-weighted dividend yield of 1.76 percent and a weighted long-term growth rate of 10.27 percent, the estimated required market return for the S&P 500 Index is 12.12 percent.

Q. How does the current expected market return of 12.12 percent compare to observed historical market returns?

A. Given the range of annual equity returns that have been observed over the past century (shown in Figure 7), a current expected return of 12.12 percent is not unreasonable. In 50

out of the past 96 years (or roughly 52 percent of observations), the realized equity return was at least 12.12 percent or greater.

Figure 7: Realized U.S. equity market returns (1926-2022) [46]



Q. Did you consider another form of the CAPM in your analysis?

A. Yes. I have also considered the results of an ECAPM or alternatively referred to as the Zero-Beta CAPM[47] in estimating the COE for MidAmerican. The ECAPM calculates the product of the adjusted Beta coefficient and the market risk premium and applies a weight of 75.00 percent to that result. The model then applies a 25.00 percent weight to the market risk premium, without any effect from the Beta coefficient. The results of the two calculations

[46] Depicts total annual returns on large company stocks, as reported in the 2022 *Kroll* SBBI Yearbook.

[47] *See* Roger A. Morin, New Regulatory Finance at 189, Public Utilities Reports, Inc. (2006).

are summed, along with the risk-free rate, to produce the ECAPM result, as noted in Equation [5] below:

$$k_e = r_f + 0.75\beta(r_m - r_f) + 0.25(r_m - r_f) \qquad [5]$$

Where:

k_e – the required market COE;

β – Adjusted Beta coefficient of an individual security;

rf – the risk-free rate of return; and

r_m = the required return on the market as a whole.

In essence, the Empirical form of the CAPM addresses the tendency of the "traditional" CAPM to underestimate the cost of equity for companies with low Beta coefficients such as regulated utilities. In that regard, the ECAPM is not redundant to the use of adjusted Betas; rather, it recognizes the results of academic research indicating that the risk-return relationship is different (in essence, flatter) than estimated by the CAPM, and that the CAPM underestimates the "alpha," or the constant return term.[48]

As with the CAPM, my application of the ECAPM uses the forward-looking market risk premium estimates, the three yields on 30-year Treasury securities noted earlier as the risk-free rate, and the Bloomberg, Value Line, and long-term average Beta coefficients.

Q. What are the results of your CAPM analyses?

A. As shown in Figure 8 (see also Bulkley Direct Exhibit 4), my traditional CAPM analysis produces a range of returns from 9.85 percent to 10.81 percent. The ECAPM analysis results range from 10.41 percent to 11.13 percent.

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[48] *Id.*, at 191.

Figure 8: CAPM and ECAPM Results

	Current Risk-Free Rate (3.81%)	Q1 2023 – Q1 2024 Projected Risk-Free Rate (3.78%)	2024-2028 Projected Risk-Free Rate (3.90%)
		CAPM	
Value Line Beta	10.79%	10.79%	10.81%
Bloomberg Beta	10.17%	10.16%	10.19%
Long-term Avg. Beta	9.85%	9.85%	9.88%
		ECAPM	
Value Line Beta	11.12%	11.12%	11.13%
Bloomberg Beta	10.66%	10.65%	10.67%
Long-term Avg. Beta	10.42%	10.41%	10.44%

D. Bond Yield Plus Risk Premium Analysis

Q. Please describe the Bond Yield Plus Risk Premium approach.

A. In general terms, this approach is based on the fundamental principle that equity investors bear the residual risk associated with equity ownership and therefore require a premium over the return they would have earned as a bondholder. That is, because returns to equity holders have greater risk than returns to bondholders, equity investors must be compensated to bear that risk. Risk premium approaches, therefore, estimate the COE as the sum of the equity risk premium and the yield on a particular class of bonds. In my analysis, I used actual authorized returns for natural gas distribution companies as the historical measure of the COE to determine the risk premium.

Q. Are there other considerations that should be addressed in conducting this analysis?

A. Yes, there are. It is important to recognize both academic literature and market evidence indicate that the equity risk premium (as used in this approach) is inversely related to the level of interest rates. That is, as interest rates increase, the equity risk premium decreases, and vice versa. Consequently, it is important to develop an analysis that: (1) reflects the inverse relationship between interest rates and the equity risk premium; and (2) relies on recent and expected market conditions. Such an analysis can be developed based on a regression of the risk premium as a function of U.S. Treasury bond yields. If we let authorized ROEs for natural gas utilities serve as the measure of required equity returns and define the yield on the long-term U.S. Treasury bond as the relevant measure of interest rates, the risk premium simply would be the difference between those two points.[49]

Q. Is the Bond Yield Plus Risk Premium analysis relevant to investors?

A. Yes, it is. Investors are aware of ROE awards in other jurisdictions, and they consider those awards as a benchmark for a reasonable level of equity returns for utilities of comparable risk operating in other jurisdictions. Because my Bond Yield Plus Risk Premium analysis is based on authorized ROEs for utility companies relative to corresponding Treasury yields, it provides relevant information to assess the return expectations of investors in the current interest rate environment.

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[49] *See* S. Keith Berry, Interest Rate Risk and Utility Risk Premia during 1982-93, Managerial and Decision Economics, Vol. 19, No. 2 (March, 1998), in which the author used a methodology similar to the regression approach described below, including using allowed ROEs as the relevant data source, and came to similar conclusions regarding the inverse relationship between risk premia and interest rates. *See also* Robert S. Harris, Using Analysts' Growth Forecasts to Estimate Shareholders Required Rates of Return at 66, Financial Management (Spring 1986).

Q. What did your Bond Yield Plus Risk Premium analysis reveal?

A. As shown in Figure 9 below, from 1992 through February 2023, there was a strong negative relationship between risk premia and interest rates. To estimate that relationship, I conducted a regression analysis using the following equation:

$$RP = a + b(T) \text{ [6]}$$

Where:

RP = Risk Premium (difference between allowed ROEs and the yield on 30-year U.S. Treasury bonds)

