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IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION)	CASE NO. AVU-E-09-01
OF AVISTA CORPORATION FOR THE)	CASE NO. AVU-G-09-01
AUTHORITY TO INCREASE ITS RATES)	
AND CHARGES FOR ELECTRIC AND)	DIRECT TESTIMONY
NATURAL GAS SERVICE TO ELECTRIC)	OF
AND NATURAL GAS CUSTOMERS IN THE)	WILLIAM E. AVERA
STATE OF IDAHO)	
)	

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

DIRECT TESTIMONY OF WILLIAM E. AVERA

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EXHIBIT No. 3

Schedule -1 -	Qualifications of William E. Avera
Schedule -2 -	Description of Quantitative Analyses
Schedule -3 -	Capital Structure
Schedule -4 -	Constant Growth DCF Model - Utility Proxy Group
Schedule -5 -	Sustainable Growth Rate - Utility Proxy Group
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Schedule -7 -	Sustainable Growth Rate - Non-Utility Proxy Group
Schedule -8 -	Forward-looking CAPM - Utility Proxy Group
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Schedule -10-	Comparable Earnings Approach

1 I. INTRODUCTION

2 Q. Please state your name and business address.

3 A. William E. Avera, 3907 Red River, Austin, Texas,
4 78751.

5 Q. In what capacity are you employed?

6 A. I am the President of FINCAP, Inc., a firm
7 providing financial, economic, and policy consulting
8 services to business and government.

9 Q. Please describe your educational background and
10 professional experience.

11 A. A description of my background and
12 qualifications, including a resume containing the details
13 of my experience, is attached as Exhibit 3, Schedule 1.

14 A. Overview

15 Q. What is the purpose of your testimony in this
16 case?

17 A. The purpose of my testimony is to present to the
18 Idaho Public Utilities Commission (the "Commission" or
19 "IPUC") my independent evaluation of the fair rate of
20 return on equity ("ROE") for the jurisdictional electric
21 and gas utility operations of Avista Corp. ("Avista" or
22 "the Company"). In addition, I also examined the
23 reasonableness of Avista's capital structure, considering
24 both the specific risks faced by the Company and other
25 industry guidelines.

1 **Q. Please summarize the information and materials**
2 **you relied on to support the opinions and conclusions**
3 **contained in your testimony.**

4 A. To prepare my testimony, I used information from
5 a variety of sources that would normally be relied upon by
6 a person in my capacity. I am familiar with the
7 organization, finances, and operations of Avista from my
8 participation in prior proceedings before the IPUC, the
9 Washington Utilities and Transportation Commission, and the
10 Oregon Public Utility Commission. In connection with the
11 present filing, I considered and relied upon corporate
12 disclosures, publicly available financial reports and
13 filings, and other published information relating to
14 Avista. I also reviewed information relating generally to
15 current capital market conditions and specifically to
16 current investor perceptions, requirements, and
17 expectations for Avista's utility operations. These
18 sources, coupled with my experience in the fields of
19 finance and utility regulation, have given me a working
20 knowledge of the issues relevant to investors' required
21 return for Avista, and they form the basis of my analyses
22 and conclusions.

23 **Q. What is the role of the rate of return on common**
24 **equity in setting a utility's rates?**

25 A. The ROE serves to compensate common equity
26 investors for the use of their capital to finance the plant

1 and equipment necessary to provide utility service.
2 Investors commit capital only if they expect to earn a
3 return on their investment commensurate with returns
4 available from alternative investments with comparable
5 risks. To be consistent with sound regulatory economics
6 and the standards set forth by the U.S. Supreme Court in
7 the *Bluefield*¹ and *Hope*² cases, a utility's allowed ROE
8 should be sufficient to: 1) fairly compensate the utility's
9 investors, 2) enable the utility to offer a return adequate
10 to attract new capital on reasonable terms, and 3) maintain
11 the utility's financial integrity.

12 **Q. How did you go about developing your conclusions**
13 **regarding a fair rate of return for Avista?**

14 A. I first reviewed the general conditions in
15 capital markets, as well as the operations and finances of
16 Avista and industry-specific risks perceived by investors.
17 With this as a background, I conducted various well-
18 accepted quantitative analyses to estimate the current cost
19 of equity, including alternative applications of the
20 discounted cash flow ("DCF") model and the Capital Asset
21 Pricing Model ("CAPM"), as well as reference to expected
22 earned rates of return. Based on the cost of equity
23 estimates indicated by my analyses, the Company's ROE was

¹ *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923).

² *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

1 evaluated taking into account the specific risks and
2 potential challenges for Avista's utility operations in
3 Idaho.

4 **B. Summary of Conclusions**

5 **Q. What are your findings regarding the fair rate of**
6 **return on equity for Avista?**

7 A. Based on the results of my analyses and the
8 economic requirements necessary to support continuous
9 access to capital under reasonable terms, I determined that
10 a fair ROE for Avista falls in the range of **11.3 percent to**
11 **13.3 percent**. The bases for my conclusion are summarized
12 below:

- 13 • The turmoil in financial markets has resulted in a
14 fundamental shift in investors' risk perceptions,
15 which has increased the cost of capital for
16 utilities such as Avista:
- 17 o The dramatic sell-off in common stocks and
18 sharp increase in utility bond yields
19 associated with the ongoing credit crisis are
20 indicative of a significant revision in
21 investors' willingness to assume risks, which
22 has led to higher costs for long-term capital;
 - 23 o Yields on triple-B rated utility bonds have
24 increased approximately 110 basis points since
25 the all-party settlement in Avista's last Idaho
26 rate proceeding was reached in August 2008,
27 which specified an ROE of 10.2 percent;
 - 28 o Because of the "flight to quality", government
29 bond yields have fallen sharply at the same
30 time that the required returns for other asset
31 classes, such as common stocks and public
32 utility bonds, have moved sharply higher to
33 compensate for increased perceptions of risk.
34 As a result trends in Treasury bond yields have
35 virtually no relevance in evaluating long-term
36 capital costs for Avista in the current capital
37 market climate.

1 • In order to reflect the risks and prospects
2 associated with Avista's jurisdictional utility
3 operations, my analyses focused on a proxy group of
4 seventeen other utilities with comparable
5 investment risks. Consistent with the fact that
6 utilities must compete for capital with firms
7 outside their own industry, I also referenced a
8 proxy group of comparable risk companies in the
9 non-utility sector of the economy;

10 • Because investors' required return on equity is
11 unobservable and no single method should be viewed
12 in isolation, I applied both the discounted cash
13 flow ("DCF") and capital asset pricing model
14 ("CAPM") methods, as well as the comparable
15 earnings approach, to estimate a fair ROE for
16 Avista:

- 17 o My application of the constant growth DCF model
18 considered four alternative growth measures
19 based on projected earnings growth, as well as
20 the sustainable, "br+sv" growth rate for each
21 firm in the respective proxy groups;
- 22 o After eliminating low- and high-end outliers,
23 my DCF analyses implied a cost of equity range
24 of **11.5 percent to 13.4 percent** for the proxy
25 group of utilities and **13.1 percent to 13.5**
26 **percent** for the group of non-utility companies;
- 27 o Application of the CAPM approach using forward-
28 looking data that best reflects the underlying
29 assumptions of this approach implied a cost of
30 equity of **11.2 percent** for the utility proxy
31 group and **11.5 percent** for the firms in the
32 non-utility proxy group;
- 33 o My evaluation of earned rates of return
34 expected for utilities suggested a cost of
35 equity on the order of at least **11.4 percent**;
- 36 o Based on these results, I concluded that the
37 cost of equity for the proxy groups of
38 utilities and non-utility companies is in the
39 **11.3 percent to 13.3 percent** range.

