

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA**

**IN RE:
MIDAMERICAN ENERGY
COMPANY**

: DOCKET NO. NG26-____
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:

**DIRECT TESTIMONY
OF
ANN E. BULKLEY**

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1 **I. WITNESS INFORMATION**

2 **Q. Please state your name and business address.**

3 A. My name is Ann E. Bulkley. I am a Principal at The Brattle Group (“Brattle”). My business
4 address is One Beacon Street, Suite 2600, Boston, Massachusetts 02108.

5 **Q. On whose behalf are you submitting this direct testimony?**

6 A. I am submitting this direct testimony before the South Dakota Public Utilities Commission
7 (“Commission”) on behalf of MidAmerican Energy Company (“MidAmerican” or “the
8 Company”). My testimony addresses the regulated natural gas utility operations of
9 MidAmerican within South Dakota.

10 **Q. Please describe your education and experience.**

11 A. I hold a Bachelor of Arts degree in Economics and Finance from Simmons College and a
12 Master of Science degree in Economics from Boston University, with over 30 years of
13 experience consulting to regulated utilities and the energy industry. I have advised
14 numerous energy and utility clients on a wide range of financial and economic issues with
15 primary concentrations in valuation and utility rate matters. Many of these assignments
16 have included the determination of the cost of capital for valuation and ratemaking
17 purposes. A summary of testimony that I have filed in other proceedings is attached as
18 Exhibit AEB 1.1, Schedule 1.

19 **Q. What is the purpose of your direct testimony?**

20 A. The purpose of my direct testimony is to present evidence and provide a recommendation
21 regarding the appropriate return on equity (“ROE”) and an assessment of the
22 reasonableness of the Company’s proposed capital structure for ratemaking purposes for
23 its natural gas operations in South Dakota.

1 **Q. Are you sponsoring any exhibits in support of your direct testimony?**

2 A. Yes. My analysis and recommendations are supported by the data presented in Exhibit
3 AEB 1.1, Schedule 2 through Schedule 14, which were prepared by me or under my
4 direction.

5 **Q. Please provide a brief overview of the analyses supporting your ROE**
6 **recommendation.**

7 A. I estimate the market-based cost of equity by applying traditional estimation methodologies
8 to a proxy group of comparable utilities, including the constant growth form of the
9 discounted cash flow (“DCF”) model, the Capital Asset Pricing Model (“CAPM”), the
10 Empirical Capital Asset Pricing Model (“ECAPM”), and a Bond Yield Risk Premium
11 (“BYRP” or “Risk Premium”) analysis. My recommendation also takes into consideration
12 the business and regulatory risk of the Company relative to the proxy group, and the
13 Company’s proposed capital structure as compared with the capital structures of the
14 operating utilities of the proxy group companies. Although I do not make specific
15 adjustments to my recommended ROE for these factors, I do consider them in the aggregate
16 when determining where my recommended ROE falls within the range of the analytical
17 results.

18 **Q. How is the remainder of your direct testimony organized?**

19 A. The remainder of my direct testimony is organized as follows:

- 20 • Section II provides a summary of my analyses and conclusions.
- 21 • Section III reviews the regulatory guidelines pertinent to the development of the cost
- 22 of capital.

- 1 • Section IV discusses current and projected capital market conditions and the effect
- 2 of those conditions on the cost of equity.
- 3 • Section V explains my selection of a proxy group used to develop my analytical
- 4 results.
- 5 • Section VI describes my analyses and the analytical basis for my recommended ROE
- 6 in this proceeding.
- 7 • Section VII discusses the specific regulatory, business, and financial risks that have
- 8 a direct bearing on the ROE to be authorized for the Company in this proceeding.
- 9 • Section VIII assesses the reasonableness of the Company's proposed capital
- 10 structure.
- 11 • Section IX presents my conclusions and recommendations.

12 **II. SUMMARY OF ANALYSIS AND CONCLUSIONS**

13 **Q. Please summarize the key factors you consider in your analyses and upon which you**
14 **base your recommended ROE.**

15 A. The key factors that I have considered in developing my recommendation regarding the
16 appropriate ROE for the Company in this proceeding are:

- 17 • The United States Supreme Court's *Hope* and *Bluefield* decisions,¹ which established
- 18 the standards for determining a fair and reasonable authorized ROE for public
- 19 utilities, including consistency of the allowed return with the returns of other
- 20 businesses having similar risk, adequacy of the return to provide access to capital and
- 21 support credit quality, and the requirement that the result lead to just and reasonable
- 22 rates.

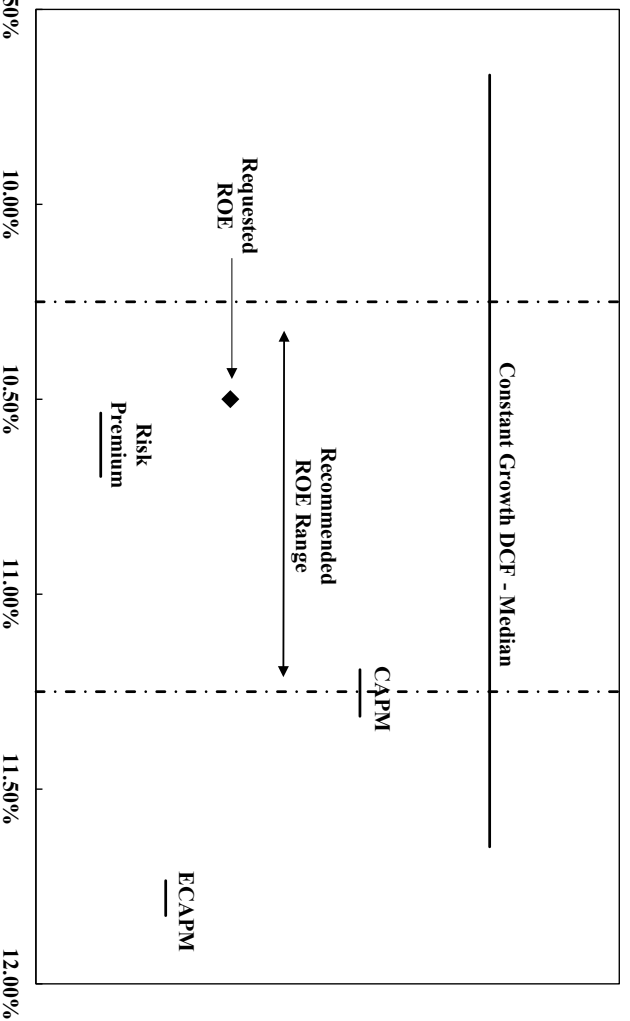
¹ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope*"); *Bluefield Waterworks & Improvement Co., v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) ("*Bluefield*").

- The effect of current and prospective capital market conditions on the cost of equity estimation models and on investors' return requirements.
- The results of several analytical approaches that provide estimates of the Company's cost of equity. Because the Company's authorized ROE should be a forward-looking estimate over the period during which the rates will be in effect, 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).
- Company-specific considerations, since 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 consider the Company's regulatory, business, and financial risks relative to the proxy group of comparable companies in 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. What are the results of the models that you have used to estimate the cost of equity for the Company?

A. Figure 1 summarizes the range of results produced by the models that I have conducted based on data through the end of June 2026.

Figure 1: Summary of Cost of Equity Analytical Results



1 **Q. What is your conclusion regarding the appropriate authorized ROE for the Company**
2 **in this proceeding?**

3 A. Considering the analytical results presented in Figure 1, current and prospective capital
4 market conditions, as well as the level of regulatory, business, and financial risk faced by
5 MidAmerican relative to the proxy group, a range for the Company's ROE from 10.25
6 percent to 11.25 percent is reasonable, and within that range, the Company's requested
7 ROE of 10.50 percent is reasonable.

8 **Q. Is the Company's requested capital structure reasonable and appropriate?**

9 A. Yes. The Company's proposed equity ratio of 54.481 percent is based on the company's
10 historical test year average equity ratio. This equity ratio is within the range of the actual
11 capital structures of the utility operating subsidiaries of the proxy group companies, and,
12 in fact, is below the average of the proxy group.

13 **III. REGULATORY GUIDELINES**

14 **Q. Please describe the guiding principles to be used in establishing the cost of capital for**
15 **a regulated utility.**

16 A. The U.S. Supreme Court's precedent-setting *Hope* and *Bluefield* decisions established the
17 standards for determining the fairness or reasonableness of a utility's authorized ROE.
18 Among the standards established by the Court in those cases are: (1) consistency with other
19 businesses having similar or comparable risks; (2) adequacy of the return to support credit
20 quality and access to capital; and (3) the principle that the specific means of arriving at a
21 fair return are not important, only that the end result leads to just and reasonable rates.²

² *Bluefield*, 262 U.S. at 692-93; *Hope*, 320 U.S. at 603.

1 **Q. Has the Commission provided similar guidance in establishing the appropriate return**
2 **on common equity?**

3 A. Yes. The Commission follows the precedents of the *Hope* and *Bluefield* cases and
4 acknowledges that utility investors are entitled to a fair and reasonable return. This position
5 has been set forth by the Commission as follows:

6 Determining a reasonable ROE rests primarily on sound judgment looking
7 at the overall results of the analysis. Under SDCL 49-34A-8 and relevant
8 case law, rates set in this proceeding must be just and reasonable. *Federal*
9 *Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1994).

10 The just and reasonableness test focuses on whether the “total effect of the
11 rate order [is] unreasonable.” *Duquesne Light Co. v. Barasch*, 488 S. 299,
12 310 (1989). Under the just and reasonable test “it is the result reached, not
13 the method employed that is controlling” and “the impact of the rate order
14 which counts.” *Hope, supra* at 602. The South Dakota Supreme Court
15 recognized that rates that do not yield a fair return are unreasonable. *In Re*
16 *Northwestern Bell*, 43 N.W. 2d 553, 555 (S.D. 1950). The rate of return
17 must be ‘commensurate with returns on other investments of corresponding
18 risks’ and “be sufficient... to attract capital.” *Northwestern Public Service*
19 *v. Cities of Chamberlain et al*, 265 N.W. 2d 867, (1) the Company’s actual
20 capital expenditure requirements, (S.D. 1978).³

21 This guidance is in accordance with my view that an authorized rate of return on
22 equity must be sufficient to enable regulated companies such as MidAmerican the ability
23 to attract equity capital on reasonable terms.

24 **Q. How did the Court connect achieving a fair rate of return to providing utility service**
25 **to customers?**

26 A. The Court stated in *Bluefield*, a proper rate of return not only assures “confidence in the
27 financial soundness of the utility and should be adequate, under efficient and economical

³ The Public Utilities Commission of South Dakota, In the Matter of the Application of Otter Tail Power Company for Authority to Increase its Electric Rates, Final Decision and Order Notice of Entry, EL18-021, at 3-4.