a = intercept term

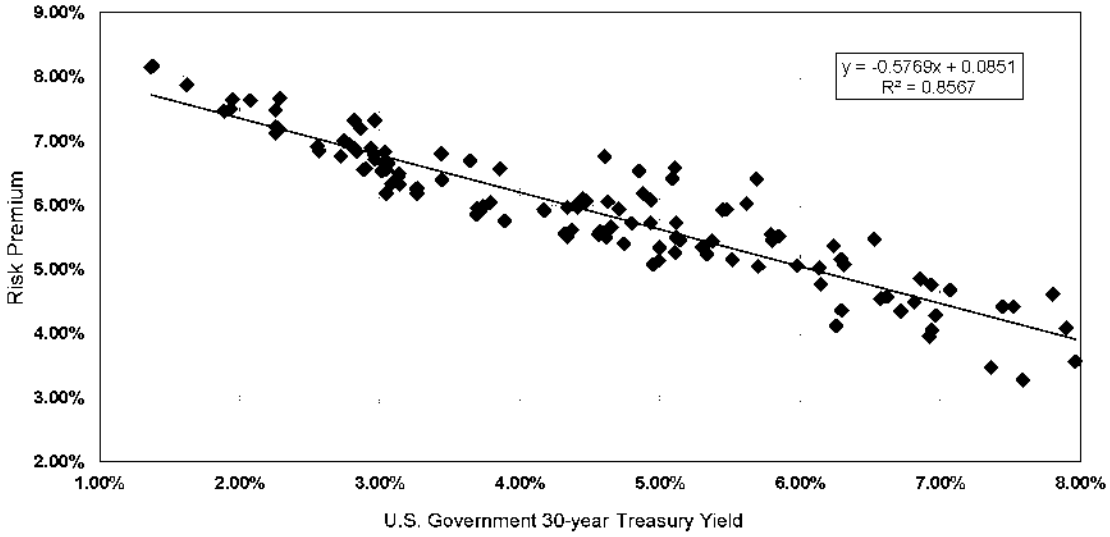
b = slope term

T = 30-year U.S. Treasury bond yield

Data regarding allowed ROEs were derived from all of natural gas distribution rate cases from 1992 through February 2023 as reported by Regulatory Research Associates ("RRA").[50] This equation's coefficients were statistically significant at the 99.00 percent level.

[50] This analysis began with a total of 1,192 cases and was screened to eliminate limited issue rider cases, transmission-only cases, and cases that were silent with respect to the authorized ROE. After applying those screening criteria, the analysis was based on data for 742 cases.

Figure 9: Risk Premium Results



As shown in Bulkley Direct Confidential Exhibit 7, based on the current 30-day average of the 30-year U.S. Treasury bond yield (i.e., 3.81 percent), the risk premium would be 6.31 percent, resulting in an estimated ROE of 10.12 percent. Based on the near-term (Q3 2023 – Q3 2024) projections of the 30-year U.S. Treasury bond yield (i.e., 3.78 percent), the risk premium would be 6.32 percent, resulting in an estimated ROE of 10.10 percent. Based on longer-term (2024 – 2028) projections of the 30-year U.S. Treasury bond yield (i.e., 3.90 percent), the risk premium would be 6.26 percent, resulting in an estimated ROE of 10.16 percent.

Q. How did the results of the Bond Yield Risk Premium inform your recommended ROE for MidAmerican?

A. I have considered the results of the Bond Yield Risk Premium analysis in setting my recommended ROE for MidAmerican's natural gas distribution operations in Iowa. As noted above, investors consider the ROE award of a company when assessing the risk of that company as compared to utilities of comparable risk operating in other jurisdictions. The

Risk Premium analysis considers this comparison by estimating the return expectations of investors based on the current and past ROE awards of natural gas distribution companies across the U.S.

VII. REGULATORY AND BUSINESS RISKS

Q. Do the DCF, CAPM and ECAPM results for the proxy group, taken alone, provide an appropriate estimate of the COE for the Company?

A. No. These results provide only a range of the appropriate estimate of the Company's COE. Several additional factors must also be considered with respect to their overall effect on the Company's risk profile relative to the proxy group when determining where the COE falls within the range of results.

A. Small Size

Q. Please explain the risk associated with small size.

A. Both the financial and academic communities have long accepted the proposition that the COE for small firms is subject to a "size effect." While empirical evidence of the size effect often is based on studies of industries other than regulated utilities, utility analysts also have noted the risk associated with small market capitalizations. Specifically, an analyst for Ibbotson Associates noted:

> For small utilities, investors face additional obstacles, such as a smaller customer base, limited financial resources, and a lack of diversification

across customers, energy sources, and geography. These obstacles imply a higher investor return.[51]

Q. How does the smaller size of a utility affect its business risk?

A. In general, smaller companies are less able to withstand adverse events that affect their revenues and expenses. The impact of weather variability, the loss of large customers to bypass opportunities, or the destruction of demand as a result of general macroeconomic conditions or fuel price volatility will have a proportionately greater impact on the earnings and cash flow volatility of smaller utilities. Similarly, capital expenditures for non-revenue producing investments, such as system maintenance and replacements, will put proportionately greater pressure on customer costs, potentially leading to customer attrition or demand reduction. Taken together, these risks affect the return required by investors for smaller companies.

Q. How do MidAmerican's Iowa natural gas operations compare in size to the proxy group companies?

A. MidAmerican's natural gas operations in Iowa are substantially smaller than the median for the proxy group companies in terms of market capitalization. Bulkley Direct Confidential Exhibit 10 provides the actual market capitalization for the proxy group companies and estimates the implied market capitalization for MidAmerican's Iowa natural gas operations (*i.e.*, the implied market capitalization if MidAmerican's natural gas operations in Iowa were a stand-alone publicly traded entity). To estimate the size of the Company's market capitalization relative to the proxy group, I used the Company's 2022 Iowa Jurisdictional

[51] Michael Annin, Equity and the Small-Stock Effect, Public Utilities Fortnightly, October 15, 1995.

Rate Base per books of $760.53 million.[52] I then applied the median market-to-book ratio for the proxy group of 1.63 to the implied common equity balance of MidAmerican's natural gas operations in Iowa and arrived at an implied market capitalization of approximately $683.79 million, or 15.47 percent of the median market capitalization for the proxy group.

Q. How did you estimate the size premium for MidAmerican?

A. Given this relative size information, it is possible to estimate the impact of size on the COE for MidAmerican's Iowa natural gas operations using *Kroll* Cost of Capital Navigator data that estimates the stock risk premia based on the size of a company's market capitalization.[53] As shown in Bulkley Direct Confidential Exhibit 10, the median market capitalization of the proxy group of approximately $4.42 billion corresponds to the fourth decile of *Kroll's* market capitalization data.[54] Based on *Kroll's* analysis, that decile corresponds to a size premium of 0.58 percent (*i.e.*, 58 basis points). The implied market capitalization of MidAmerican's Iowa natural gas operations of approximately $683.79 million falls within the eighth decile, which comprises market capitalization levels up to $782.38 million and corresponds to a size premium of 1.18 percent (*i.e.*, 118 basis points). The difference between those size premia is 60 basis points (*i.e.*, 1.18 percent minus 0.58 percent).

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[52] Company provided data at Rooney Direct Exhibit 1, Schedule A.

[53] *Kroll* Cost of Capital Navigator – Size Premium, Annual Data as of December 31, 2022.

[54] *Ibid.*

Q. Were utility companies included in the size premium study conducted by *Kroll*?

A. Yes. In fact, as shown in Exhibit 7.2 of *Kroll's* 2019 Valuation Handbook, OGE Energy Corp. had the largest market capitalization of the companies contained in the fourth decile.[55] Therefore, *Kroll* did include utility companies in its size risk premium study.

Q. Is the size premium applicable to companies in regulated industries such as natural gas utilities?

A. Yes, it is. For example, Thomas Zepp in his article "Utility stocks and the size effect – revisited" provided the results of two studies which showed evidence of the required risk premium for small water utilities. The first study conducted by Staff of the California Public Utilities Commission ("CPUC Staff") computed proxies for Beta risk using accounting data from 1981 through 1991 for 58 water utilities and concluded that smaller water utilities had greater risk and required higher returns on equity than larger water utilities.[56] The second study referenced by Zepp examined the differences in required returns over the period of 1987-1997 for two large and two small water utilities in California. As Zepp showed, the required return for the two small water utilities calculated using the DCF model was on average 99 basis points higher than the two larger water utilities.[57]

Additionally, Stéphane Chrétien and Frank Coggins in the article "Cost of Equity for Energy Utilities: Beyond the CAPM,"[58] recently studied the CAPM and its ability to

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[55] Duff &Phelps, Valuation Handbook: Guide to Cost of Capital, 2019, Exhibit 7.2.