40 Considering investors' expectations for capital
41 markets and the need to support financial integrity and
42 fund crucial capital investment even under adverse
43 circumstances, I concluded that Avista's requested ROE of

1 11.0 percent is reasonable and, if anything, understated.

2 Based on my evaluation, I determined that:

3 • Because Avista's requested ROE of 11.0 percent
4 falls below the lower bound of my recommended
5 range, it represents a conservative estimate of
6 investors' required rate of return;

7 • The reasonableness of an 11.0 percent minimum ROE
8 for Avista is also supported by the need to
9 consider the Company's credit standing, which
10 remains relatively weak:

11 o The pressure of funding significant capital
12 expenditures of \$420 million in the next two
13 years, given that the Company's ratebase is
14 \$1.9 billion, coupled with increased operating
15 risks, heighten the uncertainties associated
16 with Avista;

17 o Because of Avista's reliance on hydroelectric
18 generation and increasing dependence on natural
19 gas fueled capacity, the Company is exposed to
20 relatively greater risks of power cost
21 volatility;

22 o Standard and Poor's Corporation ("S&P") ranks
23 Avista as 159 out of a total 175 utilities with
24 investment grade credit ratings, with only 16
25 companies in the industry having a credit
26 profile weaker than Avista's;

27 o Given Avista's present credit ratings, an
28 inadequate rate of return imposed in this
29 proceeding would further pressure the Company's
30 financial flexibility and credit standing;

31 o My conclusion that an 11.0 percent ROE for
32 Avista is a conservative estimate of investors'
33 required return is also reinforced by the
34 Company's relatively greater risks as compared
35 with the proxy groups, the greater
36 uncertainties associated with Avista's
37 relatively small size, and the fact that my
38 recommended ROE range does not consider
39 flotation costs.

1 **Q. What is your conclusion as to the reasonableness**
2 **of the Company's capital structure?**

3 A. Based on my evaluation, I concluded that a common
4 equity ratio of 50.0 percent represents a reasonable basis
5 from which to calculate Avista's overall rate of return.
6 This conclusion was based on the following findings:

7 • Avista's requested capitalization is consistent
8 with the Company's need to strengthen its credit
9 standing and financial flexibility as it seeks to
10 raise additional capital to fund significant system
11 investments and meet the requirements of its
12 service territory;

13 • Avista's proposed common equity ratio is entirely
14 consistent with the range of common equity ratios
15 maintained by the proxy group of utilities and is
16 in-line with the 47.2 percent and 50.8 percent
17 average equity ratios, based on year-end 2007 data
18 and near-term expectations, respectively.

19 • My conclusion is reinforced by the investment
20 community's focus on the need for a greater equity
21 layer to accommodate higher operating risks and the
22 pressures of funding significant capital
23 investments. This is reinforced by the need to
24 consider the impact of unfavorable capital markets
25 conditions, as well as off-balance sheet
26 commitments such as purchased power agreements,
27 which carry with them some level of imputed debt.

28 **Q. What other evidence did you consider in**
29 **evaluating your recommendation in this case?**

30 A. My recommendation was reinforced by the following
31 findings:

32 • Sensitivity to regulatory uncertainties has
33 increased dramatically and investors recognize
34 that constructive regulation is a key ingredient
35 in supporting utility credit standing and
36 financial integrity;

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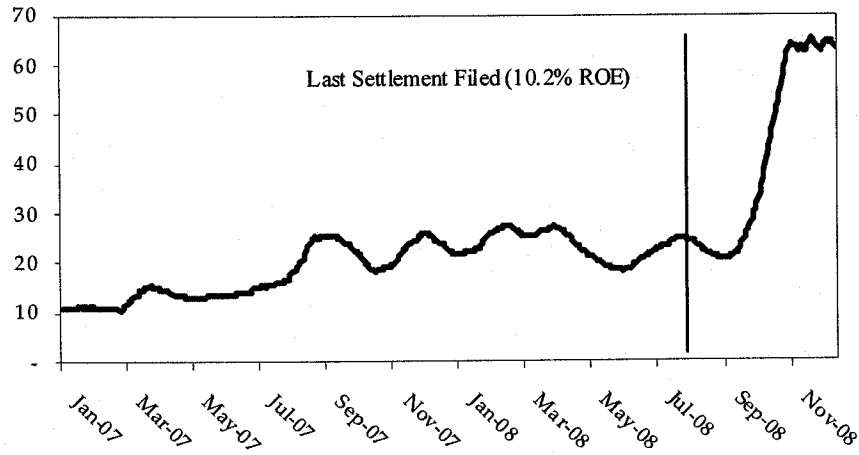
A. Long-term Capital Costs Have Increased

Q. What are the implications of recent capital market conditions?

A. Recent volatility in the debt and equity markets linked to the ongoing financial crisis and the economic downturn evidences investors' trepidation to commit capital and marks a significant upward revision in their perceptions of risk and required returns since the last agreed-upon ROE of 10.2%. The Chicago Board Options Exchange Volatility Index, commonly known as the "VIX", is a key measure of expectations of near-term volatility and market sentiment based on options prices for the S&P 500 Composite Stock Index ("S&P 500"). The unprecedented price fluctuations and uncertainty that investors have endured since the third-quarter of 2008 is mirrored in the sharp and sustained increase in the VIX, plotted in Figure WEA-1, below. The vertical line on the graph represents the date that Avista's settlement agreement was filed with the IPUC in the last case. The graph illustrates the dramatic increase in volatility since that rate case.

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FIGURE WEA-1
CBOE VIX INDEX – ONE-MONTH MOVING AVERAGE



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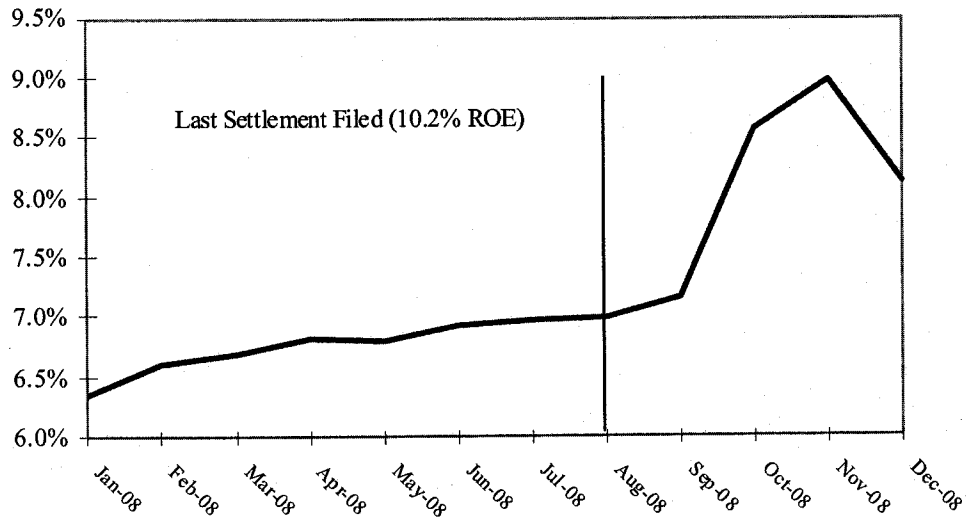
Bloomberg reported in October 2008 that the VIX had surged 26 percent to almost triple its average during the past year.³

7 With respect to utilities specifically, as of year-end
8 2008, the Dow Jones Utility Average stock index had
9 declined over 28 percent since June 2008, while yields on
10 utility bonds have increased precipitously. Figure WEA-2
11 below plots the monthly average yields on triple-B utility
12 bonds reported by Moody's Investors Service ("Moody's")
13 from January to December 2008:

³ Kearns, Jeff, "VIX 'Exploding' as Stocks Plunge on Growing Recession Concern," *Bloomberg* (Oct. 15, 2008).