1 management, to maintain and support its credit [but also] enable[s the utility] to raise the
2 money necessary for the proper discharge of its public duties.”⁴

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

5 A. An authorized ROE that is adequate to attract capital at reasonable terms enables a utility
6 to continue to provide safe, reliable service while maintaining its financial integrity. The
7 authorized return should be commensurate with returns expected elsewhere in the market
8 for investments of comparable risk. If it is not, debt and equity investors will seek
9 alternative investment opportunities for which the expected return reflects the perceived
10 risks, thereby inhibiting the Company’s ability to attract capital at reasonable cost. When
11 the Company is afforded a reasonable opportunity to earn its market-based cost of capital,
12 a fair and reasonable balance is achieved between customers’ and shareholders’ interests.

13 **Q. Is a utility’s ability to attract capital also affected by the ROEs authorized for other**
14 **utilities?**

15 A. Yes. Utilities compete directly for capital with other investments of similar risk, which
16 include other utilities. Therefore, the ROE authorized for a utility sends an important signal
17 to investors regarding whether there is regulatory support for financial integrity, dividends,
18 growth, and fair compensation for business and financial risk. The cost of capital
19 represents an opportunity cost to investors. If higher returns are available for other
20 investments of comparable risk, over the same period, investors have an incentive to direct
21 their capital to those alternative investments. Thus, an authorized ROE significantly below

⁴ *Bluefield*, 262 U.S. at 679, 693.

1 authorized ROEs for other utilities can inhibit the utility's ability to attract capital for
2 investment.

3 **Q. What is the standard for setting the ROE in a jurisdiction?**

4 A. The stand-alone ratemaking principle is a foundation of jurisdictional ratemaking,
5 requiring that the rates that are charged in any operating jurisdiction are incurred in that
6 jurisdiction. The stand-alone ratemaking principle ensures that customers in each
7 jurisdiction only pay for the costs of the service provided in that jurisdiction, which is not
8 influenced by the business operations in other operating companies. To maintain this
9 principle, the cost of equity analysis is performed for an individual operating company as
10 a stand-alone entity. As such, I have evaluated the investor-required return for
11 MidAmerican natural gas operations in South Dakota.

12 **Q. Does the fact that the Company is a subsidiary of Berkshire Hathaway Inc., a publicly**
13 **traded company, affect your analysis?**

14 A. No. In this proceeding, consistent with stand-alone ratemaking principles, it is appropriate
15 to establish the cost of equity for the Company, not its publicly traded entity, Berkshire
16 Hathaway Inc. More importantly, however, it is appropriate to establish a cost of equity
17 and capital structure that provides the Company with the ability to attract capital on
18 reasonable terms on a stand-alone basis and within Berkshire Hathaway Inc.

19 **Q. Is the regulatory framework, including the authorized ROE and equity ratio,**
20 **important to the financial community?**

21 A. Yes. The regulatory framework is one of the most important factors in investors'
22 assessments of risk. Specifically, the authorized ROE and equity ratio for regulated utilities
23 is very important for determining the degree of regulatory support for a utility's credit

1 quality and financial stability in the jurisdiction. To the extent that the authorized returns
2 in a jurisdiction are lower than the returns that have been authorized more broadly, credit
3 rating agencies will consider this in the overall risk assessment of the regulatory
4 jurisdiction in which the utility operates.

5 **Q. What are your conclusions regarding regulatory guidelines?**

6 A. The ratemaking process is premised on the principle that, for investors and companies to
7 commit the capital needed to provide safe and reliable utility services to customers, a utility
8 must have a reasonable opportunity to recover the return of, and the market-required return
9 on, its invested capital. Accordingly, the Commission's order in this proceeding should
10 establish rates that provide the Company with a reasonable opportunity to earn a ROE that
11 is: (1) adequate to attract capital on reasonable terms; (2) sufficient to ensure its financial
12 integrity; and (3) commensurate with returns on investments in enterprises with similar
13 risk. It is important for the ROE authorized in this proceeding to take into consideration
14 current and projected capital market conditions, as well as investors' expectations and
15 requirements for both risks and returns. Because utility operations are capital-intensive,
16 regulatory decisions should enable the utility to attract capital at reasonable terms under a
17 variety of economic and financial market conditions. Providing the opportunity to earn a
18 market-based cost of capital supports the financial integrity of the Company, which is in
19 the interest of both customers and shareholders.

20 **IV. CAPITAL MARKET CONDITIONS**

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

22 A. Capital market conditions influence cost of equity models by affecting inputs in the model
23 at the time the analysis is performed. Although the ROE that is established in a rate

1 proceeding is intended to be forward-looking, the analyst uses current and projected market
2 data, specifically stock prices, dividends, growth rates and interest rates, in the models to
3 estimate the required return for the subject company.

4 Analysts and regulatory commissions recognize the importance of considering how
5 these conditions affect the results of the cost of equity estimation models when determining
6 the appropriate range and recommended ROE for a future period. If investors do not expect
7 current market conditions to be sustained in the future, it is possible that the cost of equity
8 estimation models will not provide an accurate estimate of investors' required return during
9 that rate period. Therefore, it is important to consider projected market data to estimate
10 the return for the forward-looking period.

11 **Q. What has the level of inflation been over the past several years?**

12 A. As shown in Figure 2, core inflation increased steadily beginning in early 2021, rising from
13 1.40 percent in January 2021 to a high of 6.64 percent in September 2022, which was the
14 largest 12-month increase since 1982.⁵ While core inflation has declined in response to
15 the Federal Reserve's monetary policy, it continues to remain above the Federal Reserve's
16 target level of 2.00 percent.

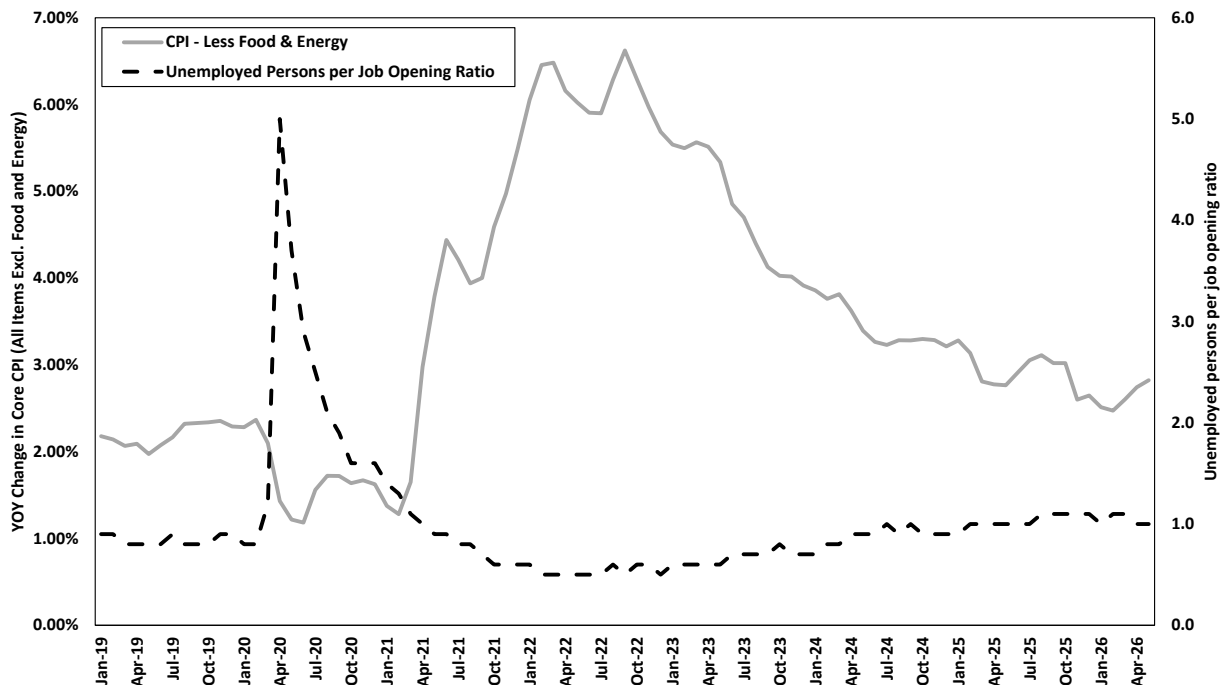
17 Because the Federal Reserve's dual mandate is to promote stable prices and
18 employment, it is important to consider employment data in addition to inflation. The ratio
19 of unemployed persons per job opening was 1.10 in March 2026.⁶ While the ratio of
20 unemployed persons per job opening increased slightly in recent months, it had been
21 consistently at or below 1.00 between April 2021 and October 2025, which suggested a

⁵ Reade Pickert, "Core US Inflation Rises to 40-Year High, Securing Big Fed Hike," *Bloomberg*, October 13, 2022.

⁶ The most recent data available at the time of this testimony; also March 2026 noted as "preliminary."

1 tighter labor market. The strength in the labor market allowed the Federal Reserve to
2 prioritize reducing inflation by pursuing the restrictive monetary policy needed to achieve
3 its 2.00 percent target benchmark.

4 **Figure 2: Core Inflation and Unemployed Persons-to-Job Openings,**
5 **January 2019 to June 2026⁷**



6
7 **Q. What policy actions has the Federal Reserve taken to respond to increased inflation?**

8 A. The dramatic increase in inflation prompted the Federal Reserve to pursue an aggressive
9 normalization of monetary policy, removing the accommodative policy programs used to
10 mitigate the economic effects of COVID-19. Between the March 2022 Federal Open
11 Market Committee (“FOMC”) meeting and the July 2023 FOMC meeting, the Federal
12 Reserve increased the target federal funds rate through a series of increases from a range
13 of 0.00 percent to 0.25 percent to a range of 5.25 percent to 5.50 percent.

⁷ Bureau of Labor Statistics; reflects data available as of June 30, 2026.

1 **Q. How did yields on long-term government bonds respond to the Federal Reserve's**
2 **normalization of monetary policy?**

3 A. Since the Federal Reserve's December 2021 meeting, the yield on 10-year Treasury bonds
4 has increased by over 350 basis points, increasing from 1.47 percent on December 15,
5 2021, to a peak of 4.98 percent on October 19, 2023. It currently remains well above 2021
6 levels (*i.e.*, 4.44 percent as of June 30, 2026).⁸

7 **Q. Has the Federal Reserve reduced the federal funds rate?**

8 A. Yes. The Federal Reserve reduced the federal funds rate in the fourth quarters of 2024 and
9 2025. Although the Federal Reserve kept rates unchanged through the first five meetings
10 in 2025, its decision to reduce the federal funds rate at the final three meetings in 2025 was
11 due to an increase in the downside risk to employment at that time.⁹

12 **Q. What is the expected path of monetary policy over the near term?**

13 A. At June 2026 FOMC meeting, Chairman Warsh noted that economic activity was
14 expanding at a "solid pace" despite uncertainty due to the conflict in Iran, "job gains have
15 kept pace with the workforce" and the unemployment rate has remained steady.¹⁰
16 Chairman Warsh did acknowledge that inflation has been above the Federal Reserve's 2
17 percent target for more than five years and that "high prices" are a "burden for the
18 American people"; however, he noted that the FOMC will "deliver price stability".¹¹
19 Considering the current economic conditions, the FOMC decided to maintain the federal

⁸ *S&P Capital IQ Pro.*

⁹ Federal Reserve, "Federal Reserve issues FOMC statement," Press Release, September 17, 2025, October 29, 2025, and December 10, 2025.