[56] Zepp, Thomas M. "Utility Stocks and the Size Effect—Revisited." *The Quarterly Review of Economics and Finance*, vol. 43, no. 3, 2003, pp. 578–582., doi:10.1016/s1062-9769(02)00172-2.

[57] Ibid.

[58] Chrétien, Stéphane, and Frank Coggins. "Cost Of Equity For Energy Utilities: Beyond The CAPM." Energy Studies Review, vol. 18, no. 2, 2011, doi:10.15173/esr.v18i2.531.

estimate the risk premium for the utility industry in particular subgroups of utilities. One of the subgroups was a group of natural gas distribution companies that contained many of the same natural gas distribution companies included in my proxy group.[59] The article considered the CAPM, the Fama-French three-factor model and a model similar to the ECAPM that I have also considered above. In the article, the Fama-French three-factor model explicitly included an adjustment to the CAPM for risk associated with size. As Chrétien and Coggins show the Beta coefficient on the size variable for the U.S. natural gas utility group was positive and statistically significant indicating that small size risk was relevant for regulated natural gas utilities.[60] These two studies demonstrate that the size premium is evident in market data and is clearly applicable to natural gas and water utilities.

Q. Have regulators in other jurisdictions made a specific risk adjustment to the COE results based on a company's small size?

A. Yes. In Order No. 15, the Regulatory Commission of Alaska ("RCA") concluded that Alaska Electric Light and Power Company ("AEL&P") was riskier than the proxy group companies due to small size as well as other business risks. The RCA did "not believe that adopting the upper end of the range of ROE analyses in this case, without an explicit adjustment, would adequately compensate AEL&P for its greater risk."[61] Thus, the RCA awarded AEL&P an ROE of 12.875 percent which was 108 basis points above the highest COE estimate from

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[59] The U.S. natural gas utility group included: AGL Resources Inc., Atmos Energy Corp., Laclede Group, New Jersey Resources Corp., Northwest Natural Gas Co., Piedmont Natural Gas Co., South Jersey Industries, Southwest Gas Corp. and WGL Holdings Inc.

[60] Chrétien, Stéphane, and Frank Coggins. "Cost of Equity For Energy Utilities: Beyond The CAPM." Energy Studies Review, vol. 18, no. 2, 2011, doi:10.15173/esr.v18i2.531.

[61] Docket No. U-10-29, In the Matter of the Revenue Requirement and Cost of Service Study Designated as TA381-1 Filed by Alaska Electric Light and Power Company, Order entered September 2, 2011 (Order No. 15) at 37.

any model presented in the case.[62] Similarly, in Order No. 19, the RCA noted that small size as well as other business risks such as structural regulatory lag, weather risk, alternative rate mechanisms, gas supply risk, geographic isolation and economic conditions increased the risk of ENSTAR Natural Gas Company.[63] Ultimately, the RCA concluded that:

> Although we agree that the risk factors identified by ENSTAR increase its risk, we do not attempt to quantify the amount of that increase. Rather, we take the factors into consideration when evaluating the remainder of the record and the recommendations presented by the parties. After applying our reasoned judgment to the record, we find that 11.875% represents a fair ROE for ENSTAR.[64]

Additionally, in Docket No. E017/GR-15-1033 for Otter Tail Power Company ("Otter Tail"), the Minnesota Public Utilities Commission ("Minnesota PUC") selected an ROE above the mean DCF results, as a result of multiple factors including Otter Tail's small size. The Minnesota PUC stated:

> The record in this case establishes a compelling basis for selecting an ROE above the mean average within the DCF range, given Otter Tail's unique characteristics and circumstances relative to other utilities in the proxy group. These factors include the company's relatively smaller size,

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62 *Id.*, at 32 and 37.

63 Docket No. U-16-066, In the Matter of the Tariff Revision Designated as TA285-4 Filed by ENSTAR Natural Gas Company, A Division of Semco Energy, Inc., Order entered September 22, 2017 (Order No. 19) at 50-52.

64 Ibid.

geographically diffuse customer base, and the scope of the Company's planned infrastructure investments.[65]

Finally, in Opinion No. 569 and 569-A, FERC has relied on a size premium adjustment in its CAPM estimates for electric utilities. In those decisions, FERC noted that "the size adjustment was necessary to correct for the CAPM's inability to fully account for the impact of firm size when determining the cost of equity."[66,67]

Q. How have you considered the smaller size of MidAmerican's Iowa natural gas distribution operations in your recommended ROE?

A. While I have estimated the effect of the size of MidAmerican's Iowa natural gas distribution operations on the COE, I am not proposing a specific adjustment for this risk factor. Rather, I believe it is important to consider the small size of MidAmerican's Iowa natural gas distribution operations in the determination of where, within the range of analytical results, the Company's required COE falls. Therefore, the additional risk associated with small size indicates that the Company's ROE should be established above the mean and median results for the proxy group companies.

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[65] Order in Docket No. E017/GR-15-1033, In the Matter of the Application of Otter Tail Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota (August 16, 2016) at 55.

[66] Federal Energy Regulatory Commission, Opinion No. 569-A, May 21, 2020, at para 75.

[67] The U.S. Court of Appeals recently vacated the FERC Order 569 decisions that related to its risk premium model and remanded the case to FERC to reopen proceedings. However, in that decision, the Court did not reject FERC's inclusion of the size premium to estimate the CAPM. United States Court of Appeals Case No. 16-1325, Decision No. 16-1325, August 9, 2022 at 20.

B. Capital Expenditures

Q. Please summarize the capital expenditure requirements for MidAmerican's natural gas distribution operations in Iowa.

A. The Company's current projections for 2023 through 2027 include at least $529.60 million in capital investments for the period.[68] Based on the Company's net utility plant of approximately $953.80 million as of December 31, 2022,[69] the projected capital expenditures are approximately 55.57 percent of MidAmerican's Iowa-jurisdiction net utility plant as of December 31, 2022.

Q. How is the Company's risk profile affected by their substantial capital expenditure requirements?

A. As with any utility faced with substantial capital expenditure requirements, the Company's risk profile may be adversely affected in two significant and related ways: (1) the heightened level of investment increases the risk of under-recovery or delayed recovery of the invested capital, particularly since the Company does not have any mechanism to provide for recovery of equity costs or capital investments other than those to replace or modify infrastructure to meet state or federal natural gas pipeline safety regulations between rate cases; and (2) an inadequate return would put downward pressure on key credit metrics.

[68] Company provided data.

[69] Company provided data.