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FIGURE WEA-2
MOODY'S TRIPLE-B PUBLIC UTILITY BOND YIELDS⁴



3 As illustrated above, from January to August 2008 the
4 average yield on triple-B rated utility bonds increased
5 gradually to approximately 7 percent. Meanwhile, Moody's
6 reported that for the months of October and November 2008
7 the average yield on triple-B utility bonds had climbed to
8 8.6 percent and 9.0 percent, respectively. The monthly
9 yield for December 2008 of 8.1 percent is approximately 110
10 basis points higher than the average in August 2008, when
11 the all-party settlement in Avista's last Idaho rate
12 proceeding was reached, establishing a 10.2% ROE. Thus,
13 bondholders are demanding a higher return to hold utility
14 debt.

⁴ Based on seasoned bonds with maturities of at least 20 years.

1 **Q. What does this evidence indicate with respect to**
2 **establishing a fair ROE for Avista?**

3 A. The dramatic sell-off in common stocks and sharp
4 increase in utility bond yields are indicative of higher
5 costs for long-term capital, and the ongoing credit crisis
6 has spilled over into the utility industry. For example,
7 utilities have been forced to draw on short-term credit
8 lines to meet debt retirement obligations because of
9 uncertainties regarding the availability of long-term
10 capital.⁵ As the *Edison Electric Institute* ("EEI") noted
11 in a letter to congressional representatives, the financial
12 crisis has serious implications for utilities and their
13 customers:

14 In the wake of the continuing upheaval on Wall
15 Street, capital markets are all but immobilized,
16 and short-term borrowing costs to utilities have
17 already increased substantially. If the
18 financial crisis is not resolved quickly,
19 financial pressures on utilities will intensify
20 sharply, resulting in higher costs to our
21 customers and, ultimately, could compromise
22 service reliability.⁶

23 Similarly, an October 1, 2008, *Wall Street Journal*
24 report confirmed that dislocations in credit markets were
25 also impacting the utility sector:

26 Disruptions in credit markets are jolting the
27 capital-hungry utility sector, forcing companies

⁵ Riddell, Kelly, "Cash-Starved Companies Scrap Dividends, Tap Credit,"
Pittsburgh Post-Gazette (Oct. 2, 2008).

⁶ *Letter to House of Representatives*, Thomas R. Kuhn, President, Edison
Electric Institute (Sep. 24, 2008).

1 to delay new borrowing or come up with different-
2 often more costly-ways of raising cash.⁷

3 An October 2008 report on the implications of credit market
4 upheaval for utilities noted that, while high-quality
5 companies can still issue debt, "they now have to pay an
6 unusually high risk premium over Treasuries."⁸ Similarly,
7 S&P recently concluded:

8 Regulated electric issuers continued to access
9 debt markets during the fourth quarter of 2008 at
10 rates in line with the 10-year average of about
11 8% for five-year notes, not the abnormally low
12 interest rate environment of the 2000's which is
13 a distant memory.⁹

14 Meanwhile, a Managing Director with Fitch Ratings, Ltd.
15 ("Fitch") observed that with debt costs at present levels,
16 "significantly higher regulated returns will be required to
17 attract equity capital."¹⁰ As Fitch concluded:

18 The collapse in secondary market debt pricing and
19 in equity valuations is worrisome. We see new
20 debt now priced at around 9% or higher pushing up
21 against average authorized ROEs for utilities of
22 around 10.25% to 10.50%. Thus, raising new
23 equity, which is now priced close to book value,
24 is likely to be dilutive.¹¹

25 More recently, Fitch confirmed "sharp repricing of and
26 aversion to risk in the investment community," and noted

⁷ *Wall Street Journal* "Turmoil in Credit Markets Send Jolt to Utility Sector" (Oct. 1, 2008), p. B4.

⁸ *Rudden's Energy Strategy Report* (Oct. 1, 2008).

⁹ Standard & Poor's Corporation, "Industry Report Card: U.S. Electric Utility Credit Quality Remains Strong Amid Continuing Economic Downturn," *RatingsDirect* (Dec. 19, 2008).

¹⁰ Fitch Ratings Ltd., "EEI 2008 Wrap-Up: Cost of Capital Rising," *Global Power North America Special Report* (Nov. 17, 2008).

¹¹ Fitch Ratings Ltd., "Investing In An Unpredictable World," *Fitch Ratings' 20th Annual Global Power Breakfast* (Nov. 10, 2008).

1 that the disruptions in financial markets and the
2 fundamental shift in investors' risk perceptions has
3 increased the cost of capital for utilities such as Avista:

4 The broad credit markets are in shambles and
5 access to credit is restrictive, particularly at
6 lower credit ratings. While credit is available
7 to investment-grade issuers in the utilities,
8 power and gas sectors, it is more expensive,
9 particularly when viewed against the easy money
10 environment which prevailed for most of this
11 decade.¹²

12 Fitch concluded, "The sharp increase in the cost of
13 equity capital is a negative credit development."¹³

14 **Q. Do trends in the yields on Treasury notes and**
15 **bonds accurately reflect the expectations and requirements**
16 **of Avista's equity investors?**

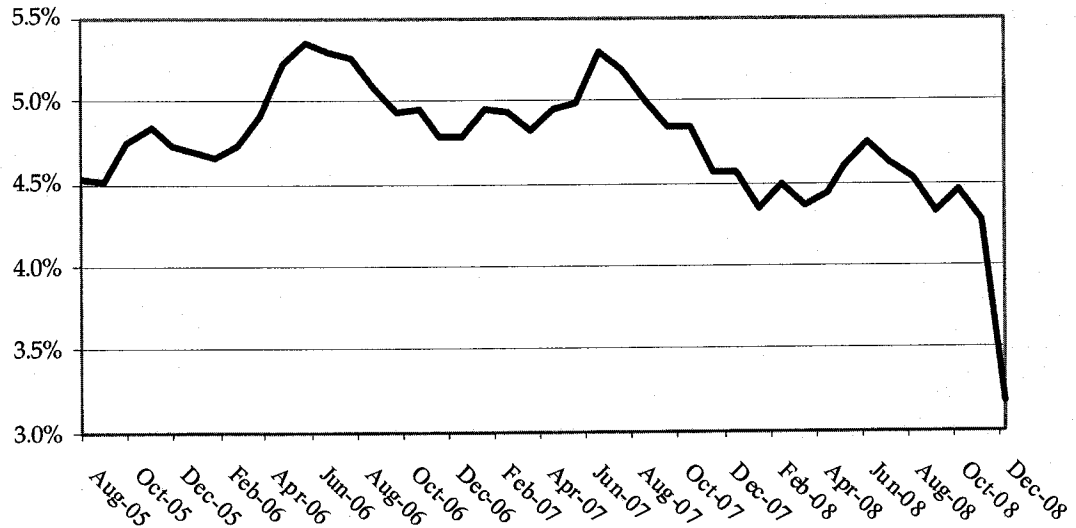
17 A. No. Figure WEA-3, below, plots the yields on
18 20-year Treasury bonds from 2006 through December 2008:

¹² Fitch Ratings Ltd., "U.S. Utilities, Power and Gas 2009 Outlook,"
Global Power North America Special Report (Dec. 22, 2008).