¹⁰ Federal Reserve, "Transcript of Chairman Warsh's Press Conference," June 17, 2026.

¹¹ *Id.*

1 funds rate range of 3.50 percent to 3.75 percent.¹² While Chairman Warsh did not comment
2 on the possible path of monetary policy, the FOMC did publish a forecast at the June 2026
3 meeting, where the median federal funds rate projection was 3.8 percent for 2026 and 3.6
4 percent for 2027.¹³ Thus, the FOMC currently expects the federal funds rate to remain
5 steady over the near-term. Following the July FOMC meeting Chairman Warsh reiterated
6 the importance of the 2 percent inflation target and Warsh noted that market interest rates
7 increased significantly between the June and July FOMC meetings, which continues to
8 support the view that interest rates will remain at current levels.¹⁴

9 **Q. What has happened to the yields on long-term government bonds since the FOMC**
10 **first reduced the federal funds rate in September 2024?**

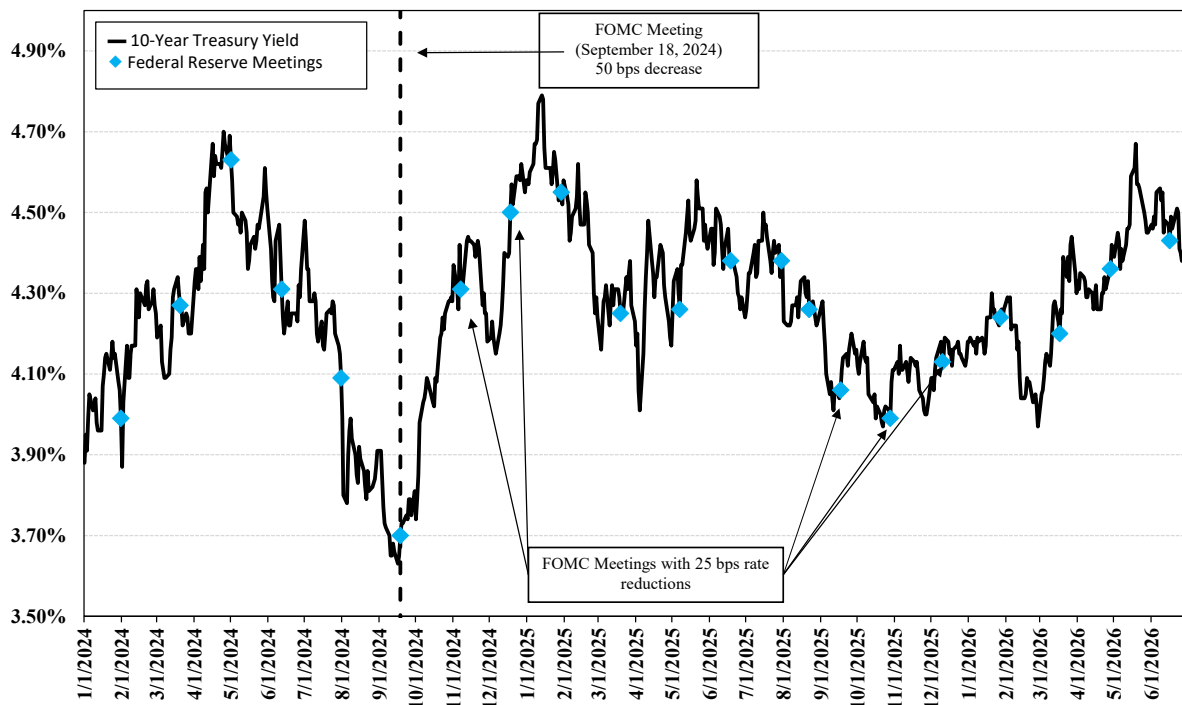
11 A. As shown in Figure 3, while the yield on the 10-year Treasury bond declined prior to the
12 time of the first federal funds rate cut, the yield has generally increased since the September
13 2024 FOMC meeting. Further, while the yield on the 10-year Treasury bond has been
14 volatile recently, as of June 30, 2026, the 10-year Treasury bond yield was 4.44 percent,
15 which is generally consistent with levels seen approximately three months prior to the first
16 reduction in the federal funds rate.

¹² *Id.*

¹³ Federal Reserve, “Summary of Economic Projections”, June 17, 2026.

¹⁴ Federal Reserve Open Market Committee, Transcript of Chairman Warsh’s Press Conference, July 29, 2026.

1 **Figure 3: 10-Year Treasury Bond Yield, January 2024 through June 30, 2026¹⁵**



3 **Q. Why have long-term interest rates remained above the levels at the time the Federal**
4 **Reserve first reduced the federal funds rate in September 2024?**

5 **A.** Ongoing policies of the current administration's economic plans have resulted in higher
6 deficits, and persistent inflation. For example, since January 2025, the administration
7 announced several sets of tariffs on each of the U.S.'s trading partners.¹⁶ The implemented
8 tariffs are largely viewed as inflationary. Inflation affects bonds, in particular long-term
9 government bonds, because it erodes the value of future bonds payments. Therefore, in an
10 inflationary environment, investors will demand higher returns on bonds to compensate for
11 the added risk of inflation thus bond prices decline and the yields on bonds increase. The

¹⁵ S&P Capital IQ Pro.

¹⁶ Jennifer Clarke, "What Are Tariffs, How Do They Work and Why Is Trump Using Them?" *BBC News*, August 27, 2025.

1 longer the duration of the bond, the greater the effect of inflation which is why inflation
2 risk is greater for long-term government bonds. The significant tariff increases
3 implemented by the current administration increase the risk that inflation will remain
4 elevated, which is why the yields on long-term bonds have not decreased and in fact have
5 increased since the Federal Reserve first reduced the federal funds rate in September 2024.
6 Further, the use of tariffs strains the relationship with trading partners, which could result
7 in a reduction in the foreign demand for long-term U.S. government bonds resulting in
8 additional upward pressure on long-term government bond yields.¹⁷

9 **Q. What effect does the recent Supreme Court ruling have on the tariffs implemented**
10 **by the administration in 2025?**

11 A. On February 20, 2026, the Supreme Court ruled that the tariffs implemented in 2025 under
12 the International Emergency Economic Powers Act were illegal. However, the
13 administration responded to the ruling by imposing a 15.00 percent tariff on all goods
14 imported into the U.S. under Section 122 of the 1974 Trade Act,¹⁸ which allows a President
15 to implement global tariffs up to 15.00 percent for a period of five months after which the
16 approval of Congress is needed for continuation of the tariffs. Therefore, the
17 administration is still able to at least temporarily impose global tariffs, which, as noted,
18 will continue to place upward pressure on prices.

19 **Q. Has the war in Iran affected inflation and long-term government bond yields?**

20 A. Yes. The war in Iran and the resulting increase in underlying oil prices has put upward
21 pressure on inflation as increased oil prices not only increase gasoline prices for consumers,

¹⁷ Karishma Vanjani, "U.S. Treasury Bonds Sell Off as 30-Year Yield Rises Most Since 1982," *Barron's*, April 9, 2025.

¹⁸ Dearbail Jordan, "Trump says he will increase his new global tariffs to 15%," *BBC*, February 22, 2026.

1 but also the prices of other products as well given that nearly all goods need to be
2 transported from the place of production. The likelihood of continued elevated inflation
3 suggests interest rates are expected to remain higher in the near term.¹⁹ In fact, as shown
4 in Figure 3, since the start of the war in Iran, the yield on the 10-year Treasury bond has
5 increased 48 basis points (*i.e.*, from 3.97 percent on February 27, 2026 to 4.44 percent on
6 June 30, 2026).

7 **Q. What are the expectations for the yields on long-term government bonds?**

8 A. Economists are still expecting elevated long-term interest rates. In the most recently
9 published report by *Blue Chip Financial Forecasts*, the consensus estimate of economists
10 is that the 30-year treasury bond yield will be 4.90 percent in Q4/2026 and 4.80 percent
11 through Q4/2027.²⁰ Additionally, the consensus estimate over the longer term (*i.e.*, 2028-
12 2032) is 4.70 percent.²¹ This is important because it means that long-term interest rates are
13 expected to remain elevated during the period that the Company's rates will be in effect.

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

16 A. It is important to consider current and projected market conditions in setting the forward-
17 looking ROE due to its effect on the estimated cost of equity. Although the FOMC reduced
18 the federal funds rate several times in late 2025, the FOMC's current projections are for
19 the federal funds rate to remain at the current level over the near-term.²² Long-term interest
20 rates remain elevated and are expected to continue to remain elevated due to inflationary

¹⁹ See, e.g., Finbar Flynn and Ruth Carson, "Bonds Lose \$2.5 Trillion in Iran War Wipeout That Mirrors 2022" *Bloomberg*, March 23, 2026.

²⁰ *Blue Chip Financial Forecasts*, Vol. 45, No. 7, July 1, 2026, at 9.

²¹ *Blue Chip Financial Forecasts*, Vol. 45, No. 6, June 1, 2026, at 14.

²² Federal Reserve, "Summary of Economic Projections", June 17, 2026.

1 policies such as tariffs and tax cuts and the uncertainty regarding the Iran conflict and the
2 increase in underlying energy costs. With long-term interest rates expected to remain
3 relatively high, borrowing also remains relatively more expensive, and thus investors also
4 demand a relatively high cost of capital, which means the cost of capital also remains
5 relatively high.

6 **V. PROXY GROUP SELECTION**

7 **Q. Please provide a brief profile of MidAmerican.**

8 A. MidAmerican Energy Company is a wholly owned indirect subsidiary of Berkshire
9 Hathaway Energy Company, a holding company that owns a highly diversified portfolio
10 of locally managed businesses principally engaged in the energy industry and is a
11 consolidated subsidiary of Berkshire Hathaway Inc. MidAmerican owns and operates
12 approximately 1,721 miles of natural gas mains and approximately 1,482 miles of service
13 lines that provide service to approximately 114,000 customers in the South Dakota.²³
14 MidAmerican is currently rated A-/Stable by S&P Ratings (“S&P”)²⁴ and A1/Stable by
15 Moody’s Ratings (“Moody’s”).²⁵

16 **Q. Why have you used a proxy group of publicly traded companies to estimate the cost
17 of equity for MidAmerican?**

18 A. In this proceeding, I am estimating the cost of equity for MidAmerican, a rate-regulated
19 subsidiary of Berkshire Hathaway Inc. Because the cost of equity is a market-based
20 concept and MidAmerican does not make up the entirety of a publicly traded entity, it is
21 necessary to establish a group of companies that is both publicly traded and comparable to

²³ Data provided by the Company.

²⁴ S&P Capital IQ Pro.

²⁵ Moody’s Ratings.

1 the Company in certain fundamental business and financial respects to serve as its “proxy”
2 in the cost of equity estimation process.

3 Even if the Company was a publicly traded entity, it is possible that transitory
4 events could bias its market value over a given period. Using a proxy group moderates the
5 effects of unusual events that may be associated with any one company. The companies
6 included in the proxy group all possess a set of operating and risk characteristics that are
7 substantially comparable to MidAmerican’s and thus provide a reasonable basis to derive
8 and estimate the appropriate cost of equity for the Company.