Q. Do credit rating agencies recognize the risks associated with elevated levels of capital expenditures?

A. Yes, they do. From a credit perspective, the additional pressure on cash flows associated with high levels of capital expenditures exerts corresponding pressure on credit metrics and, therefore, credit ratings. To that point, S&P explains the importance of regulatory support for large capital projects:

> When applicable, a jurisdiction's willingness to support large capital projects with cash during construction is an important aspect of our analysis. This is especially true when the project represents a major addition to rate base and entails long lead times and technological risks that make it susceptible to construction delays. Broad support for all capital spending is the most credit-sustaining. Support for only specific types of capital spending, such as specific environmental projects or system integrity plans, is less so, but still favorable for creditors. Allowance of a cash return on construction work-in-progress or similar ratemaking methods historically were extraordinary measures for use in unusual circumstances, but when construction costs are rising, cash flow support could be crucial to maintain credit quality through the spending program. Even more favorable are those jurisdictions that present an opportunity for a higher return on capital projects as an incentive to investors.[70]

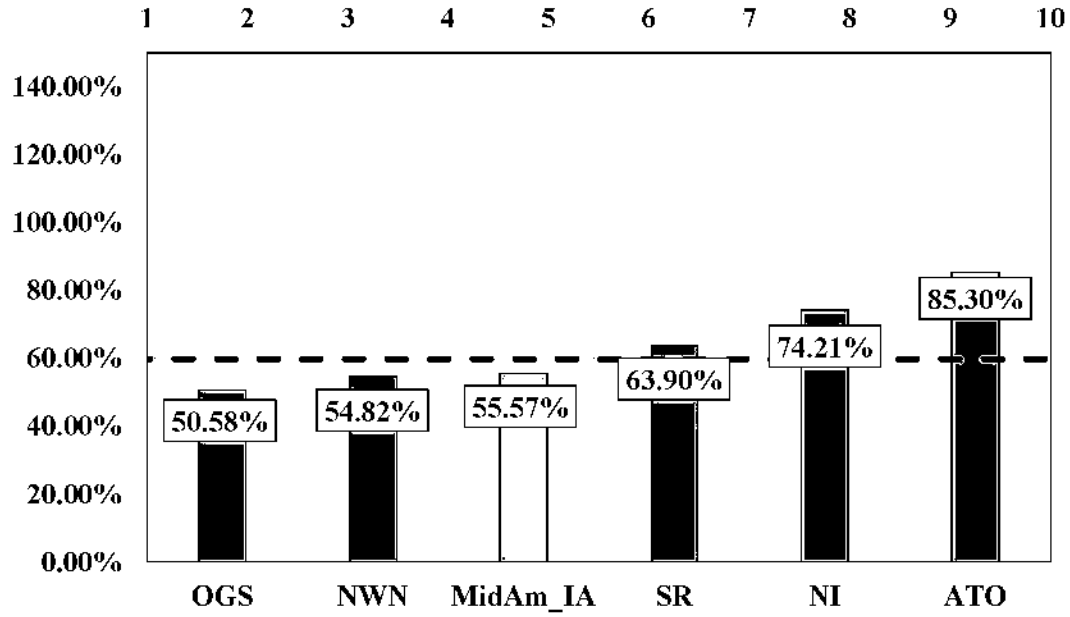
[70] S&P Global Ratings, "Assessing U.S. Investor-Owned Utility Regulatory Environments," August 10, 2016, at 7.

Therefore, to the extent that MidAmerican's Iowa rates do not permit the opportunity to earn an appropriate equity return and recover its capital investments on a regular and timely basis, the Company will face increased recovery risk and thus increased pressure on its credit metrics.

Q. How do MidAmerican's capital expenditure requirements in Iowa compare to those of the proxy group companies?

A. As shown in Bulkley Direct Confidential Exhibit 7, I calculated the ratio of expected capital expenditures to net utility plant for MidAmerican's natural gas distribution operations in Iowa and each of the companies in the proxy group by dividing each company's projected capital expenditures for the period from 2023-2027 by its total net utility plant as of December 31, 2022. As shown in Bulkley Direct Exhibit 8 (see also Figure 10 below), the Company's ratio of capital expenditures as a percentage of net utility plant is 55.57 percent, which is similar to the median for the proxy group companies of 59.74 percent.

Figure 10: Comparison of Capital Expenditures



Q. Does the Company have a capital tracking mechanism to recover the costs associated with its capital expenditures plan between rate cases?

A. Not entirely. MidAmerican has a capital infrastructure investment adjustment mechanism available in Iowa, known as the Capital Investment Charge ("CIC"). The CIC provides for the ability to recover certain capital infrastructure investment between rate cases if the investment meets the criteria that it (1) does not serve to increase revenues; (2) is in service; (3) replaces or modifies existing infrastructure required by state or local government action, to meet state or federal natural gas pipeline safety regulations; or (4) otherwise enhance safety as approved in advance by the Board. It is my understanding that this mechanism is limited in several important respects: (1) the mechanism provides only for recovery of debt and depreciation, not a return on equity on the new qualifying investments between rate proceedings; (2) the debt costs that are recovered are not based on the actual incurred cost of debt, but rather are based on the embedded cost of debt as determined in the Company's last rate proceeding; (3) the depreciation expense shall be based upon the depreciation rates approved in the Company's last rate proceeding, not current depreciation rates; and (4) the scope of the mechanism is limited to non-revenue producing investments and excludes all IT related and facility costs. Further, there are a limited number of filings that can be made through this mechanism between rate proceedings.

Q. Does the Company invest in capital that cannot be recovered through the Rider CIC?

A. Yes. When a community expands and requests new service, MidAmerican will request a 10-year refundable contribution in aid of construction ("CIAC") equal to the estimated construction cost for the new distribution main extension less three times estimated base revenue to be produced by the customer thereby offsetting the cost of the infrastructure.

However, CIAC cannot be requested for the first 100 feet of service lines from the distribution main to the customer's connection and cannot be recovered through the CIC. It is my understanding that the service line investments made to connect new customers to the system have not produced sufficient revenue to recover the cost of the investments. Therefore, between rate cases, these investments reduce the Company's ability to earn its return. Further, all costs related to facility improvements, and required relocations, that provides for efficient, low-maintenance, low-cost functionality while supporting an enhanced employee work environment is not recoverable through the Rider CIC. Finally, costs related to customer service and information technology which helps improve the customer experience such as the replacement of failing gas Encoder Receiver Transmitters discussed in Witness Hoogwerf's testimony, as well as other software or computer system improvements, are not eligible to be recovered through the Rider CIC.

Q. Are capital investment recovery mechanisms common amongst natural gas distribution utilities?

A. Yes. As shown in Bulkley Direct Confidential Exhibit 9, 18 out of 25 (or approximately 72 percent) of the operating companies of the proxy group recover costs through capital investment reconciling mechanisms. Therefore, the Company has significantly greater risk relative to the proxy group from the regulatory lag associated with the recovery of its capital expenditures plan.

Q. What are your conclusions regarding the effect of the Company's capital spending requirements on its risk profile and COE?