¹³ *Id.*

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**FIGURE WEA-3
20-YEAR TREASURY BOND YIELDS**



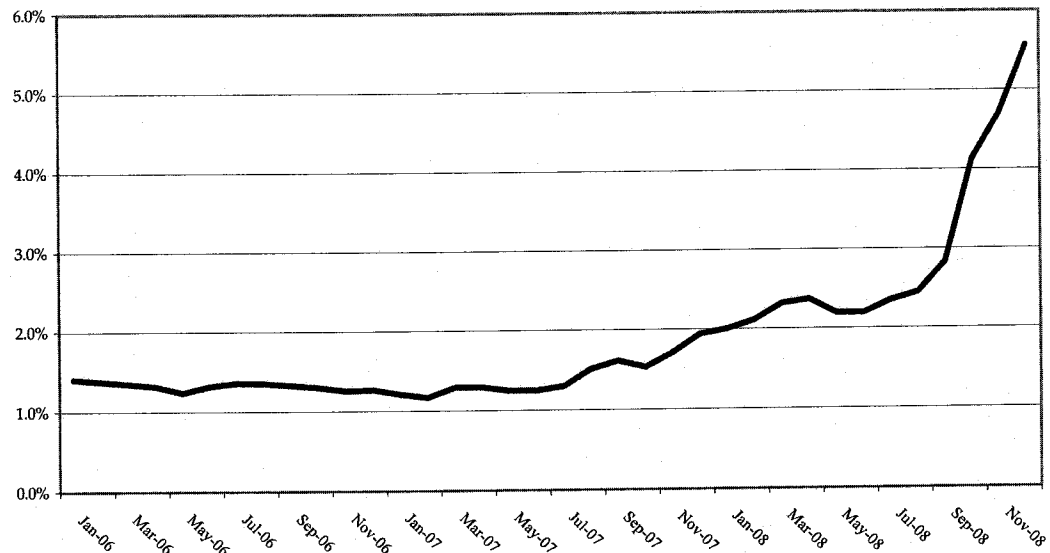
3 As shown above, beginning in the third quarter of 2007, the
4 yields on 20-year Treasury bonds began a general decline.
5 In response to accelerating concerns over economic
6 uncertainties and the Federal Reserve's actions to increase
7 liquidity in the face of a profound crisis in credit
8 markets, the fall in Treasury bond yields has become
9 increasingly pronounced, with daily yields on 20-year bonds
10 falling below 3 percent in December 2008. Meanwhile, the
11 price of 3-month Treasury bills rose high enough to push
12 rates into the negative for the first time in history.¹⁴

13 While the yields on Treasury securities have fallen
14 significantly, the required returns for common stocks and

¹⁴ Kruger, Daniel and Cordell Eddings, "Treasury Bills Trade at Negative Rates as Haven Demand Surges," www.bloomberg.com (Dec. 9, 2008).

1 public utility bonds have moved sharply higher to
2 compensate for increased perceptions of risk. This "flight
3 to quality" has caused the spread between the observable
4 yields on triple-B rated utility bonds and 20-year Treasury
5 bonds to spike dramatically. Figure WEA-4, below, plots
6 the monthly spread between triple-B public utility bond
7 yields and 20-year Treasury bond yields since January 2006:

8 **FIGURE WEA-4**
9 **YIELD SPREAD - BBB UTILITY VERSUS 20-YR. TREASURY BONDS**



10 As illustrated above, the gap between the yields on
11 20-year government bonds and triple-B utility bonds has
12 widened as the extent of the challenges facing the
13 financial system and economy became increasingly clear to
14 investors. During 2007, this yield spread averaged 142
15 basis points, versus 293 basis point in 2008, and 556 basis

1 points in December 2008. As Standard & Poor's recently
2 observed:

3 The Standard & Poor's composite spreads widened
4 to new five-year highs yesterday, leaving the
5 investment-grade spread at 554 basis points (bps)
6 and the speculative grade spread at 1,598 bps,
7 both well more than triple their five-year moving
8 averages. ... With speculative-grade defaults on
9 the rise, a higher preponderance of credit
10 downgrades, and a general malaise about the
11 future of the economy, we expect spreads to
12 remain at their elevated levels for some time
13 until confidence is restored to the market.¹⁵

14 **Q. What does this imply with respect to the ROE for**
15 **a utility such as Avista?**

16 A. Because of the dramatic increase in the spreads
17 between public utility and government bond yields, trends
18 in Treasury bond yields have virtually no relevance in
19 evaluating long-term capital costs for Avista.

20 As a result of the turmoil and uncertainty spreading
21 through financial markets, investors have sought a safe
22 haven in government-backed securities, such as Treasury
23 bonds. While the required returns for other asset classes,
24 such as common stocks and public utility bonds, have moved
25 sharply higher to compensate for increased perceptions of
26 risk, the yields on Treasury securities have fallen
27 significantly. As evidenced above, the spread between the

¹⁵ Standard & Poor's Corporation, "Credit Trends: U.S. Composite Credit Spreads Daily (Dec. 2, 2008)," *RatingsDirect* (Dec. 2, 2008).

1 observable yields on utility bonds and Treasury securities
2 has spiked dramatically as a result.

3 In other words, while focusing solely on the decrease
4 in Treasury bond yields experienced since 2007 would
5 suggest that investors' required returns might have fallen,
6 the exact opposite is true. Treasury bond yields have
7 declined because of a "flight to quality" as investors'
8 risk perceptions have mounted in the face of the ongoing
9 financial crisis. As the Wall Street Journal noted, "Real-
10 world borrowing costs are in a different universe from
11 Treasury yields and Fed rates."¹⁶ (emphasis added) The fact
12 that the prices of Treasury bonds have been driven sharply
13 higher is the mirror image of higher, not lower returns for
14 more risky asset classes, such as the common stock of
15 utilities like Avista.

16 **Q. Would expectations of an economic recession lead**
17 **to lower capital costs?**

18 A. No. Investors' required rates of return for
19 Avista and other financial assets are a function of risk,
20 with greater exposure to uncertainty requiring higher - not
21 lower - rates of return to induce long-term investment.
22 This has been vividly demonstrated in numerous segments of
23 the debt markets where heightened uncertainties regarding

¹⁶ Gongloff, Mark, "Ahead of the Tape: The Shocks Are Getting A
Workout," *The Wall Street Journal* at C1 (Sep. 17, 2008) (emphasis
added).

1 risk exposure has resulted in the almost complete inability
2 of borrowers to access credit at reasonable rates.

3 It is important not to confuse investors' expectations
4 for future growth and cash flows, which is one
5 consideration in estimating the cost of equity, with their
6 required rate of return. In fact, trends in growth rates
7 say nothing at all about investors' overall risk
8 perceptions. The fact that investors' required rates of
9 return for long-term capital can rise in tandem with
10 expectations of declining growth that would accompany an
11 economic slowdown is demonstrated in the bond markets,
12 where perceptions of greater risks have pushed yields on
13 long-term utility bonds sharply higher.

14 Similarly, the uncertainty over future trends in
15 corporate earnings and stock prices has led investors to
16 sharply reevaluate what they are willing to pay for common
17 stocks. While the precipitous decline in utility stock
18 prices may in part be attributed to somewhat diminished
19 expectations of future cash flows, there is also every
20 indication that investors' discount rate, or cost of
21 equity, has moved significantly higher to accommodate the
22 greater risks they now associate with equity investments.

23 The idea that the current recession would lead the
24 rate of return demanded by equity investors to decline is
25 also contrary to economic logic. As documented above, the

1 required yield on long-term utility bonds has increased
2 substantially in response to investors' heightened risk
3 perceptions. A drop in the cost of common equity would
4 imply that the risk premium between common stocks and bonds
5 has declined. The notion that equity risk premiums would
6 be declining at a time of unprecedented capital market
7 turmoil runs counter to common sense. Investors require a
8 higher rate of return to assume more risk and common stocks
9 have the lowest priority claim on a company's cash flows.
10 Given the significant increase in triple-B utility bond
11 yields documented earlier, the dramatic widening of the
12 yield spreads between risk-free Treasury bonds and
13 corporate debt instruments, and investors heightened
14 sensitivity to risk, there is no evidence to suggest that
15 the return demanded by equity investors has declined.