9 **Q. How have you selected the companies included in your proxy group?**

10 A. I began with the universe of companies that *Value Line Investment Survey* (“*Value Line*”)
11 classifies as Natural Gas Distribution Utilities and applied the following screening criteria
12 to select publicly traded companies that:

- 13 • pay consistent quarterly cash dividends because companies that do not pay dividends
14 cannot be analyzed using the DCF model;
- 15 • have an investment grade long-term issuer rating;
- 16 • have positive long-term earnings growth forecasts from at least two utility industry
17 equity analysts;
- 18 • derive more than 70.00 percent of their total operating income from regulated
19 operations;
- 20 • derive more than 45.00 percent of regulated operating income from regulated natural
21 gas operations; and,
- 22 • were not parties to a merger or transformative transaction during the analytical period
23 relied on.

24 **Q. What is the composition of your proxy group?**

25 A. The screening criteria discussed results in a proxy group consisting of the companies shown
26 in Figure 4 below and detailed in Exhibit AEB 1.1, Schedule 3.

1 **Q. Have you modified your screening criteria from your previous cost of capital**
2 **testimonies for natural gas companies?**

3 A. Yes. *Value Line* currently classifies only nine companies as natural gas utilities, meaning
4 the universe of natural gas utilities is already small before a set of screening criteria are
5 applied. Additionally, there has been a trend towards consolidation in the utility industry,
6 which reduces the number of available proxy companies. For example, Spire, Inc.
7 regularly has been included in the proxy group for natural gas utilities; however, recently
8 has been involved in a number of transactions that resulted in removing it from my proxy
9 group.²⁶ Therefore, because there are a small number of companies that are available for
10 inclusion in the proxy group, it is reasonable to balance the screening criteria used to
11 establish a proxy group with the size of the proxy group. Accordingly, I have lowered the
12 threshold for the percent of regulated operating income from gas distribution operations
13 from 60.00 percent to 45.00 percent, and as a result, Chesapeake Utilities Corporation
14 (“CPK”) is included in the proxy group.

15 ***Figure 4: Proxy Group***

Company	Ticker
Atmos Energy Corporation	ATO
Chesapeake Utilities Corporation	CPK
NiSource	NI
Northwest Natural Gas Company	NWN
ONE Gas, Inc.	OGS
Southwest Gas Corporation	SWX

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²⁶ Spire, Inc., “Spire and I Squared announce agreement for sale of natural gas storage assets for \$650 million,” Press Release, April 15, 2026; PR Newswire, “Spire announces sale of its Mississippi natural gas business to Delta Utilities for \$75 million,” April 22, 2026.

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1 **Q. Is it important to use more than one analytical approach to estimate the cost of**
2 **equity?**

3 A. Yes. A reasonable cost of equity estimate appropriately considers alternative
4 methodologies and the reasonableness of their individual and collective results. Because
5 the cost of equity is not directly observable, it must be estimated based on both quantitative
6 and qualitative information. When faced with the task of estimating the cost of equity,
7 analysts and investors are inclined to gather and evaluate as much relevant data as
8 reasonably can be analyzed. Several models have been developed to estimate the cost of
9 equity, and I use multiple approaches to estimate the cost of equity. As a practical matter,
10 however, all the models available for estimating the cost of equity are subject to limiting
11 assumptions or other methodological constraints. Consequently, many well-regarded
12 finance texts recommend using multiple approaches when estimating the cost of equity.
13 For example, Copeland, Koller, and Murrin²⁷ suggest using the CAPM and Arbitrage
14 Pricing Theory model, while Brigham and Gapenski²⁸ recommend the CAPM, DCF, and
15 BYRP approaches.

16 **Q. Has the Commission made similar findings regarding the reliance on multiple**
17 **models?**

18 A. Yes. In a 2018 decision for Otter Tail Power, the Commission noted that determining a
19 reasonable return on equity rests primarily on sound judgment looking at the overall results
20 of the analysis. Further, the Commission noted that under SDCL 49-34A-8 and relevant

²⁷ 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.

²⁸ Eugene Brigham, Louis Gapenski, *Financial Management: Theory and Practice*, 7th Ed. (Orlando: Dryden Press, 1994), at 341.

case law, rates set must be just and reasonable. Under the just and reasonable standard the Commission noted that “it is the result reached, not the method employed that is controlling”. Witnesses for both Otter Tail Power and Commission staff relied on multiple models that collectively supported the result reached by the Commission in this proceeding.²⁹

A. Constant Growth DCF Model

Q. Please describe the DCF model.

A. The DCF model 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:

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

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

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

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.

²⁹ Before the Public Utilities Commission of the State of South Dakota, In the Matter of the Application of Otter Tail Power Company for Authority to Increase Its Electric Rates, Docket No. EL-18-021, Final Decision and Order; May 30, 2019, at 3.

1 **Q. What assumptions are required for the constant growth DCF model?**

2 A. The constant growth DCF model requires the following four assumptions: (1) a constant
3 growth rate for earnings and dividends; (2) a stable dividend payout ratio; (3) a constant
4 price-to-earnings ratio; and (4) a discount rate greater than the expected growth rate. To
5 the extent that any of these assumptions are not objectively valid, considered judgment
6 and/or specific adjustments should be applied to the results.

7 **Q. What market data do you use to calculate the dividend yield in your constant growth**
8 **DCF model?**

9 A. The dividend yield in my constant growth DCF model is based on the proxy group
10 companies' current annualized dividend and average closing stock prices over the 30-day,
11 90-day, and 180-day trading periods ended June 30, 2026.

12 **Q. Why do you use these averaging periods?**

13 A. I use an average of recent trading days to calculate the term P_0 in the DCF model to reflect
14 current market data while also ensuring that the result of the model is not skewed by
15 anomalous events that may affect stock prices on any given trading day.

16 **Q. Do you make any adjustments to the dividend yield to account for periodic growth in**
17 **dividends?**

18 A. Yes. Since utility companies tend to increase their quarterly dividends at different times
19 throughout the year, it is reasonable to assume that dividend increases will be evenly
20 distributed over calendar quarters. Given that assumption, it is reasonable to apply one-
21 half of the expected annual dividend growth rate for purposes of calculating the expected
22 dividend yield component of the DCF model. This adjustment ensures that the expected

1 first-year dividend yield is, on average, representative of the coming twelve-month period,
2 and does not overstate the aggregated dividends to be paid during that time.

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

5 A. In its constant growth form, the DCF model (*i.e.*, Equation [2]) assumes a single growth
6 estimate in perpetuity. To reduce the long-term growth rate to a single measure, one must
7 assume that the payout ratio remains constant and that earnings per share (“EPS”),
8 dividends per share, and book value per share all grow at the same constant rate. However,
9 over the long run, dividend growth can only be sustained by earnings growth, meaning
10 earnings are the fundamental driver of a company’s ability to pay dividends. Therefore,
11 projected EPS growth is the appropriate estimate of a company’s long-term projected
12 growth. In contrast, changes in a company’s dividend payments are based on management
13 decisions related to cash management and other factors. For example, a company may
14 decide to retain earnings rather than pay out a portion of those earnings to shareholders
15 through dividends. Thus, dividend growth rates are less likely than earnings growth rates
16 to accurately reflect investor perceptions of a company’s growth prospects. Accordingly,
17 I have incorporated several sources of long-term EPS growth rates into the constant growth
18 DCF model.

19 **Q. Which sources of long-term earnings growth rates do you use in your DCF analyses?**

20 A. My constant growth DCF model incorporates three sources of long-term projected EPS
21 growth rates: (1) *Zacks Investment Research* (“Zacks”); (2) *S&P Capital IQ*; and (3) *Value*
22 *Line*.

1 **Q. Have you previously relied on projected EPS growth rates provided by *Yahoo!***
2 ***Finance*?**

3 A. Yes, however, *Yahoo! Finance* no longer reports consensus projected 3- to 5-year EPS
4 growth rates. As a result, I have replaced this source with the consensus projected 3- to 5-
5 year EPS growth rates reported by *S&P Capital IQ*.

6 **Q. How do you calculate the range of results for the constant growth DCF models?**

7 A. I calculate results using the average EPS growth rate from all three sources for each proxy
8 group company. In addition, I calculate a low-end result for the constant growth DCF
9 models using the minimum growth rate of the three sources (*i.e.*, the lowest of the *Zacks*,
10 *S&P Capital IQ*, and *Value Line* projected EPS growth rates) for each of the proxy group
11 companies, and use a similar approach to calculate a high-end result, using the maximum
12 growth rate of the three sources for each proxy group company.

13 **Q. What are the results of your DCF analyses?**

14 A. Figure 5 summarizes the results of my DCF analyses, which are also provided in Exhibit
15 AEB 1.1, Schedule 4.

16 ***Figure 5: Discounted Cash Flow Results***

	Minimum Growth Rate	Average Growth Rate	Maximum Growth Rate
<u>Constant Growth DCF</u>			
30-Day Avg. Stock Price	9.74%	10.61%	11.67%
90-Day Avg. Stock Price	9.56%	10.55%	11.62%
180-Day Avg. Stock Price	9.71%	10.71%	11.66%
Average	9.67%	10.62%	11.65%

1 B. CAPM and ECAPM Analyses

2 **Q. Please briefly describe the CAPM.**

A. The CAPM is a risk premium approach that estimates the cost of equity for a given security as a function of a risk-free return plus a risk premium to compensate investors for the non-diversifiable or “systematic” risk of that security.³⁰ The CAPM is defined by four components:

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

8 Where:

9 K_e = the required return of an individual security

β = the beta coefficient of an individual security

1 r_f = the risk-free rate of return

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

In this specification, the term $(r_m - r_f)$ represents the market risk premium, which measures the relative riskiness of the security being evaluated. 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. Non-diversifiable risk is measured by beta, which is defined as:

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

8 *Variance* (r_m) represents the variance of the market return which is a measure of the
9 uncertainty of the general market. *Covariance* (r_e , r_m) represents the covariance between
10 the return on a specific security and the general market, which reflects the extent to which

³⁰ 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.

1 the return on that security will respond to a given change in the general market return.
2 Thus, beta represents the risk of the security relative to the general market.

3 **Q. What risk-free rate do you use in your CAPM analyses?**

4 A. I use three estimates of the yield on U.S. Treasury bonds: (1) the current 30-day average
5 yield on the 30-year Treasury bond;³¹ (2) the average projected yield on the 30-year
6 Treasury bond for Q4/2026 through Q4/2027;³² and (3) the average projected yield on the
7 30-year Treasury bond for the period 2028 through 2032.³³

8 **Q. What beta coefficients do you use in your CAPM analyses?**

9 A. As shown Exhibit AEB 1.1, Schedule 5, I use the beta coefficients for the proxy group
10 companies as reported by *Value Line*, which are based on five years of weekly returns
11 relative to the New York Stock Exchange Composite Index. Additionally, as shown on
12 Exhibit AEB 1.1, Schedule 5 and Exhibit AEB 1.1, Schedule 6, I also consider another
13 CAPM analysis that relies on the long-term average beta coefficient for the companies in
14 my proxy group, which is calculated as an average of the *Value Line* beta coefficients for
15 the companies in my proxy group from 2013 through 2025.