A. The Company's capital expenditure requirements as a percentage of net utility plant are significant and will continue over the next few years. Additionally, unlike a number of the

operating subsidiaries of the proxy group, MidAmerican does not have a comprehensive capital tracking mechanism in Iowa to recover the Company's projected capital expenditures. Therefore, MidAmerican's significant capital expenditures plan and limited ability to recover the full capital investment on an as incurred basis in Iowa results in a risk profile that is greater than that of the proxy group and supports an ROE toward the higher end of the reasonable range of ROEs.

C. Regulatory Risk

Q. How does the regulatory environment affect investors' risk assessments?

A. The ratemaking process is premised on the principle that, for investors and companies to commit the capital needed to provide safe and reliable utility service, the subject utility must have the opportunity to recover the return of, and the market-required return on, invested capital. Regulatory authorities recognize that because utility operations are capital intensive, regulatory decisions should enable the utility to attract capital at reasonable terms; doing so balances the long-term interests of investors and customers. To achieve this balance, the Company must be able to finance its operations assuming a reasonable opportunity to earn an appropriate return on invested capital to maintain an acceptable financial profile. In that respect, the regulatory environment is one of the most important factors considered in both debt and equity investors' risk assessments.

From the perspective of debt investors, the authorized return should enable the Company to generate the cash flow needed to meet its near-term financial obligations, make the capital investments needed to maintain and expand its systems, and maintain the necessary levels of liquidity to fund unexpected events. This financial liquidity must be derived not only from internally generated funds, but also by efficient access to capital markets. Moreover,

because fixed income investors have many investment alternatives, even within a given market sector, the Company's financial profile must be adequate on a relative basis to ensure its ability to attract capital under a variety of economic and financial market conditions.

Equity investors, on the other hand, require that the authorized return be adequate to provide a risk-comparable return on the equity portion of the Company's capital investments. Because equity investors are the residual claimants on the Company's cash flows (which is to say that the equity return is subordinate to interest payments for debt investors), they are particularly concerned with the strength of regulatory support and its effect on future returns.

Q. How do credit rating agencies consider regulatory risk in establishing a company's credit rating?

A. Both S&P and Moody's consider the overall regulatory framework in establishing credit ratings. Moody's establishes credit ratings based on four key factors: (1) regulatory framework; (2) the ability to recover costs and earn returns; (3) diversification; and (4) financial strength, liquidity and key financial metrics. Of these criteria, regulatory framework, and the ability to recover costs and earn returns are each given a broad rating factor of 25.00 percent. Therefore, Moody's assigns regulatory risk a 50.00 percent weighting in the overall assessment of business and financial risk for regulated utilities.[71]

S&P also identifies the regulatory framework as an important factor in credit ratings for regulated utilities, stating: "One significant aspect of regulatory risk that influences credit

[71] Moody's Investors Service, Rating Methodology: Regulated Electric and Gas Utilities, June 23, 2017, at 4.

quality is the regulatory environment in the jurisdictions in which a utility operates."[72] S&P identifies four specific factors that it uses to assess the credit implications of the regulatory jurisdictions of investor-owned regulated utilities: (1) regulatory stability; (2) tariff-setting procedures and design; (3) financial stability; and (4) regulatory independence and insulation.[73]

Q. How does the regulatory environment in which a utility operates affect its access to and cost of capital?

A. The regulatory environment can significantly affect both the access to, and cost of capital in several ways. First, the proportion and cost of debt capital available to utility companies are influenced by the rating agencies' assessment of the regulatory environment. As noted by Moody's, "[f]or rate regulated utilities, which typically operate as a monopoly, the regulatory environment and how the utility adapts to that environment are the most important credit considerations."[74] Moody's further highlighted the relevance of a stable and predictable regulatory environment to a utility's credit quality, noting: "[b]roadly speaking, the Regulatory Framework is the foundation for how all the decisions that affect utilities are made (including the setting of rates), as well as the predictability and consistency of decision-making provided by that foundation."[75]

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[72] Standard & Poor's Global Ratings, Ratings Direct, U.S. and Canadian Regulatory Jurisdictions Support Utilities' Credit Quality—But Some More So Than Others, June 25, 2018, at 2.

[73] *Id.*, at 1.

[74] Moody's Investors Service, Rating Methodology: Regulated Electric and Gas Utilities, June 23, 2017, at 6.

[75] *Id.*

Q. Have you conducted any analysis of the regulatory framework in Iowa relative to the jurisdictions in which the companies in your proxy group operate?

A. Yes. I have evaluated the regulatory framework in Iowa considering the cost recovery mechanisms which are important to ensuring MidAmerican maintains access to capital at reasonable terms. As I will discuss in more detail below, the cost recovery mechanisms allow a utility to recover costs in a timely manner between rate cases and provide the utility the opportunity to earn its authorized return.

1. Cost Recovery Mechanisms

Q. Have you conducted any analysis to compare the cost recovery mechanisms of MidAmerican's Iowa natural gas operations to the cost recovery mechanisms approved in the jurisdictions in which the companies in your proxy group operate?

A. Yes. I selected three mechanisms that are important to provide a regulated utility an opportunity to earn its authorized ROE. These are: (1) test year convention (*i.e.*, forecast vs. historical test year); (2) use of revenue decoupling mechanisms or other clauses that mitigate volumetric risk; and (3) prevalence of capital cost recovery between rate cases. The results of my regulatory risk assessment are summarized as follows, and the details are shown in Bulkley Direct Confidential Exhibit 9:

Test Year Convention: MidAmerican is relying on a historical test year for the period ending December 31, 2022 in Iowa. Similarly, 52 percent of the operating companies held by the proxy group provide service in jurisdictions that use a historical test year.

Volumetric Risk: The Company does not have protection against volumetric risk in Iowa, either through a revenue decoupling mechanism or a weather

normalization adjustment clause. By comparison, 88 percent of the operating companies in the proxy group have some form of protection against volumetric risk.

Capital Cost Recovery: The Company does not have a comprehensive capital tracking mechanism to recover capital investment costs between rate cases. By comparison, 72 percent of the operating companies in the proxy group have some form of capital cost recovery mechanism in place.

2. Earned ROE

Q. Is there evidence that MidAmerican's natural gas distribution operations in Iowa has been unable to earn its authorized return on equity?

A. Yes, as shown in Figure 11, MidAmerican's natural gas distribution operations in Iowa has persistently under-earned its authorized ROE. Over the period of last three years, the Company's average earned ROE was 7.77 percent as compared with the average authorized ROE of 10.75 percent, for an average under-earning of 298 basis points per year. This under-earning is due in part to significant increases in rate base as a result of significant capital investment in the safety and reliability of the natural gas distribution operations and the regulatory environment in Iowa where a limited number of adjustment mechanisms have historically been available to utilities. As discussed above, the Company does not have a comprehensive capital tracking mechanism to recover the full amount of capital investment costs between rate cases, which contributes to the inability to earn the currently authorized ROE. The prior under earning and the near-term effect of inflation, highlights the importance of a constructive outcome in the current proceeding so that MidAmerican has the opportunity to earn its authorized ROE in Iowa.