16 **Q. Is there any basis to ignore current capital**
17 **market conditions in establishing a fair ROE for Avista?**

18 A. Absolutely not. As noted earlier, the standards
19 underlying a fair rate of return require that Avista's
20 authorized ROE reflect a return competitive with other
21 investments of comparable risk and preserve the Company's
22 ability to maintain access to capital on reasonable terms.
23 This standard can only be met by considering the
24 requirements of investors in today's capital markets.

25 The events of the last several months undoubtedly mark
26 a significant transition in investors' expectations and

1 there is very little indication that the dire conditions
2 confronting the economy and financial markets will be
3 resolved quickly. As Fitch recently concluded, "higher
4 corporate interest rates are likely to prevail through 2009
5 and into the foreseeable future."¹⁷ Moreover, the fact that
6 market volatility may complicate the evaluation of the cost
7 of equity provides no basis to ignore the upward shift in
8 investors' risk perceptions and required rates of return
9 for long-term capital.

10 **B. Support For Avista's Credit Standing**

11 **Q. What credit ratings have been assigned to Avista?**

12 A. On February 7, 2008, S&P raised the Company's
13 corporate credit rating from "BB+" to "BBB-", while Moody's
14 Investors Service ("Moody's") upgraded Avista's issuer
15 credit rating from "Ba1" to "Baa3" in December 2007.¹⁸
16 Fitch Ratings, Ltd. ("Fitch") upgraded its issuer default
17 rating for Avista one notch to "BB+" in 2007, and has since
18 assigned the Company a "Positive Outlook", indicating the
19 potential for higher ratings going forward.¹⁹ The ratings
20 assigned by S&P and Moody's represent the lowest rung on
21 the ladder of the investment grade scale, with Fitch

¹⁷ Grabelsky, Glen, "Surviving the Present, Preparing for the Future," *Fitch Ratings' 20th Annual Global Power Breakfast* (Nov. 10, 2008).

¹⁸ Moody's Investors Service, "Credit Opinion: Avista Corp.," *Global Credit Research* (Dec. 21, 2007).

¹⁹ Fitch Ratings, Ltd, "Fitch Upgrades Avista Corp.'s IDR to 'BB+' from 'BB'; Outlook Positive," *Press Release* (Aug. 9, 2007).

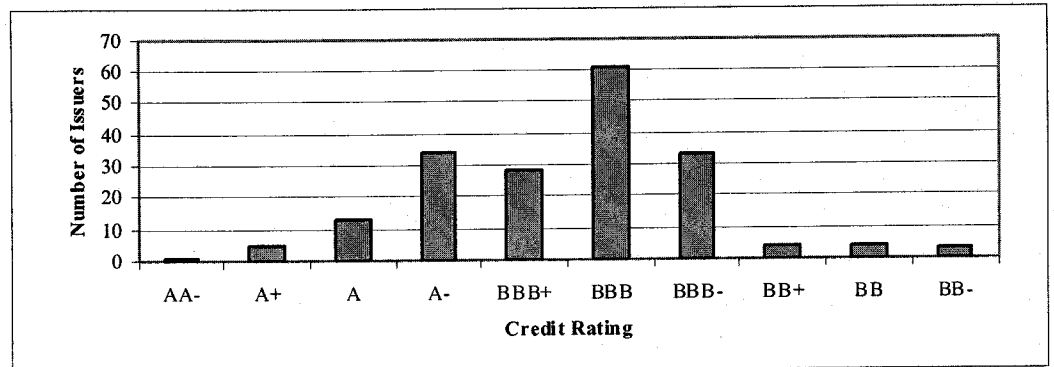
1 continuing to maintain a speculative grade, or "junk"
2 credit rating.

3 **Q. How have investors' risk perceptions for firms**
4 **involved in the utility industry evolved?**

5 A. The past decade witnessed steady erosion in
6 credit quality throughout the utility industry, both as a
7 result of revised perceptions of the risks in the industry
8 and the weakened finances of the utilities themselves. As
9 illustrated in Figure WEA-5, below, S&P reports that the
10 majority of the companies in the utility sector now fall in
11 the "BBB" rating category:²⁰

12
13
14

FIGURE WEA-5
S&P'S DISTRIBUTION OF CREDIT RATINGS OF
U.S. REGULATED ELECTRIC UTILITIES



15
16

17 Fitch recently concluded that the short- and long-term
18 outlook for investor-owned electric utilities is negative.²¹
19 Similarly, Moody's observed, "Material negative bias

²⁰ Standard & Poor's Corporation, "Issuer Ranking: U.S. Regulated Electric Utilities, Strongest To Weakest," *RatingsDirect* (Jan. 8, 2009).

²¹ Fitch Ratings, Ltd., "U.S. Utilities, Power and Gas 2009 Outlook," *Global Power North America Special Report* (Dec. 22, 2008).

1 appears to be developing over the intermediate and longer
2 term due to rapidly rising business and operating risks."²²

3 **Q. How does Avista's relative credit standing**
4 **compare with others in the utility industry?**

5 A. Avista's senior debt ratings from S&P and Moody's
6 remain at the very bottom of the investment grade scale,
7 with the "BB+" rating assigned by Fitch falling in the
8 speculative grade category. In a recent report by S&P
9 ranking U.S. regulated utilities from strongest to weakest,
10 Avista was ranked 159 out of the total 175 companies with
11 investment grade credit ratings.²³ In other words, only 16
12 companies in the utility industry with investment grade
13 ratings have a credit profile weaker than Avista's.
14 Meanwhile, in a ranking of electric and gas utility parent
15 companies, Fitch placed Avista at 44th position out of 48
16 companies.²⁴

17 **Q. What are the implications of Avista's relative**
18 **credit standing, given the current climate in the capital**
19 **markets?**

20 A. As documented earlier and in the testimony of Mr.
21 Mark Thies, the current environment poses significant
22 challenges with respect to a utility's ability to raise

²² Moody's Investors Service, "U.S. Electric Utility Sector," *Industry Outlook* (Jan. 2008).

²³ Standard & Poor's Corporation, "Issuer Ranking: U.S. Regulated Electric Utilities, Strongest To Weakest," *RatingsDirect* (Jan. 8, 2009).

²⁴ Fitch Ratings Ltd., "U.S. Utilities, Power and Gas 2009 Outlook," *Global Power North America Special Report* (Dec. 22, 2008).

1 capital on reasonable terms. For Avista, these concerns
2 are magnified by the fact that its credit standing remains
3 relatively weak. The Company's efforts to regain
4 investment grade credit ratings have been successful, but
5 Avista's finances remain pressured.

6 Fitch recently observed that in current credit
7 markets, "'flight to quality' is selective within the
8 [utility] sector, favoring companies at higher rating
9 levels."²⁵ Because Avista's ratings are at the very bottom
10 of the investment grade barrel, there is no backstop in the
11 event of a prolonged and/or worsening crisis and reduced
12 flexibility to respond to other challenges, such as a
13 continuation of poor hydro condition or increased capital
14 outlays.

15 As Mr. Thies confirms in his testimony, regulatory
16 support will be a key driver in securing additional
17 progress in the Company's financial health. Further
18 strengthening Avista's financial integrity and continued
19 progress in raising the Company's credit standing is
20 imperative to ensure the capability to maintain an
21 investment grade rating while confronting potential
22 challenges.

²⁵ Fitch Ratings Ltd., "U.S. Utilities, Power and Gas 2009 Outlook,"
Global Power North America Special Report (Dec. 22, 2008).