16 **Q. How do you estimate the market risk premium in the CAPM?**

17 A. I estimate the market risk premium as the difference between the implied expected equity
18 market return and the risk-free rate. As shown in Exhibit AEB 1.1, Schedule 7, the
19 expected market return is calculated using the constant growth DCF model discussed
20 previously in my testimony for the companies in the S&P 500 Index. Based on an
21 estimated market capitalization-weighted dividend yield of 1.27 percent and a weighted

³¹ *Bloomberg Professional*, as of June 30, 2026.

³² *Blue Chip Financial Forecasts*, Vol. 45, No. 7, July 1, 2026, at 9.

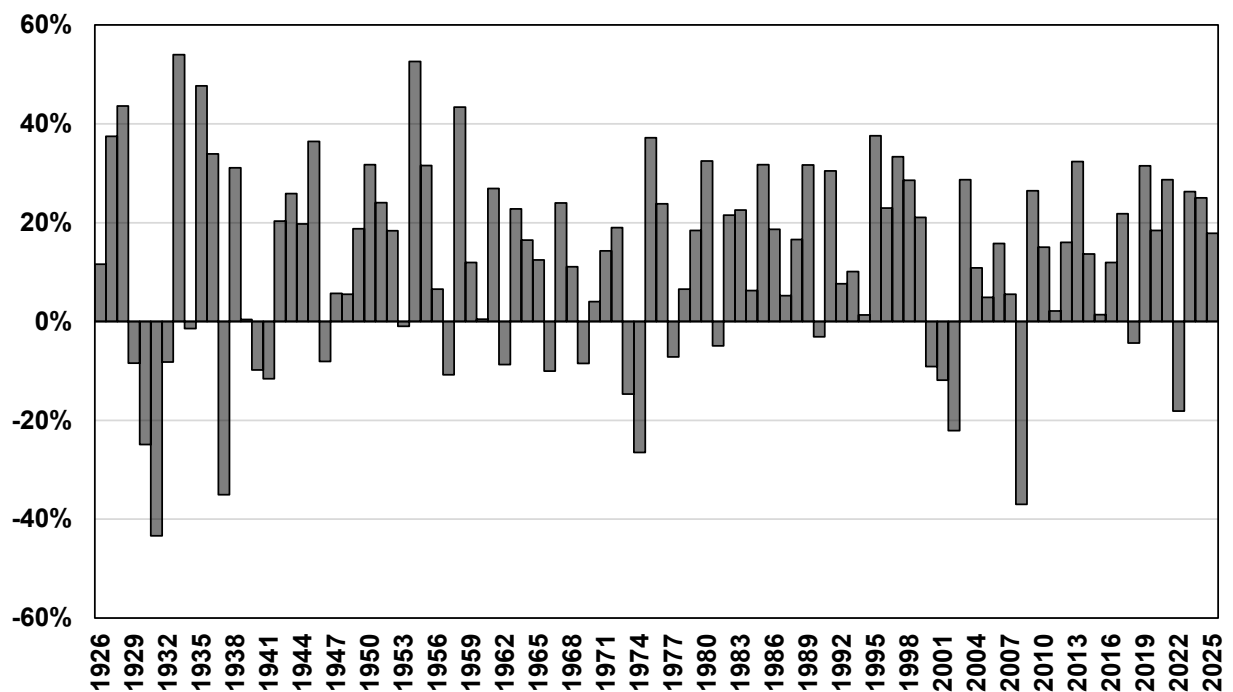
³³ *Blue Chip Financial Forecasts*, Vol. 45, No. 6, June 1, 2026, at 14.

long-term growth rate of 12.01 percent, the estimated required market return for the S&P 500 Index as of June 30, 2026 is 13.36 percent.

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

A. As shown in Figure 6, given the range of annual equity returns that have been observed over the past century, the current expected market return is reasonable. In 53 out of the past 100 years (or 53.00 percent of observations), the realized equity market return was at least 13.36 percent or greater.

Figure 6: Realized U.S. Equity Market Returns (1926-2025)³⁴



³⁴ Depicts total annual returns on large company stocks, as reported in the 2023 *Kroll SBBI Yearbook* for 1926-2022 and from *S&P Capital IQ Pro* for 2023-2025.

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

2 A. Yes. I have also considered the results of an ECAPM analysis in estimating the cost of
3 equity for the Company.³⁵ The ECAPM calculates the product of the adjusted beta
4 coefficient and the market risk premium and applies a weight of 75.00 percent to that result.
5 The model then applies a 25.00 percent weight to the market risk premium without any
6 effect from the beta coefficient. The results of the two calculations are summed, along
7 with the risk-free rate, to produce the ECAPM result, as noted in Equation [5] below:

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

9 Where:

10 k_e = the required return of an individual security

11 β = the adjusted beta coefficient of an individual security

12 r_f = the risk-free rate of return

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

14 The ECAPM addresses the tendency of the “traditional” CAPM to underestimate
15 the cost of equity for companies with low beta coefficients such as regulated utilities. In
16 that regard, the ECAPM is not redundant to the use of adjusted betas in the traditional
17 CAPM; rather, it recognizes the results of academic research indicating that the risk-return
18 relationship is different (in essence, flatter) than estimated by the CAPM, meaning that the
19 CAPM underestimates the cost of equity for companies with a beta less than 1.0 and
20 overestimates the cost of equity for companies with a beta greater than 1.0.³⁶

³⁵ See, e.g., Roger A. Morin, *New Regulatory Finance*, Public Utilities Reports, Inc., 2006, at 189.

³⁶ *Id.*, at 191.

Consistent with the CAPM, my application of the ECAPM uses the same three yields on the 30-year Treasury bond as the risk-free rate, forward-looking market return, and beta coefficients.

Q. What are the results of your CAPM and ECAPM analyses?

A. The results of my CAPM and ECAPM analyses are summarized below in Figure 7 and presented in more detail in Exhibit AEB 1.1, Schedule 5.

Figure 7: CAPM and ECAPM Results

	30-Year Treasury Bond Yield		
	Current	Near-Term	Longer-Term
	30-Day Avg.	Forecast	Forecast
<u>CAPM</u>			
Current <i>Value Line</i> Beta	11.27%	11.23%	11.19%
Long-term Avg. <i>Value Line</i> Beta	11.31%	11.28%	11.24%
<u>ECAPM</u>			
Current <i>Value Line</i> Beta	11.79%	11.77%	11.74%
Long-term Avg. <i>Value Line</i> Beta	11.82%	11.80%	11.77%

C. Bond Yield Plus Risk Premium Analysis

Q. Please describe the BYRP analysis.

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 bondholders. In other words, because returns to equity holders have greater risk than returns to bondholders, equity investors must be compensated to bear that risk. Thus, risk premium approaches estimate the expected cost of equity as the sum of the equity risk premium and the yield on a particular class of bonds. In my analysis, I use historical authorized returns for natural gas utilities across the United

States as the measure of the expected cost of equity at that time to determine the risk premium at that time.

Q. What is the fundamental relationship between the equity risk premium and interest rates?

A. 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 (*i.e.*, 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. The analysis presented in Exhibit AEB 1.1, Schedule 8 establishes that relationship using a regression of the risk premium as a function of U.S. Treasury bond yields. When the authorized ROEs serve as the measure of expected equity returns and the long-term Treasury bond yield is defined as the relevant measure of interest rates, the risk premium is the difference between those two points.³⁷

Q. What does your BYRP analysis reveal?

A. As shown in Figure 8, there is a strong negative relationship between risk premia and interest rates. To estimate that relationship, I have conducted a regression analysis using the following equation:

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

Where:

³⁷ See *e.g.*, S. Keith Berry, "Interest Rate Risk and Utility Risk Premia during 1982-93," *Managerial and Decision Economics*, Vol. 19, No. 2, March 1998 (the author used a similar methodology, including using authorized 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," *Financial Management*, Spring 1986, at 66.

RP = risk premium (difference between authorized ROEs and the yield on 30-year U.S. Treasury bonds)

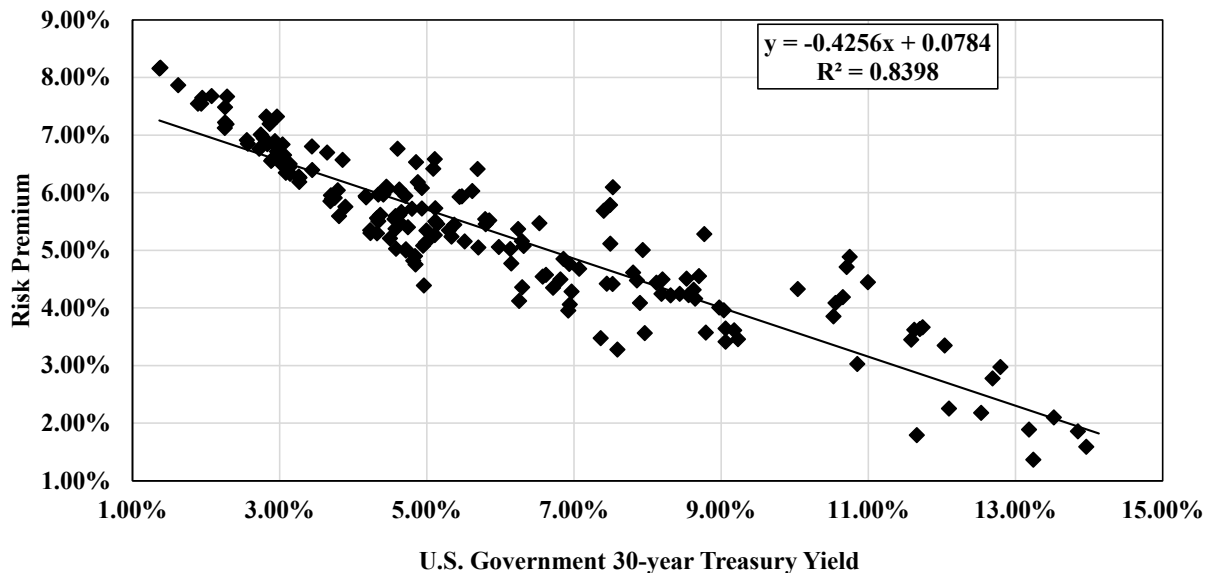
a = intercept term

b = slope term

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

Data regarding authorized ROEs is derived from all natural gas distribution rate cases from January 1980 through June 2026 as reported by Regulatory Research Associates (“RRA”).³⁸ This equation’s coefficients are statistically significant at the 99.00 percent level.

Figure 8: Risk Premium Regression Analysis



Q. What are the results of your BYRP analysis?

A. The results of the BYRP analysis are shown in Figure 9, which are also presented in more detail in Exhibit AEB 1.1, Schedule 8.

³⁸ The data was screened to eliminate limited issue rider cases, transmission-only cases, and cases that were silent with respect to the authorized ROE.

Figure 9: BYRP Results

	30-Year Treasury Bond Yield		
	Current	Near-Term	Longer-Term
	30-Day Avg.	Forecast	Forecast
Bond Yield Risk Premium	10.70%	10.63%	10.54%

VII. REGULATORY AND BUSINESS RISKS

Q. Taken alone, do the results from the cost of equity estimation models for the proxy group provide an appropriate estimate of the cost of equity for the Company?