Figure 11: Earned vs. Authorized ROE (2020-2022)

	Earned ROE	Authorized ROE	Earnings differential (bps)
2020	9.10%	10.75%	(165)
2021	7.50%	10.75%	(325)
2022	6.70%	10.75%	(405)
Average	**7.77%**	**10.75%**	**(298)**

VIII. CAPITAL STRUCTURE

Q. Is the capital structure of a company an important consideration in the determination of the appropriate ROE?

A. Yes, it is. Assuming other factors equal, a higher debt ratio increases the risk to investors. For debt holders, higher debt ratios result in a greater portion of the available cash flow being required to meet debt service, thereby increasing the risk associated with the payments on debt. The result of increased risk is a higher interest rate. The incremental risk of a higher debt ratio is more significant for common equity shareholders. Common shareholders are the residual claimants on the cash flow of a company. Therefore, the greater the debt service requirement, the less cash flow available for common equity holders.

Q. What is MidAmerican's proposed capital structure?

A. MidAmerican is proposing to establish a capital structure consisting of 55.00 percent common equity and 45.00 percent long-term debt.

Q. Did you conduct any analysis to determine if this requested equity ratio was reasonable?

A. Yes. I reviewed the Company's proposed capital structure relative to the actual capital structures of the utility operating subsidiaries of the companies in the proxy group. Since the

ROE is set based on the return that is derived from the risk-comparable proxy group, it is reasonable to look to the average capital structure for the proxy groups to benchmark the equity ratios for the Company.

Q. Please discuss your analysis of the capital structures of the proxy group companies.

A. Specifically, I calculated the mean proportions of common equity and long-term debt over the past three years for each of companies in the proxy group at the operating subsidiary level. Bulkley Direct Confidential Exhibit 11 summarizes the actual capital structures of the operating subsidiaries. As shown, the three-year average equity ratios for the operating subsidiaries of the proxy group range from 48.73 percent to 61.47 percent, with a mean of 56.39 percent. MidAmerican's proposed equity ratio of 55.00 percent is within the range established by the capital structures of the utility operating subsidiaries of the proxy group.

Q. Are there other factors to be considered in setting the Company's capital structure?

A. Yes. The effect of both the Tax Cuts and Jobs Act of 2017 ("TCJA") and the Inflation Reduction Act ("IRA") must also be considered when determining the equity ratio. All three rating agencies have noted that the TCJA has negative implications for utility cash flows. S&P and Fitch specifically identified increasing the equity ratio as one approach to ensure that utilities have sufficient cash flows following the federal income tax rate reductions and the loss of bonus depreciation. As S&P noted "[r]egulators must also recognize that tax reform is a strain on utility credit quality, and we expect companies to request stronger

capital structures and other means to offset some of the negative impact."[76] Furthermore, Moody's downgraded the rating outlook for the entire utilities sector in June 2018 and downgraded the ratings of numerous utilities based in part on the negative effects of the TCJA on cash flows.

Most recently, Moody's revised its 2023 outlook for the utilities sector to "negative" based on ongoing challenges of inflation, increasing interest rates and higher natural gas prices. Moody's noted that these challenges increase the pressure on customer affordability and the ability of utilities to promptly recover their costs. Moody's concluded that regulated utilities' financial metrics are already under pressure with little cushion, and that sustained capital spending is likely as utilities continue.[77]

S&P also continues to maintain a negative outlook for the utility industry in 2022[78] and noted that since downgrades outpaced upgrades for a second consecutive year in 2021 for the first time ever the median investor-owned utility credit rating fell to the "BBB" category.[79] Further, S&P expects continued pressure on cash flows over the near-term recognizing that natural gas utilities have significant planned capital investment to replace mature gas distribution infrastructure to address safety concerns.[80] Finally, S&P also highlighted inflation, higher interest rates and rising commodity prices as additional risks

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[76] Standard & Poor's Ratings, "U.S. Tax Reform: For Utilities' Credit Quality, Challenges Abound," January 24, 2018, at 5.

[77] *See, e.g.*, Walton, Robert, "Moody's adopts negative outlook for regulated utility sector, warns on gas prices, economy and cost recovery," Utility Dive, November 11, 2022; Bennett, Abbie, "Moody's revises US regulated utilities outlook to negative," S&P Capital IQ Pro, November 11, 2022.

[78] S&P Global Ratings, "Regulated Utilities: Credit quality has weakened and credit risks are rising," July 14, 2022.

[79] S&P Global Ratings, "For the First Time Ever, the Median Investor-Owned Utility Ratings Falls to the 'BBB' Category," January 20, 2022.

[80] S&P Global Market Intelligence, The Big Picture 2023 Electric, Natural Gas and Water Utilities Outlook, October 2022, p. 9.

that could further constrain the credit metrics for utilities over the near-term. In regards to inflation S&P noted:

> Inflation recently spiked to its highest level in decades after rising for several consecutive months in 2021. Given the sustained increase to the U.S. consumer price index in 2021, inflation no longer appears to be just transitory and may have financial implications for the investor-owned North American regulated utility industry. Because of the regulatory lag within the industry, inflation, which causes prices to rise, typically leads to a weakening of financial performance. The regulatory lag is the timing difference between when costs are incurred and when regulators allow those costs to be fully recovered from ratepayers.[81]

The credit ratings agencies' continued concerns over the negative effects of inflation, and increased capital expenditures underscore the importance of maintaining adequate cash flow metrics for the industry, as a whole, and MidAmerican natural gas operations in Iowa, particularly, in the context of this proceeding.

The IRA may reduce the demand for natural gas domestically, as electric generation moves towards renewable resources like wind, solar and battery storage and away from natural gas peaking facilities, creating increasing pressure on natural gas distribution rates that are structured to recover fixed costs on a volumetric basis.

Q. What is your conclusion with regard to the Company's proposed capital structure?

A. Considering the actual capital structures of the proxy group operating companies, I believe that MidAmerican's proposed common equity ratio of 55.00 percent is appropriate. The proposed equity ratio is within the range established by the capital structures of the utility operating subsidiaries of the proxy companies.

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[81] Ibid.

IX. CONCLUSIONS AND RECOMMENDATION

Q. What is your conclusion regarding a fair ROE for MidAmerican's Iowa natural gas distribution operations?

A. Based on the quantitative and qualitative analyses presented in my Direct Testimony, and in light of the business and financial risks of MidAmerican's natural gas distribution operations in Iowa as compared to the proxy group, it is my view that an ROE of 10.50 percent on an equity ratio of 55.00 percent would fairly balance the interests of customers and shareholders.