1 Moreover, the negative impact of declining credit
2 quality on a utility's capital costs and financial
3 flexibility becomes more pronounced as debt ratings move
4 down the scale from investment to non-investment grade.
5 Fitch recently noted the penalty associated with
6 speculative grade ratings:

7 The incentives for companies to attain investment
8 grade ratings are significant. As of June 20,
9 2008, the Bloomberg US 10-year 'BB'-rated
10 Corporate Bond Composite Index (BB Index) was
11 trading at a yield of 8.75%, representing a
12 spread of approximately 452 basis points over US
13 Treasuries. The Bloomberg 10-year 'BBB'-rated
14 Corporate Bond Composite Index (BBB Index) was
15 trading at a yield of 6.56%, a spread of 233
16 basis points over US Treasuries. The yield and
17 spread differential of 219 basis points between
18 the BBB Index and the BB Index underscores the
19 considerably lower cost of capital incurred by
20 investment grade companies relative to
21 speculative grade companies in the public debt
22 markets at present. In addition to a lower cost
23 of capital, investment grade companies also
24 typically enjoy significantly fewer covenant
25 constraints in bond indentures and loan
26 agreements as well as less security in the form
27 of collateral than their speculative grade
28 counterparts.²⁶

29 Since that time, speculative grade yields spreads have
30 increased dramatically. As noted earlier, S&P reported
31 that the premium on speculative debt issues was now more
32 than triple the five-year moving average and exceeded 1,500
33 basis points. This assessment of widening yield spreads
34 for utilities was recently confirmed by Fitch:

²⁶ Fitch Ratings Ltd., "Borderline Credits - Part II," *Leveraged Finance US Special Report* (June 24, 2008).

1 Several investment-grade issuers, mostly 'BBB' to
2 'A' rated operating companies, have issued senior
3 unsecured debt with financing costs clustered in
4 a range approximating 250 to 450 basis points
5 above the 5% to 6% range of just 12 months ago,
6 and spreads have widened 700-1000 basis points
7 for speculative-grade companies.²⁷

8 With Avista's credit ratings poised on the precipice
9 between investment grade and junk bond status, the stakes
10 associated with an inadequate rate of return are increased
11 dramatically. In turn, the need for supportive regulation
12 and an adequate ROE may never have been greater.

13 **Q. What are the implications of disregarding actual**
14 **capital market conditions in setting the allowed rate of**
15 **return on equity?**

16 A. If the increase in investors' required rate of
17 return on long-term capital is not incorporated in the
18 allowed rate of return on equity, the results will fail to
19 meet the comparable earnings standard that is fundamental
20 in determining the cost of capital. From a more practical
21 perspective, failing to provide investors with the
22 opportunity to earn a rate of return commensurate with
23 Avista's risks will only serve to further weaken its
24 financial integrity, while hampering the Company's ability
25 to attract the capital needed under reasonable terms to
26 meet the economic and reliability needs of its service
27 area.

²⁷ Fitch Ratings Ltd., "U.S. Utilities, Power and Gas 2009 Outlook,"
Global Power North America Special Report (Dec. 22, 2008).

1 **III. RISKS OF AVISTA**

2 **Q. What is the purpose of this section?**

3 A. As a predicate to my capital market analyses,
4 this section examines the investment risks that investors
5 consider in evaluating their required rate of return for
6 Avista.

7 **A. Operating Risks**

8 **Q. How does Avista's generating resource mix affect**
9 **investors' risk perceptions?**

10 A. Because close to one-half of Avista's total
11 energy requirements are provided by hydroelectric
12 facilities, the Company is exposed to a level of
13 uncertainty not faced by most utilities. While hydropower
14 confers advantages in terms of fuel cost savings and
15 diversity, reduced hydroelectric generation due to below-
16 average water conditions forces Avista to rely more heavily
17 on wholesale power markets or more costly thermal
18 generating capacity to meet its resource needs. As S&P has
19 observed:

20 A reduction in hydro generation typically
21 increases an electric utility's costs by
22 requiring it to buy replacement power or run more
23 expensive generation to serve customer loads.
24 Low hydro generation can also reduce utilities'
25 opportunity to make off-system sales. At the
26 same time, low hydro years increase regional
27 wholesale power prices, creating potentially a
28 double impact - companies have to buy more power

1 than under normal conditions, paying higher
2 prices.²⁸

3 Investors recognize that volatile energy markets,
4 unpredictable stream flows, and Avista's reliance on
5 wholesale purchases to meet a significant portion of its
6 resource needs can expose the Company to the risk of
7 reduced cash flows and unrecovered power supply costs. S&P
8 concluded that Avista's "key utility risk going forward is
9 its exposure to high-cost replacement power, particularly
10 in low water years,"²⁹ and concluded that Avista, along with
11 Idaho Power Company, "face the most substantial risks
12 despite their PCAs and cost-update mechanisms."³⁰
13 Similarly, Fitch concluded, "The potential negative cash
14 flow impact from a prolonged period of below normal hydro
15 conditions and high natural gas prices are primary sources
16 of concern" for Avista's investors.³¹

17 Additionally, Avista has become increasingly reliant
18 on natural gas fired generating capacity to meet base-load
19 needs. Given the significant price fluctuations
20 experienced in energy markets discussed subsequently,

²⁸ Standard & Poor's Corporation, "Pacific Northwest Hydrology And Its Impact On Investor-Owned Utilities' Credit Quality," *RatingsDirect* (Jan. 28, 2008).

²⁹ Standard & Poor's Corporation, "Avista Corp.'s Corporate Credit Rating Raised One Notch To 'BBB-', " *RatingsDirect* (Feb. 7, 2008).

³⁰ Standard & Poor's Corporation, "Pacific Northwest Hydrology And Its Impact On Investor-Owned Utilities' Credit Quality," *RatingsDirect* (Jan. 28, 2008).

³¹ Fitch Ratings, Ltd., "Fitch Affirms Avista Corp.'s IDR at 'BB+' ; Outlook Positive," *Press Release* (Feb. 6, 2008).

1 increasing reliance on natural gas heightens Avista's
2 exposure to fuel cost volatility.

3 **Q. Does Avista anticipate the need to access the**
4 **capital markets going forward?**

5 A. Most definitely. Avista will require capital
6 investment to meet customer growth, provide for necessary
7 maintenance and replacements of its natural gas utility
8 systems, as well as fund new investment in electric
9 generation, transmission and distribution facilities. As
10 discussed by Company witness Mr. Thies, planned capital
11 expenditures for 2009-2010 total approximately \$420 million
12 for Avista's electric utility operations alone. This
13 represents a substantial investment given Avista's ratebase
14 was \$1.9 billion as of November 30, 2008.

15 Continued support for Avista's financial integrity and
16 flexibility will be instrumental in attracting the capital
17 necessary to fund these projects in an effective manner.
18 Avista's reliance on purchased power to meet shortfalls in
19 hydroelectric generation magnifies the importance of
20 strengthening financial flexibility, which is essential to
21 guarantee access to the cash resources and interim
22 financing required to cover inadequate operating cash
23 flows, as well as fund required investments in the utility
24 system.