A. No. These results provide only a range for the appropriate estimate of the Company's cost of equity. There are several additional factors that must be taken into consideration when determining the reasonableness of the Company's cost of equity relative to the range of model results. These factors, which are discussed below, should be considered with respect to their overall effect on the Company's risk profile.

A. Capital Expenditures

Q. Please summarize the Company's capital expenditure requirements.

A. As of December 31, 2025, the Company had net utility plant of approximately \$213 million, and the Company currently projects capital expenditures for 2026 through 2030 of approximately \$99 million.³⁹ Therefore, the Company's projected capital expenditures represent approximately 46.83 percent of its net utility plant as of December 31, 2025.

³⁹ Data provided by the Company.

1 **Q. How do the Company's projected capital expenditures compare to those of the proxy**
2 **group companies?**

3 A. As shown on Exhibit AEB 1.1, Schedule 9, I have calculated the ratio of expected capital
4 expenditures to net utility plant for MidAmerican and each of the companies in the proxy
5 group. As shown therein, the Company's ratio of capital expenditures as a percentage of
6 net utility plant is lower than the median of the proxy group companies (*i.e.*, 0.83 times),
7 which, all else equal, would indicate a risk level that is slightly lower than that of the
8 companies in the proxy group; however, the ability to recover the costs of these capital
9 investments between rate proceedings must also be considered.

10 **Q. How is the Company's risk profile affected by its substantial capital expenditure**
11 **requirements?**

12 A. As with any utility faced with substantial capital expenditure requirements, the Company's
13 risk profile may be adversely affected in two significant and related ways: (1) the
14 heightened level of investment increases the risk of under-recovery or delayed recovery of
15 the invested capital; and (2) an inadequate return would put downward pressure on key
16 credit metrics.

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

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

23 When applicable, a jurisdiction's willingness to support large capital
24 projects with cash during construction is an important aspect of our analysis.

1 This is especially true when the project represents a major addition to rate
2 base and entails long lead times and technological risks that make it
3 susceptible to construction delays. Broad support for all capital spending is
4 the most credit-sustaining. Support for only specific types of capital
5 spending, such as specific environmental projects or system integrity plans,
6 is less so, but still favorable for creditors. Allowance of a cash return on
7 construction work-in-progress or similar ratemaking methods historically
8 were extraordinary measures for use in unusual circumstances, but when
9 construction costs are rising, cash flow support could be crucial to maintain
10 credit quality through the spending program. Even more favorable are those
11 jurisdictions that present an opportunity for a higher return on capital
12 projects as an incentive to investors.⁴⁰

13 Recently, S&P evaluated the capital expenditure trends in the utility sector, noting
14 that the balance between operating with negative discretionary cash flow from operations
15 offset by reliable access to capital markets for financing may be tested through increasing
16 capital expenditure requirements as a result of, among other things, the transformation of
17 the energy sector through the focus on low/no carbon generation, electrification, and the
18 replacement of aging infrastructure.⁴¹

19 Therefore, to the extent that the Company's rates do not permit the opportunity to
20 recover its capital investments on a regular and timely basis, it will face increased recovery
21 risk and thus increased pressure on its credit metrics.

22 **Q. Does the Company have mechanisms in place to recover the costs associated with its**
23 **capital expenditures plan between rate cases?**

24 **A.** No. MidAmerican does not currently have a capital tracking mechanisms to recover capital
25 investment costs between rate cases.

⁴⁰ S&P Global Ratings, "Assessing U.S. Investor-Owned Utility Regulatory Environments," August 10, 2016, at 7.

⁴¹ S&P Global Ratings, "Industry Credit Outlook 2026, North American Regulated Utilities: Data center growth will support credit quality in 2026," January 14, 2026, at 3-4.

1 **Q. How does MidAmerican's capital cost recovery between rate proceedings compare to**
2 **the operating subsidiaries of the proxy group companies?**

3 A. As shown on Exhibit AEB 1.1, Schedule 10, 80.00 percent of the operating utilities of the
4 companies in the proxy group have mechanisms for some form of capital cost recovery
5 between rate proceedings.

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

8 A. While the Company's capital expenditure requirements as a percentage of net plant are
9 slightly below the median of the proxy group companies, unlike a number of the operating
10 subsidiaries of the proxy group, MidAmerican does not currently have the ability to recover
11 capital investments between rate cases. As a result, all else equal, the Company's limited
12 ability to timely recover their capital investment when those costs are incurred results in a
13 relatively greater risk as compared to the proxy group.

14 **B. Regulatory Risk**

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

16 A. The ratemaking process is premised on the principle that, for investors and companies to
17 commit the capital needed to provide safe and reliable utility service to customers, the
18 subject utility must have the opportunity to recover the return of, and the market-required
19 return on, invested capital. Regulatory authorities recognize that because utility operations
20 are capital-intensive, regulatory decisions should enable the utility to attract capital on
21 reasonable terms, and doing so balances the long-term interests of investors and customers.
22 To achieve this balance, the Company must be able to finance its operations assuming a
23 reasonable opportunity to earn an appropriate return on invested capital to maintain an

1 acceptable financial profile. In that respect, the regulatory environment is one of the most
2 important factors considered in both debt and equity investors' risk assessments.

3 From the perspective of debt investors, the authorized return should enable the
4 utility to generate the cash flow needed to meet its near-term financial obligations, make
5 the capital investments needed to maintain and expand its systems, and maintain the
6 necessary levels of liquidity to fund unexpected events. This financial liquidity must be
7 derived not only from internally generated funds, but also by efficient access to capital
8 markets. Moreover, because fixed income investors have many investment alternatives,
9 even within a given market sector, the utility's financial profile must be adequate on a
10 relative basis to ensure its ability to attract capital under a variety of economic and financial
11 market conditions.

12 In addition, equity investors require that the authorized return be adequate to
13 provide a risk-comparable return on the equity portion of the utility's capital investments.
14 Because equity investors are the residual claimants on the utility's cash flows (which is to
15 say that the equity return is subordinate to interest payments), they are particularly
16 concerned with the strength of regulatory support and its effect on future cash flows.

17 **1. Credit Rating Agencies Perspective**

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

20 **A.** Both Moody's and S&P consider the overall regulatory framework in establishing credit
21 ratings. Moody's establishes credit ratings based on four key factors: (1) regulatory
22 framework; (2) the ability to recover costs and earn returns; (3) diversification; and (4)
23 financial strength, liquidity, and key financial metrics. Of these criteria, regulatory

1 framework and the ability to recover costs and earn returns are each given a broad rating
2 factor of 25.00 percent. Therefore, Moody's assigns regulatory risk a 50.00 percent
3 weighting in the overall assessment of business and financial risk for regulated utilities.⁴²

4 S&P also identifies the regulatory framework as an important factor in credit ratings
5 for regulated utilities, stating: "we assess regulatory advantage because the influence of the
6 regulatory framework and regime is of critical importance. It defines the environment in
7 which a utility operates and has a significant bearing on a utility's financial performance."⁴³
8 S&P identifies four specific factors that it uses to assess the credit implications of the
9 regulatory jurisdictions of investor-owned regulated utilities: (1) regulatory stability; (2)
10 tariff-setting procedures and design; (3) financial stability; and (4) regulatory independence
11 and insulation.⁴⁴

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

14 A. The regulatory environment can significantly affect both the access to and cost of capital
15 in several ways. First, the proportion and cost of debt capital available to utility companies
16 are influenced by the rating agencies' assessment of the regulatory environment. As noted
17 by Moody's, "[u]tility rates are set in a political/regulatory process rather than a
18 competitive or free-market process; thus, the regulatory framework is a key determinant of
19 the credit quality of a utility."⁴⁵ Moody's further highlighted the relevance of a stable and
20 predictable regulatory environment to a utility's credit quality, noting: "[t]he regulatory

⁴² Moody's Ratings, "Rating Methodology: Regulated Electric and Gas Utilities," August 6, 2024, at 2.

⁴³ S&P Global Ratings, "Sector-Specific Corporate Methodology," April 4, 2024, at 147.

⁴⁴ *Id.*

⁴⁵ Moody's Ratings, "Rating Methodology: Regulated Electric and Gas Utilities," August 6, 2024, at 8.

1 framework is important because it provides the basis for decisions that affect utilities,
2 including rate-setting as well as the consistency and predictability of regulatory decision-
3 making.”⁴⁶

4 **Q. Have the credit rating agencies identified significant risk factors for utilities in the**
5 **current regulatory environment?**

6 A. Yes. The credit rating agencies have specifically identified political risk as well as
7 pressures related to affordability at a time when utilities have significant capital
8 investments as increasing the overall regulatory risk for utilities.

9 At the end of 2025 Moody’s had maintained its “stable” outlook for 2026 for the
10 regulated gas and electric utilities sector based on the expectation of continued regulatory
11 support in “most states.”⁴⁷ Moody’s makes clear that constructive regulatory outcomes
12 that promote timely cost recovery is the key factor in supporting utility credit quality as
13 Moody’s has identified that utilities could be exposed to a number of credit negative factors
14 over the next 12 to 18 months. Specifically, Moody’s noted the following factors: (1)
15 macroeconomic factors are expected to be modestly credit negative due to upward pressure
16 on natural gas prices and elevated inflation; and (2) increased power demand due to “the
17 development of new data centers, electrification of transportation and buildings,
18 manufacturing customers and underlying population growth” will increase power prices
19 which when coupled with inflation and elevated capital spending increases utilities’
20 exposure to affordability concerns.⁴⁸ In May 2026 Moody’s issued a report indicating that

⁴⁶ *Id.*

⁴⁷ Moody’s Ratings, Outlook, “Outlook Stable; supportive regulation to offset modestly negative macro factors,” October 31, 2025.

⁴⁸ *Id.*

1 political intervention in the rate process is credit negative for electric, gas and water
2 utilities. Moody's also noted that "affordability is becoming an increasingly important
3 credit consideration for regulated utilities in the US amid rising supply costs and steady
4 inflation."⁴⁹

5 In January 2026, S&P's outlook for the industry stated that after five years of
6 downgrades outpacing upgrades, in 2025, upgrades outpaced downgrades and the
7 percentage of companies with a negative outlook declined, which S&P noted pointed to a
8 "more stable environment for credit quality in 2026."⁵⁰ However, S&P expected the
9 industry to have increased cash flow deficits as a result of significant capital spending,
10 which must be funded with both debt and equity to maintain credit quality.⁵¹ S&P
11 recognized the need for the utility industry to access capital markets to fund the significant
12 capital expenditures. S&P also noted that credit quality would depend on the ability of
13 utilities to manage regulatory risk and achieve fair rate case orders.

14 While S&P's base case results in a stable outlook for the utility sector, S&P states
15 that about 40 percent of the industry has "minimal financial cushion" from the downgrade
16 threshold and therefore would have limited ability to absorb any unexpected events outside
17 of what is assumed in S&P's base case.⁵² Three months later, S&P issued a white paper
18 that highlighted the risks associated with affordability concerns, highlighting the effect on
19 credit quality.