Figure 12: Summary of Results

Constant Growth DCF			
	Min Growth Rate	Mean Growth Rate	Max Growth Rate
30-Day Average	8.82%	10.00%	11.28%
90-Day Average	8.80%	9.97%	11.26%
180-Day Average	8.82%	10.00%	11.29%
	Min Growth Rate	Mean Growth Rate	Max Growth Rate
30-Day Average	8.44%	10.17%	10.74%
90-Day Average	8.41%	10.12%	10.67%
180-Day Average	8.47%	10.18%	10.68%
CAPM			
	Current 30-day Average Treasury Bond Yield	Near-Term Blue Chip Forecast Yield	Long-Term Blue Chip Forecast Yield
Value Line Beta	10.79%	10.79%	10.81%
Bloomberg Beta	10.17%	10.16%	10.19%
Long-term Avg. Beta	9.85%	9.85%	9.88%
ECAPM			
Value Line Beta	11.12%	11.12%	11.13%
Bloomberg Beta	10.66%	10.65%	10.67%

Long-term Avg. Beta	10.42%	10.41%	10.44%
	Bond Yield Risk Premium		
	Current 30-day Average Treasury Bond Yield	Near-Term Blue Chip Forecast Yield	Long-Term Blue Chip Forecast Yield
Results	10.12%	10.10%	10.16%

Q. Does this conclude your Direct Testimony?

A. Yes, it does.

AFFIDAVIT OF ANN E. BULKLEY

STATE OF MASSACHUSETTS :

: SS:

COUNTY OF SUFFOLK :

I, Ann Bulkley being first duly sworn on oath, depose and state that I am the same person identified in the foregoing Direct Testimony, that I have caused the Direct Testimony, including any original exhibits, to be prepared and am familiar with the contents thereof; and that the Direct Testimony, including any original exhibits, is true and correct to the best of my knowledge, information and belief as of the date of this Affidavit.

/s/Ann E. Bulkley
Ann E. Bulkley

Subscribed and sworn to before me,
a Notary Public in and for said County
and State, this 12th day of June, 2023.

/s/ Jennifer M. Ossen [Seal]
Notary Public
My commission expires on March 22, 2023

IOWA UTILITIES BOARD

IN RE: MIDAMERICAN ENERGY COMPANY	DOCKET NOS. RPU-2023-0001, TF-2023-0216, TF-2023-0217

ORDER APPROVING SETTLEMENT WITH CONCURRING OPINION

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INTRODUCTION

On June 12, 2023, MidAmerican Energy Company (MidAmerican) filed with the Utilities Board (Board) a proposal to increase its annual revenue requirement for retail natural gas service rates by $39,351,381 pursuant to Iowa Code § 476.6 and chapter 26 of the Board's administrative rules. MidAmerican's application was identified as Docket

No. RPU-2023-0001. In addition, MidAmerican filed a proposed tariff reflecting a temporary increase in rates, identified as Docket No. TF-2023-0216, effective June 22, 2023, and permanent proposed tariff revisions, identified as Docket No. TF-2023-0217.

The Office of Consumer Advocate (OCA), a division of the Iowa Department of Justice, is automatically a party to the docket. The Board granted intervention to the following additional parties: Iowa Business Energy Coalition (IBEC); International Brotherhood of Electrical Workers, Local 109 (IBEW); and Encore Energy Services, Inc. (Encore Energy).

PROCEDURAL HISTORY

On July 7, 2023, the Board issued an "Order Approving Corporate Undertaking, Docketing Proposed Tariff, Granting Waiver, Requiring Additional Information, and Setting Scheduling Conference," which docketed the application as a formal contested case proceeding and acknowledged MidAmerican's implementation of interim rates.

On January 12, 2024, MidAmerican, OCA, and IBEW (collectively, the Settling Parties), filed a non-unanimous Stipulation and Settlement Agreement. On January 19, 2024, the parties filed an Amended Settlement Agreement (referred to as either the Agreement or Settlement). IBEC agreed to not oppose the Settlement subject to inclusion of a two-year equalization period, as described in the Settlement and in detail below. The Settling Parties state the Agreement resolves all issues among them regarding MidAmerican's application for rate relief filed in Docket No. RPU-2023-0001. Encore Energy has not objected to the Settlement. A hearing was held on January 23, 2024.

SUMMARY OF SETTLEMENT AGREEMENT

The Settling Parties filed the non-unanimous Agreement as a resolution to all issues raised in the above-captioned matter, the terms of which will be discussed in greater detail below. (Agreement, art. II, p. 2.) Pursuant to its terms, the Settling Parties jointly state that "the Agreement shall not become effective unless and until the Board accepts the same in its entirety without condition or modification." (Agreement, art. XII, p. 5.)

The Agreement provides for an annual Iowa jurisdictional natural gas base rate increase of $29,644,821 for a final total Iowa natural gas rate base of $845,631,704. (Agreement, art. III, p. 2 and art. IV, p. 2.) The Settling Parties further agree that MidAmerican's reasonable and just rate case expense, as well as the amounts assessed by both the Board and OCA related to this matter, will be recovered through a rider over a three-year period, applicable to all rate classes, and subject to true up. (Agreement, art. III, p. 2.)

STANDARD OF REVIEW

Iowa Administrative Code (IAC) rule 199—7.18 provides that parties may propose to settle all or some of the issues in a proceeding. (*See also* 199 IAC 7.18(6) (providing settlements may be submitted to the Board at any time after docketing).) The Board may not approve a settlement, whether contested or unanimous, "unless the settlement is reasonable in light of the record as a whole, consistent with the law, and in the public interest." (*Id.* at 7.18.) The Board will review the substantive provisions of the Agreement under this standard.

REVIEW OF SETTLEMENT

A. Return on Equity

In her prefiled testimony, MidAmerican witness Ann Bulkley recommended a Return on Equity (ROE) of 10.50% on an equity ratio of 55%. (Bulkley Direct, p. 9.) Ms. Bulkley stated that this ROE and equity ratio are reasonable and serve to balance the interests of customers and shareholders. (*Id.* at 70.)

OCA witness Marcos Muñoz proposed an ROE of 9.25% on an equity ratio of 49%. (Muñoz Direct, p. 3.) Mr. Muñoz considers MidAmerican's December 2021-2022 test period capital structure of 55% equity excessive, unjust, and unreasonable. (*Id.* at 4.)

The Settlement does not contain a specified ROE. Without a specified ROE, the Board does not have the opportunity to determine whether the ROE agreed to by the parties, if there was an agreement, is reasonable. The absence of a specific ROE makes the Board's consideration of the Settlement more difficult; however, the absence of a specific ROE does not make the Settlement unapprovable. (*See generally Black Hills/Iowa Gas Utility Company, LLC d/b/a Black Hills Energy,* Docket No. RPU-2010-0002.) Based upon the information provided in the settlement and information in the record, the Board estimates the ROE in this instance to likely fall between 9.605% and 9.634%. The Board finds that an ROE within this range would not be unreasonable in light of the record as a whole.

B. Revenue Increase and Revenue Requirement

In his prefiled testimony, MidAmerican witness Blake Groen provides documentation supporting a revenue deficiency of $39,351,381, or 6.1% of the

unadjusted test year tariffed revenue. (Groen Direct, p. 3.) Mr. Groen also provided documentation supporting an adjusted net operating revenue of $202,221,947, which resulted in a calculated proposed revenue requirement of $241,573,328. (Groen Direct Exhibit 1, schedule B-3, p. 18.) Mr. Groen stated that the audit and consulting firm Deloitte annually audits MidAmerican's financial statements, including those for 2022. (Groen Direct, p. 4.)

MidAmerican witness Nick Nation stated that the disparity between current base revenues and cost of service is primarily driven by capital investments to serve growing areas in Iowa. (Nation Direct, pp. 7-8.) Mr. Nation claimed the following factors also contribute to this disparity, but to a lesser extent: construction costs, regulatory changes, changes in industry best practices, and system reliability improvement investments. (*Id.* at 8-9.)