1 **Q. Is the potential for energy market volatility an**
2 **ongoing concern for investors?**

3 A. Yes. Investors recognize that the prospect of
4 further turmoil in energy markets is an ongoing concern.
5 S&P has reported continued spikes in wholesale energy
6 market prices,³² with Moody's warning investors of ongoing
7 exposure to "extremely volatile" energy commodity costs,
8 including purchased power prices, which are heavily
9 influenced by fuel costs.³³ Similarly, the FERC Staff has
10 continued to recognize the ongoing potential for market
11 disruption, with a 2008 market assessment report noting
12 ongoing concerns regarding tight supply and congestion.³⁴
13 FERC continues to warn of load pockets vulnerable to
14 periods of high peak demand and unplanned outages of
15 generation or transmission capacity and ongoing reliability
16 concerns that led FERC to establish mandatory standards for
17 the bulk power system.³⁵

18 In recent years utilities and their customers have
19 also had to contend with dramatic fluctuations in gas costs
20 due to ongoing price volatility in the spot markets. S&P

³² Standard & Poor's Corporation, "Fuel and Purchased Power Cost Recovery in the Wake of Volatile Gas and Power Markets - U.S. Electric Utilities to Watch" *RatingsDirect* (Mar. 22, 2006).

³³ Moody's Investors Service, "Storm Clouds Gathering on the Horizon for the North American Electric Utility Sector," *Special Comment* at 6 (Aug. 2007).

³⁴ FERC, Office of Market Oversight and Investigations, "2008 Summer Market and Reliability Assessment," (May 15, 2008).

³⁵ See *Open Commission Meeting Statement of Chairman Joseph T. Kelliher*, Item E-13: Mandatory Reliability Standards for the Bulk-Power System (Docket No. RM06-16-000) (Mar. 15, 2007).

1 concluded that "natural gas prices have proven to be very
2 volatile" and warned of a "turbulent journey" due to the
3 uncertainty associated with future fluctuations in energy
4 costs.³⁶ Fitch has also highlighted the challenges that
5 fluctuations in commodity prices can have for utilities and
6 recently noted that:

7 From their September 2007 low of \$5.29, spot
8 natural gas prices as reported at Henry Hub rose
9 150% to \$13.31 in early July 2008 and declined
10 57% to \$5.68 per million British thermal unit
11 (mmBtu) on Dec. 10, 2008. The sharp run-up and
12 subsequent collapse of natural gas prices in 2008
13 is emblematic of the extreme price volatility
14 that characterizes the commodity and is likely to
15 persist in the future.³⁷

16 **Q. What other financial pressures impact investors'**
17 **risk assessment of Avista?**

18 A. Investors are aware of the financial and
19 regulatory pressures faced by utilities associated with
20 rising costs and the need to undertake significant capital
21 investments. As Moody's observed:

22 [P]ressures are building. Utilities are facing
23 rising operating costs and infrastructure
24 investment needs that are prompting them to seek
25 more-frequent requests for rate relief.
26 Meanwhile, as energy (and other commodity) costs
27 rise, so does the risk of a consumer backlash
28 over electric rates that could prompt legislative

³⁶ Standard & Poor's Corporation, "Top Ten Credit Issues Facing U.S. Utilities," *RatingsDirect* (Jan. 29, 2007).

³⁷ Fitch Ratings, Ltd., "U.S. Utilities, Power and Gas 2009 Outlook," *Global Power North American Special Report* (Dec. 22, 2008).

1 intervention or a more contentious atmosphere
2 between utilities and their regulators.³⁸

3 Similarly, S&P noted that "heavy construction programs",
4 along with rising operating and maintenance costs and
5 volatile fuel costs, were a significant challenge to the
6 utility industry.³⁹ Fitch recently echoed this assessment,
7 concluding:

8 Continued access to capital at reasonable rates
9 in 2009 remains uncertain at a time when many
10 utility holding groups have historically high
11 capital investment programs and will require
12 ongoing access to reasonably priced capital in
13 order to fund new investment and refinance
14 maturing debt.⁴⁰

15 While providing the infrastructure necessary to meet
16 the energy needs of customers is certainly desirable, it
17 imposes additional financial responsibilities on Avista.
18 As noted earlier, the Company's plans include electric
19 utility capital expenditures of approximately \$420 million
20 just over the 2009-2010 period. S&P recently noted the
21 pressures associated with financing Avista's infrastructure
22 investment, concluding:

23 For a utility of its size, Avista has a large
24 capital program and will need to rely on external

³⁸ Moody's Investors Service, "U.S. Investor-Owned Electric Utilities: Six-Month Industry Update," *Industry Outlook* (July 2008).

³⁹ Standard & Poor's Corporation, "Ratings Roundup: Utility Sector Experienced Equal Number Of Upgrades And Downgrades During Second Quarter Of 2008," *RatingsDirect* (Jul. 22, 2008).

⁴⁰ Fitch Ratings Ltd., "U.S. Utilities, Power and Gas 2009 Outlook," *Global Power North America Special Report* (Dec. 22, 2008).

1 financing at a time when credit markets continue
2 to be in turmoil.⁴¹

3 Investors are aware of the challenges posed by rising costs
4 and burdensome capital expenditure requirements, especially
5 in light of Avista's relatively weak credit standing and
6 the ongoing capital market turmoil.

7 **Q. What other considerations affect investors'**
8 **evaluation of Avista?**

9 A. Avista and other utilities are confronting
10 increased environmental pressures that could impose
11 significant uncertainties and costs. In 2007 S&P cited
12 environmental mandates, including emissions, conservation,
13 and renewable resources as one of the top ten credit issues
14 facing U.S. utilities.⁴² Similarly, Moody's noted that "the
15 prospect for new environmental emission legislation, via
16 federal or state carbon emission rules, represents the
17 single-biggest emerging issue on the horizon",⁴³ while Fitch
18 recently observed that:

19 Profound changes in energy policies and
20 environmental regulations are likely to result
21 from the upcoming change of presidential
22 administration, changes in Democratic leadership
23 in the House of Representatives, and a wide
24 Democratic legislative majority. Accelerating
25 support for carbon emissions reductions to combat

⁴¹ Standard & Poor's Corporation, "Avista Corp.'s \$200 Million, 364-Day Credit Facility Addresses Liquidity Constraints," *RatingsDirect* (Dec. 1, 2008).

⁴² Standard & Poor's Corporation, "Top Ten Credit Issues Facing U.S. Utilities," *RatingsDirect* (Jan. 29, 2007).

⁴³ Moody's Investors Service, "U.S. Investor-Owned Electric Utilities," *Industry Outlook* (July 2008).

1 global climate change is expected to result in
2 enactment of carbon legislation to dramatically
3 reduce emissions late next year or in 2010, but
4 the structure, timing and implementation is still
5 uncertain.⁴⁴

6 **Q. Would investors consider Avista's relative size**
7 **in their assessment of the Company's risks and prospects?**

8 A. Yes. A firm's relative size has important
9 implications for investors in their evaluation of
10 alternative investments, and it is well established that
11 smaller firms are more risky than larger firms. With a
12 market capitalization of approximately \$1.0 billion, Avista
13 is one of the smallest publicly traded electric utilities
14 followed by Value Line, which have an average
15 capitalization of approximately \$6.3 billion.⁴⁵

16 The magnitude of the size disparity between Avista and
17 other firms in the utility industry has important practical
18 implications with respect to the risks faced by investors.
19 All else being equal, it is well accepted that smaller
20 firms are more risky than their larger counterparts, due in
21 part to their relative lack of diversification and lower
22 financial resiliency.⁴⁶ These greater risks imply a higher
23 required rate of return, and there is ample empirical

⁴⁴ Fitch Ratings, Ltd., "U.S. Utilities, Power and Gas 2009 Outlook,"
Global Power North America Special Report (Dec. 22, 2008).

⁴⁵ www.valueline.com (Retrieved Dec. 29, 2008).

⁴⁶ It is well established in the financial literature that smaller firms are more risky than larger firms. See, e.g., Eugene F. Fama and Kenneth R. French, "The Cross-Section of Expected Stock Returns", *The Journal of Finance* (June 1992); George E. Pinches, J. Clay Singleton, and Ali Jahankhani, "Fixed Coverage as a Determinant of Electric Utility Bond Ratings", *Financial Management* (Summer 1978).