⁴⁹ Moody's Ratings, Regulated Utilities- Pennsylvania, "Political Intervention in rate process is credit negative for electric, gas and water utilities," May 19, 2026.

⁵⁰ S&P Global Ratings. Industry Credit Outlook 2026, "North American Regulated Utilities: Data center growth will support credit quality in 2026," January 14, 2026.

⁵¹ *Id.*

⁵² *Id.*

1 If affordability concerns persist, political intervention may intensify, posing
2 risk to credit quality. Even in states where bills remain comparatively
3 affordable, recent increases have proven politically salient. Rising
4 competitive capacity costs, which utilities pass through to the customer bill,
5 have already become a campaign issue in certain jurisdictions.

6 ***

7 Over time, persistently elevated bills may result in less credit-supportive
8 rate case outcomes, eroding financial stability.⁵³

9 Fitch Ratings (“Fitch”) had a “neutral” outlook for the utility industry going into
10 2026 noting that the stable outlook was supported by growth in sales related to data centers
11 and a “generally benign” regulatory environment for utilities.⁵⁴ Fitch viewed load growth
12 as a “positive development,” however, because the growth is related to data centers, it
13 raises longer-term uncertainty related to “rate design, customer concentration, and
14 technology risks.”⁵⁵ Further, at that time, Fitch expected capital expenditures for the
15 industry to “set records” in order to meet the growing demand and to enhance reliability
16 and modernization and noted the need for a balanced regulatory environment to facilitate
17 cost recovery in a credit supportive manner.⁵⁶

18 On June 12, 2026, Fitch downgraded its outlook on the North American Utilities
19 sector from” neutral to ‘deteriorating’, reflecting rising affordability concerns that are
20 increasing political and regulatory risk for the sector.”⁵⁷ Further, Fitch noted that “[w]hile
21 our 2026 outlook issued in December 2025 identified regulatory resistance to rate increases

⁵³ S&P Global Ratings, RatingsDirect, White Paper: “Affordability Is Emerging As A Defining Issue For The U.S. Investor-Owned Electric Utility Industry,” March 11, 2026.

⁵⁴ Fitch Ratings, “North American Utilities & Power Outlook 2026,” December 9, 2025, at 1

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ FitchRatings, Fitch Wire, “FitchRatings Revises North American Utilities & Power Outlook to Deteriorating,” June 12, 2026.

1 as a key watchpoint, developments in 1H26 confirm that this risk is materializing faster
2 and more broadly than anticipated.⁵⁸

3 The continued concerns of the credit rating agencies over increased capital
4 expenditures underscore the importance of maintaining adequate cash flow metrics for the
5 Company in the context of this proceeding.

6 2. Regulatory Framework

7 **Q. Have you conducted any analysis of the risk associated with the regulatory**
8 **framework in South Dakota relative to the jurisdictions in which the utility operating**
9 **subsidiaries of the companies in your proxy group operate?**

10 A. Yes. I have evaluated the regulatory framework in South Dakota on three factors that are
11 important in terms of providing a regulated utility a reasonable opportunity to earn its
12 authorized ROE: (1) test year convention for ratemaking (*i.e.*, forecast vs. historical test
13 year); (2) use of rate design and/or other mechanisms that mitigate volumetric risk and
14 stabilize revenue; and (3) ability to recover capital cost costs between rate cases. The
15 results of this regulatory risk assessment are shown on Exhibit AEB 1.1, Schedule 10 and
16 are summarized below:

17 Test Year Convention: The Company is proposing to use a historical test
18 year ending December 31, 2025, while 57 percent of the utility operating
19 subsidiaries of the companies in the proxy group use forecasted or partially
20 forecasted test years. Forecasted test years have been relied on in many
21 jurisdictions for years and produce cost estimates that are more reflective of
22 future costs, which results in more accurate recovery of incurred costs and
23 mitigates the regulatory lag associated with historical test years.

24 Volumetric Risk: Currently, the Company does not have protection against
25 volumetric risk in South Dakota, either through a revenue decoupling
26 mechanism, formula rate plan, or straight fixed-variable rate design.
27 However, the Company is proposing a sales reconciliation mechanism

⁵⁸ *Id.* 1H26 is the first half of 2026.

1 (“Clause SRM”) for certain rate classes.⁵⁹ Similarly, 84 percent of the utility
2 operating subsidiaries of the proxy group companies have some form of
3 protection against volumetric risk either through revenue decoupling,
4 formula-based rates, or straight fixed-variable rate design. Therefore,
5 MidAmerican faces similar risk relative to the proxy group given that a
6 large majority of the utility operating subsidiaries of the proxy group
7 companies have some form of stabilization against volumetric risk (*e.g.*,
8 decoupling; formula-based rates; and/or straight-fixed variable rate design)
9 that allow them to break the link between customer usage and revenues.

10 Capital Cost Recovery: As noted previously, MidAmerican does not
11 currently have a capital tracking mechanism to recover capital investment
12 costs between rate cases. In contrast, 80.00 percent of the utility operating
13 subsidiaries of the proxy group companies have some form of capital cost
14 recovery mechanism.

15 **Q. Have you developed any additional analyses to evaluate the regulatory environment**
16 **in South Dakota as compared to the jurisdictions in which the companies in your**
17 **proxy group operate?**

18 A. Yes. I have conducted two additional analyses to compare the regulatory framework of
19 South Dakota to the jurisdictions in which the companies in the proxy group operate.
20 Specifically, I have considered two different rankings: (1) RRA’s ranking of regulatory
21 jurisdictions; and (2) S&P’s ranking of the credit supportiveness of regulatory jurisdictions.

22 **Q. How does RRA evaluate the regulatory environment in each jurisdiction?**

23 A. RRA evaluates the regulatory environment from an investor perspective, considering the
24 relative regulatory risk associated with ownership of securities issued by the companies
25 that are regulated in each jurisdiction. RRA considers multiple factors that affect the
26 regulatory process including state regulatory commission decisions, the impact of actions

⁵⁹ Direct Testimony of Derek C. Nelson, Exhibits DCN 1.1, Schedule A & DCN 1.2, Schedule A.

1 taken by the governor, the legislature, the courts, and consumer advocacy groups, and
2 numerous factors regarding the ratemaking environment within the jurisdiction.⁶⁰

3 **Q. How do you use the RRA rankings to compare the regulatory jurisdictions of the**
4 **proxy group companies with MidAmerican's regulatory jurisdiction?**

5 A. RRA assigns a ranking for each regulatory jurisdiction as "Above Average", "Average",
6 or "Below Average", and then within each of those categories, a numeric ranking from 1
7 to 3. Thus, there are a total of nine RRA rankings, with the rankings for each jurisdiction
8 ranging from "Above Average/1", which is considered the most supportive, to "Below
9 Average/3," which is the least supportive. I have applied a numeric ranking system to the
10 RRA rankings with "Above Average/1" assigned the highest ranking (*i.e.*, a "1") and
11 "Below Average/3" assigned the lowest ranking (*i.e.*, a "9").

12 **Q. What are the results of this RRA jurisdictional ratings comparison?**

13 A. As shown on Exhibit AEB 1.1, Schedule 11, the South Dakota jurisdictional ranking is
14 "5.0" (*i.e.*, "Average/2") as compared to the proxy group average ranking of "4.74" (*i.e.*,
15 between "Average/1" and "Average/2"), which means that South Dakota is considered by
16 RRA to have a slightly higher degree of regulatory risk as compared to the proxy group,
17 on average.

18 **Q. How have you conducted your analysis of the S&P credit supportiveness rankings?**

19 A. For credit supportiveness, S&P classifies each regulatory jurisdiction into five categories
20 that range from "Most Credit Supportive" down to "Credit Supportive." My comparison
21 of the credit supportiveness of MidAmerican's regulatory jurisdiction to those in which the
22 proxy companies operate is similar to the analysis of the RRA overall regulatory ranking

⁶⁰ S&P Global Market Intelligence, "RRA State Regulatory Evaluations – Energy," September 2025.

just discussed. I assign a numerical ranking to each category, from “Most Credit Supportive” (“1”) to “Credit Supportive” (“5”).

Q. What are the results of this S&P credit supportiveness comparison?

A. As shown on Exhibit AEB 1.1, Schedule 12, the South Dakota jurisdictional ranking is “3.00” (*i.e.*, “Very Credit Supportive”) as compared to the proxy group average ranking of “2.35” (*i.e.*, between “Highly Credit Supportive” and “Very Credit Supportive”), which means that South Dakota is considered to be moderately less credit supportive by S&P as compared to the proxy group, on average.

Q. What are your conclusions regarding the regulatory risks related to the South Dakota regulatory environment?

A. Both Moody’s and S&P have identified the supportiveness of the regulatory environment as an important consideration in developing their overall credit ratings for regulated utilities. Considering that South Dakota is viewed as a relatively less supportive jurisdiction according to the RRA and S&P rankings, the companies in the proxy group have more timely cost recovery between rate proceedings as compared to MidAmerican, the Company does not currently have the ability to mitigate volumetric risk (although, as noted, the Company is proposing the Clause SRM in this proceeding), it indicates that, on balance, the Company’s regulatory risk is moderately higher when compared to the proxy group.

C. Small Size Risk

Q. Is there a risk to a firm associated with small size?

A. Yes. Both the financial and academic communities have long accepted the proposition that the cost of equity for small firms is subject to a “size effect.” Although empirical evidence

1 of the size effect often is based on studies of industries other than regulated utilities, utility
2 analysts also have noted the risk associated with small market capitalizations. Specifically,
3 an analyst for Ibbotson Associates noted:

4 For small utilities, investors face additional obstacles, such as a smaller
5 customer base, limited financial resources, and a lack of diversification
6 across customers, energy sources, and geography. These obstacles imply a
7 higher investor return.⁶¹

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

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

18 **Q. How do MidAmerican's natural gas operations in South Dakota compare in size to**
19 **the companies in the proxy group companies?**

20 A. The Company's natural gas distribution operations are substantially smaller than the
21 median for the proxy group companies in terms of market capitalization. Although
22 MidAmerican is not publicly traded on a stand-alone basis, as shown on Exhibit AEB 1.1,
23 Schedule 13, MidAmerican's common equity based on its proposed test year rate base and

⁶¹ Michael Annin, "Equity and the Small-Stock Effect," *Public Utilities Fortnightly*, October 15, 1995.

1 equity ratio is substantially smaller than the median market capitalization of the proxy
2 group companies.

3 **Q. Have you estimated the effect of small size for MidAmerican?**

4 A. Yes. Given this relative size information, it is possible to estimate the impact of size on
5 the cost of equity for the Company using *Kroll* Cost of Capital Navigator data that estimates
6 the stock risk premia based on the size of a company's market capitalization.⁶² As shown
7 on Exhibit AEB 1.1, Schedule 13, the median market capitalization of the proxy group is
8 approximately \$5.66 billion, which corresponds to the sixth decile of *Kroll's* market
9 capitalization data.⁶³ Based on *Kroll's* analysis, that decile corresponds to a size premium
10 of 0.65 percent (*i.e.*, 65 basis points). In comparison, MidAmerican's common equity of
11 approximately \$105.14 million falls within the tenth decile, which corresponds to a size
12 premium of 4.37 percent (*i.e.*, 437 basis points). The difference between the size premium
13 for the Company and the size premium for the proxy group is 373 basis points (*i.e.*, 437
14 percent minus 0.65 percent).