OCA witness Blake Kruger provided documentation supporting a revenue deficiency of $18,588,289 and an adjusted net operating revenue of $202,742,508, resulting in a revenue requirement of $221,330,797. (Kruger Direct, pp. 7 & 9.) This reflects a decrease of $20,242,541 in comparison with MidAmerican's proposed revenue requirement.

The Settling Parties agree to an annual Iowa jurisdictional natural gas base rate increase in the amount of $29,644,821. (Agreement, art. III, p. 2.) The Settling Parties have filed documentation supporting the specific adjustments and support for the revenue requirement. (Agreement, Attachment A.) The Settling Parties agree that MidAmerican's reasonable and just rate case expense, in addition to the amounts assessed by both the Board and OCA related to this rate-review proceeding, will be removed from base rates and recovered through a Board-approved rider that is

designed to recover the rate case expense over a period of three years, and is applicable to all rate classes and subject to true up. (Agreement, art. III, p. 2.)

The document filed by MidAmerican on January 19, 2024, along with the Settlement attachment titled "Attachment B – Rate Design and Proof of Revenue," contains MidAmerican's proof of revenue calculation. Based on the Settlement information, this calculation compares base rate revenues to the base rate portion of the revenue requirement. The revenues produced are indicated to be $229,369,116, while the agreed-upon revenue requirement is $229,367,809. The result of this comparison shows that the Settlement would produce revenue in excess of the revenue requirement. The Board asked about this issue at the hearing on January 23, 2024. MidAmerican witness Stephen Stratton stated the following:

> Well, when you're doing the calculations, you have some rounding on the rates because you're rounding to a certain decimal point. So that — and you're running this process many, many, many times, and that number keeps moving around. Sometimes it's slightly positive, sometimes it's slightly negative, but that's at the end where we get — you know, the percentage, obviously, is pretty insignificant.

(Hearing Transcript, p. 27, lines 3-11.)

The Board does not believe it to be appropriate to approve a revenue requirement that is exceeded by the amount of revenue demonstrated in the associated proof of revenue calculation, regardless of the scale. Further, as noted by MidAmerican at the hearing, the small difference between the proof of revenue and the revenue requirement in this case is due to rounding. (*Id.*) Therefore, as part of its compliance filing, the Board will direct MidAmerican to make corrections to its rounding such that the proof of revenue is less than or equal to the revenue requirement. Just as MidAmerican considers the comparison of the revenue requirement to the proof of

revenue results to be insignificant, the Board expects the modified result to be insignificant as well. Further, the Board does not consider this small change to be a modification of the Settlement. With the above change made, the Board finds Article III of the Settlement, regarding revenue requirement and revenue increase, to be reasonable in light of the record as a whole, consistent with the law, and in the public interest.

C. Rate Base

In his prefiled testimony, Mr. Nation stated that MidAmerican is requesting an increase in its annual revenue requirement of $39,351,381 or 6.1% of test year tariffed revenue, including cost of gas and other adjustment clause amounts. (Nation Direct, p. 7.) Mr. Nation stated in his testimony that in the 20 years since its last gas rate case, MidAmerican's necessary investments in the distribution system have increased total plant by $984.2 million, to a total of $1.7 billion at the end of 2022. (*Id.* at 3 & 7.)

Mr. Nation stated that the current disparity between base revenues and cost of service is primarily driven by capital investments necessary to serve growing areas in Iowa, changes in regulation such as those requiring MidAmerican's integrity management programs, and government-mandated relocation projects associated with municipal infrastructure projects. (*Id.* at 7-8.)

OCA witness Kruger provided documentation supporting a final rate base of $844,481,495, which reflects a decrease of $4,013,861 in comparison with MidAmerican's proposed rate base. (Kruger Direct, p. 7.) OCA explained that this difference is a result of a proposed change to MidAmerican's adjustment for cash working capital, as well as a recommended adjustment related to MidAmerican's short-term incentive compensation. (*Id.* at 8.)

The Settling Parties agree to a rate base of $845,631,704. (Agreement, art. IV, pp. 2-3.) This amount reflects adjustments made to the cash working capital calculation, as well as an adjustment of $1,432,836 attributable to one-half of the capitalized portion of the performance incentive plan in the test year. (*Id.*) The Board finds the terms for Article IV regarding rate base to be reasonable in light of the record as a whole, consistent with the law, and in the public interest.

D. Weighted Average Cost of Capital and Capital Structure

In his prefiled testimony, Mr. Groen provided documentation supporting a 7.588% weighted average cost of capital (WACC) for MidAmerican's total company pro forma average costs for the 13 months ending on December 31, 2022. (Groen Direct, p. 13.) Mr. Groen stated that calendar year 2022 data was used to measure the capital structure and WACC, in alignment with the rate base and operating income test year data. (*Id.*) Mr. Groen stated that the equity ratio used in his calculations is 54.9%. (*Id.* at 14.) Mr. Groen stated that MidAmerican's cost of common equity is 10.50%, which is supported by Ms. Bulkley. (*Id.* at 15.)

Mr. Muñoz derived a capital structure that in his view reasonably represents the capital makeup of MidAmerican gas utility operations, and is more in line with the average common equity ratio of comparable natural gas proxy companies than that proposed by MidAmerican. (Muñoz Direct, p. 5.) Mr. Muñoz developed four separate capital structures with corresponding known and measurable changes that occurred within nine months of the test period consistent with Iowa Code § 476.33(4). (*Id.* at 4 & 12.) Mr. Muñoz recommended a WACC of 6.8431% based on a capital structure of 49% equity and 51% debt, with a 9.25% ROE. (*Id.* at 3.)

The Settling Parties agree to a WACC of 7.113%, which they believe is a reasonable compromise based on evidence offered in prefiled testimony. (Agreement, art. V, p. 3.) Additionally, the Settling Parties agree to a capital structure consisting of 51.5% common equity. (*Id.*; Agreement, Attachment A.) Based upon the Agreement regarding the WACC and capital structure, the Board finds the settlement of these issues reasonable in light of the record as a whole, consistent with the law, and in the public interest.

E. Operations and Maintenance Expense

In his prefiled testimony, Mr. Groen provided documentation supporting several pro forma adjustments to MidAmerican's operating income. Each of the adjustments is broadly composed of adjustments to operating revenue and operating expense. In total, MidAmerican proposed a $6,485,002 adjustment to its operating income. (Groen Direct Exhibit 1 Schedule B-3, p. 17.) This results in a total adjusted operating income of $35,770,705, prior to determining MidAmerican's revenue deficiency. (Groen Direct Exhibit 1 Schedule B-3, p. 20.)

Mr. Kruger expressed concerns with some of MidAmerican's proposed adjustments, including rate case expense, weather normalization, and line-locating contract costs. (Kruger Direct, p. 2.) In total, Mr. Kruger recommended an adjusted operating income of $44,087,514. (*Id.* at 7.) This reflects an increase of $8,316,809 in comparison with the adjusted operating income proposed by MidAmerican. (*Id.*) Mr. Kruger believed this change was appropriate due to MidAmerican's proposed Operation and Maintenance (O&M) expenses being considerably higher than recent historical levels. (Id. at 2.)