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

16 A. Yes. As shown in Exhibit 7.2 of *Kroll's* 2019 Valuation Handbook, OGE Energy Corp.
17 had the largest market capitalization of the companies contained in the fourth decile, which
18 indicates that *Kroll* has included utility companies in its size risk premium study.⁶⁴

⁶² *Kroll*, Cost of Capital Navigator – Size Premium: Annual data as of December 31, 2025.

⁶³ *Id.*

⁶⁴ Duff & Phelps, Valuation Handbook: Guide to Cost of Capital, 2019, Exhibit 7.2.

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

3 A. Yes. For example, Zepp (2003) provided the results of two studies that showed evidence
4 of the required risk premium for small water utilities. The first study, which was conducted
5 by the Staff of the California Public Utilities Commission, computed proxies for beta risk
6 using accounting data from 1981 through 1991 for 58 water utilities and concluded that
7 smaller water utilities had greater risk and required higher returns on equity than larger
8 water utilities.⁶⁵ The second study examined the differences in required returns over the
9 period of 1987 through 1997 for two large and two small water utilities in California. As
10 Zepp (2003) showed, the required return for the two small water utilities calculated using
11 the DCF model was on average 99 basis points higher than the two larger water utilities.⁶⁶

12 Additionally, Chrétien and Coggins (2011) studied the CAPM and its ability to
13 estimate the risk premium for the utility industry, and in particular subgroups of utilities.⁶⁷

14 The authors considered the CAPM, the Fama-French three-factor model, and a model
15 similar to the ECAPM, which as previously discussed, I have also considered in estimating
16 the cost of equity for MidAmerican. In the study, the Fama-French three-factor model
17 explicitly included an adjustment to the CAPM for risk associated with size. As Chrétien
18 and Coggins (2011) show, the beta coefficient on the size variable for the U.S. natural gas

⁶⁵ Thomas M. Zepp, “Utility Stocks and the Size Effect – Revisited,” *The Quarterly Review of Economics and Finance*, Vol. 43, No. 3, 2003, at 578-582.

⁶⁶ *Id.*

⁶⁷ Stéphane Chrétien, and Frank Coggins, “Cost Of Equity For Energy Utilities: Beyond The CAPM,” *Energy Studies Review*, Vol. 18, No. 2, 2011.

1 utility group was positive and statistically significant, indicating that small size risk was
2 relevant for regulated natural gas utilities.⁶⁸

3 **Q. Have regulators in other jurisdictions made a specific risk adjustment to the cost of**
4 **equity results based on a company's small size?**

5 A. Yes. For example, the Regulatory Commission of Alaska ("RCA") has concluded that
6 Alaska Electric Light and Power Company ("AEL&P") was riskier than the proxy group
7 companies due to small size as well as other business risks. The RCA stated that it did
8 "not believe that adopting the upper end of the range of ROE analyses in this case, without
9 an explicit adjustment, would adequately compensate AEL&P for its greater risk."⁶⁹ Thus,
10 the RCA awarded AEL&P an ROE of 12.875 percent, which was 108 basis points above
11 the highest cost of equity estimate from any model presented in the case.⁷⁰ Similarly, the
12 RCA noted that small size, as well as other business risks such as structural regulatory lag,
13 weather risk, alternative rate mechanisms, gas supply risk, geographic isolation, and
14 economic conditions, increased the risk of ENSTAR Natural Gas Company.⁷¹ Ultimately,
15 the RCA concluded that:

16 Although we agree that the risk factors identified by ENSTAR increase its
17 risk, we do not attempt to quantify the amount of that increase. Rather, we
18 take the factors into consideration when evaluating the remainder of the
19 record and the recommendations presented by the parties. After applying
20 our reasoned judgment to the record, we find that 11.875% represents a fair
21 ROE for ENSTAR.⁷²

⁶⁸ *Id.*

⁶⁹ Regulatory Commission of Alaska, Docket No. U-10-29, Order No. 15, September 2, 2011, at 37.

⁷⁰ *Id.*, at 32 and 37.

⁷¹ Regulatory Commission of Alaska, Docket No. U-16-066, Order No. 19, September 22, 2017, at 50-52.

⁷² *Id.*

1 Additionally, the Minnesota Public Utilities Commission (“Minnesota PUC”) has
2 selected an ROE above the mean DCF results for Otter Tail Power Company (“Otter Tail”)
3 as a result of multiple factors, including Otter Tail’s small size. The Minnesota PUC stated:

4 The record in this case establishes a compelling basis for selecting an ROE
5 above the mean average within the DCF range, given Otter Tail’s unique
6 characteristics and circumstances relative to other utilities in the proxy
7 group. These factors include the company’s relatively smaller size,
8 geographically diffuse customer base, and the scope of the Company’s
9 planned infrastructure investments.⁷³

10 Also, in Opinion Nos. 569 and 569-A, the Federal Energy Regulatory Commission
11 (“FERC”) has relied on a size premium adjustment in its CAPM estimates for electric
12 utilities. In those decisions, the FERC noted that “the size adjustment was necessary to
13 correct for the CAPM’s inability to fully account for the impact of firm size when
14 determining the cost of equity.”⁷⁴ FERC further agreed with the continued use of a size
15 premium adjustment in Opinion No. 594 to correct for the inability of the CAPM to fully
16 account for the impact of firm size when determining the cost of equity.⁷⁵

17 **Q. How have you considered the smaller size of the Company’s operations in your**
18 **recommendation?**

19 A. Although I have estimated the effect of the relative difference in the size of MidAmerican
20 on the cost of equity, I am not proposing a specific adjustment for this risk factor. Rather,
21 I have considered the small size of the Company’s operations, along with the other risk

⁷³ Minnesota Public Utilities Commission, Order in Docket No. E017/GR-15-1033, Order, August 16, 2016, at 55.

⁷⁴ *Ass’n. of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 171 FERC 61,154 (2020), at ¶ 75. The U.S. Court of Appeals recently vacated FERC Opinion No. 569 decisions that related to its risk premium model and remanded the case to FERC to reopen the proceedings. However, in its decision, the court did not reject FERC’s inclusion of the size premium to estimate the CAPM. (*See* United States Court of Appeals Case No. 16-1325, Decision No. 16-1325, August 9, 2022, at 20).

⁷⁵ FERC Opinion No. 594, issued March 19, 2026, at ¶ 255 and 261.

1 factors previously discussed, in determining where, within the range of analytical results,
2 it is reasonable for its ROE to be established.

3 **VIII. CAPITAL STRUCTURE**

4 **Q. Is the Company's capital structure an important consideration in determining the**
5 **appropriate ROE?**

6 A. Yes. The equity ratio is one of the primary indicators of financial risk for a regulated utility
7 such as the Company. All else equal, a higher debt ratio increases the risk to equity
8 investors. For debt holders, higher debt ratios result in a greater portion of the available
9 cash flow being required to meet debt service, thereby increasing the risk associated with
10 the payments on debt. The result of increased risk is a higher interest rate. The incremental
11 risk of a higher debt ratio is more significant for common equity shareholders, whose claim
12 on the cash flow of the Company is secondary to debt holders. Therefore, the greater the
13 debt service requirement, the less cash flow is available for common equity holders.

14 **Q. What is MidAmerican's proposed capital structure?**

15 A. The Company proposes to establish a capital structure consisting of 54.481 percent
16 common equity and 45.519 percent long-term debt.

17 **Q. Have you analyzed whether this requested equity ratio was reasonable?**

18 A. Yes. I have compared the Company's proposed capital structure relative to the actual
19 capital structures of the utility operating subsidiaries of the companies in the proxy group.
20 The cost of equity is estimated based on the return that is derived from companies in the
21 proxy group that are deemed to be comparable in risk to the Company; however, those
22 companies must be publicly traded to apply the cost of equity models. The operating utility
23 subsidiaries of the proxy group companies are most risk-comparable to the Company, and

1 thus it is important to look to the average capital structure of the operating utilities of the
2 proxy group to benchmark the equity ratios for the Company.

3 Specifically, I have calculated the average proportion of common equity, long-term
4 debt, and preferred equity for the most recent three years for each of the utility operating
5 subsidiaries of the proxy group companies. As shown in Exhibit AEB 1.1, Schedule 14,
6 the equity ratios for the utility operating subsidiaries of the proxy group range from 48.43
7 percent to 69.93 percent, with a mean of 55.82 percent. As such, MidAmerican's proposed
8 equity ratio of 54.481 percent is well within the range of equity ratios of the utility
9 operating subsidiaries of the proxy group, and, below the mean of the proxy group.

10 **IX. CONCLUSIONS AND RECOMMENDATION**

11 **Q. Will the capital structure and ROE authorized in this proceeding affect the**
12 **Company's access to capital at reasonable rates?**

13 A. Yes. Because a utility's investment horizon is very long, investors require the assurance
14 of a sufficiently high return to satisfy the long-run financing requirements of the assets
15 placed into service. Those assurances, which often are measured by the relationship
16 between internally generated cash flows and debt (or interest expense), depend quite
17 heavily on the capital structure. Consequently, both the ROE and capital structure are very
18 important to debt and equity investors, particularly given the capital market conditions
19 discussed previously.

20 **Q. What is your conclusion regarding a fair ROE for MidAmerican?**

21 A. Figure 10 summarizes the results of my cost of equity analyses. Based on these results, the
22 qualitative analyses presented in my direct testimony, the business and financial risks of

MidAmerican as compared to the proxy group, and current and prospective conditions in capital markets, the Company's requested ROE of 10.50 percent is reasonable.

Figure 10: Summary of Analytical Results

	Minimum Growth Rate	Average Growth Rate	Maximum Growth Rate
<u>Constant Growth DCF</u>			
30-Day Avg. Stock Price	9.74%	10.61%	11.67%
90-Day Avg. Stock Price	9.56%	10.55%	11.62%
180-Day Avg. Stock Price	9.71%	10.71%	11.66%
Average	9.67%	10.62%	11.65%
<u>30-Year Treasury Bond Yield</u>			
	Current 30-Day Avg.	Near-Term Forecast	Longer-Term Forecast
<u>CAPM</u>			
Current <i>Value Line</i> Beta	11.27%	11.23%	11.19%
Long-term Avg. <i>Value Line</i> Beta	11.31%	11.28%	11.24%
<u>ECAPM</u>			
Current <i>Value Line</i> Beta	11.79%	11.77%	11.74%
Long-term Avg. <i>Value Line</i> Beta	11.82%	11.80%	11.77%
<u>Bond Yield Risk Premium</u>	10.70%	10.63%	10.54%

1 **Q. What is your conclusion regarding the Company's proposed capital structure?**

2 A. The Company's proposed capital structure consisting of 54.481 percent common equity is
3 reasonable when compared to the actual capital structures of the operating utility
4 subsidiaries of the proxy group companies.

5 **Q. Does this conclude your direct testimony?**

6 A. Yes, it does.