1 evidence that investors in smaller firms realize higher
2 rates of return than in larger firms.⁴⁷ Common sense and
3 accepted financial doctrine hold that investors require
4 higher returns from smaller companies, and unless that
5 compensation is provided in the rate of return allowed for
6 a utility, the legal tests embodied in the *Hope* and
7 *Bluefield* cases cannot be met.

8 **B. Capital Structure**

9 **Q. Is an evaluation of the capital structure**
10 **maintained by a utility relevant in assessing its return on**
11 **equity?**

12 A. Yes. Other things equal, a higher debt ratio, or
13 lower common equity ratio, translates into increased
14 financial risk for all investors. A greater amount of debt
15 means more investors have a senior claim on available cash
16 flow, thereby reducing the certainty that each will receive
17 his contractual payments. This increases the risks to
18 which lenders are exposed, and they require correspondingly
19 higher rates of interest. From common shareholders'
20 standpoint, a higher debt ratio means that there are
21 proportionately more investors ahead of them, thereby
22 increasing the uncertainty as to the amount of cash flow,
23 if any, that will remain.

⁴⁷ See for example Rolf W. Banz, "The Relationship Between Return and Market Value of Common Stocks", *Journal of Financial Economics* (September 1981) at 16.

1 **Q. What common equity ratio is implicit in Avista's**
2 **requested capital structure?**

3 A. Avista's capital structure is presented in the
4 testimony of Mr. Thies. As summarized in his testimony,
5 the pro-forma common equity ratio used to compute Avista's
6 overall rate of return was 50.0 percent in this filing.

7 **Q. What was the average capitalization maintained by**
8 **the utility proxy group?**

9 A. As shown on Exhibit 3, Schedule 3, for the 17
10 firms in the utility proxy group, common equity ratios at
11 December 31, 2007 ranged between 34.4 percent and 59.6
12 percent and averaged 47.2 percent.

13 **Q. What capitalization is representative for the**
14 **proxy group of utilities going forward?**

15 A. As shown on Exhibit 3, Schedule 3, The Value Line
16 Investment Survey ("Value Line") expects an average common
17 equity ratio for the proxy group of utilities of 50.8
18 percent for its three-to-five year forecast horizon, with
19 the individual common equity ratios ranging from 41.5
20 percent to 65.0 percent.

21 **Q. How does Avista's common equity ratio compare**
22 **with those maintained by the reference group of utilities?**

23 A. The 50.0 percent common equity ratio requested by
24 Avista is entirely consistent with the range of equity
25 ratios maintained by the firms in the Utility Proxy Group
26 and is in-line with the 47.2 percent and 50.8 percent

1 average equity ratios at year-end 2007 and based on Value
2 Line's near-term expectations, respectively.

3 **Q. What implication does the increasing risk of the**
4 **utility industry have for the capital structures maintained**
5 **by utilities?**

6 A. As discussed earlier, the average credit rating
7 associated with firms in the electric industry has fallen
8 to triple-B, with Avista's "BBB-" rating occupying the
9 lowest rung on the ladder of the investment grade scale.
10 At the same time, electric utilities are facing, among
11 other things, rising cost structures, the need to finance
12 significant capital investment plans, and uncertainties
13 over accommodating future environmental mandates. A more
14 conservative financial profile, in the form of a higher
15 common equity ratio, is consistent with increasing
16 uncertainties and the need to maintain the continuous
17 access to capital that is required to fund operations and
18 necessary system investment, even during times of adverse
19 capital market conditions.

20 Moody's has warned investors of the risks associated
21 with debt leverage and fixed obligations and advised
22 utilities not to squander the opportunity to strengthen the
23 balance sheet as a buffer against future uncertainties.⁴⁸

⁴⁸ Moody's Investors Service, "Storm Clouds Gathering on the Horizon for the North American Electric Utility Sector," *Special Comment* (Aug. 2007).

1 Moody's noted that, absent a thicker equity layer,
2 utilities would be faced with lower credit ratings in the
3 face of rising business and operating risks:

4 There are significant negative trends developing
5 over the longer-term horizon. This developing
6 negative concern primarily relates to our view
7 that the sector's overall business and operating
8 risks are rising - at an increasingly fast pace -
9 but that the overall financial profile remains
10 relatively steady. A rising risk profile
11 accompanied by a relatively stable balance sheet
12 profile would ultimately result in credit quality
13 deterioration.⁴⁹

14 This is especially the case for Avista, which faces the
15 dual challenge of financing significant capital expansion
16 plans in a turbulent market while at the same time
17 endeavoring to improve its credit standing.

18 **Q. What other factors do investors consider in their**
19 **assessment of a company's capital structure?**

20 A. Depending on their specific attributes,
21 contractual agreements or other obligations that require
22 the utility to make specified payments may be treated as
23 debt in evaluating Avista's financial risk. Because power
24 purchase agreements ("PPAs") and leases typically obligate
25 the utility to make specified minimum contractual payments
26 akin to those associated with traditional debt financing,
27 investors consider a portion of these commitments as debt
28 in evaluating total financial risks. Because investors

⁴⁹ Moody's Investors Service, "U.S. Electric Utility Sector," *Industry Outlook* (Jan. 2008).

1 consider the debt impact of such fixed obligations in
2 assessing a utility's financial position, they imply
3 greater risk and reduced financial flexibility. In order
4 to offset the debt equivalent associated with off-balance
5 sheet obligations, the utility must rebalance its capital
6 structure by increasing its common equity in order to
7 restore its effective capitalization ratios to previous
8 levels.⁵⁰

9 These commitments have been repeatedly cited by major bond
10 rating agencies in connection with assessments of utility
11 financial risks. For example, in explaining its evaluation
12 of the credit implications of PPAs, S&P affirmed its
13 position that such agreements give rise to "debt
14 equivalents" and that the increased financial risk must be
15 considered in evaluating a utility's credit risks.⁵¹ S&P
16 also noted that it has refined its methodology to include
17 imputed debt associated with shorter-term PPAs and
18 operating leases.⁵²

19 As discussed earlier, a significant portion of the
20 Company's power requirements are currently obtained through
21 purchased power contracts. These contractual payment

⁵⁰ The capital structure ratios presented earlier do not include imputed debt associated with power purchase agreements or the impact of other off-balance sheet obligations.

⁵¹ Standard & Poor's Corporation, "Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements," *RatingsDirect* (May 7, 2007).

⁵² Standard & Poor's Corporation, "Implications Of Operating Leases On Analysis Of U.S. Electric Utilities," *RatingsDirect* (Jan. 15, 2008).

1 obligations, along with operating leases and obligations
2 associated with postretirement benefits, are fixed
3 commitments with debt-like characteristics and are properly
4 considered when evaluating the financial risks implied by
5 Avista's capital structure. S&P reported that it adjusts
6 Avista's capitalization to include approximately \$123
7 million in imputed debt from PPAs, leases, and
8 postretirement benefit obligations.⁵³ Unless the Company
9 takes action to offset this additional financial risk by
10 maintaining a higher equity ratio, the resulting leverage
11 will weaken Avista's creditworthiness, implying a higher
12 required rate of return to compensate investors for the
13 greater risks.⁵⁴

14 **Q. What did you conclude with respect to the**
15 **Company's capital structure?**

16 A. Based on my evaluation, I concluded that Avista's
17 requested capital structure represents a reasonable mix of
18 capital sources from which to calculate the Company's
19 overall rate of return. While industry averages provide
20 one benchmark for comparison, each firm must select its
21 capitalization based on the risks and prospects it faces,

⁵³ Standard & Poor's Corporation, "Avista Corp.," *RatingsDirect* (Aug. 29, 2008).

⁵⁴ Apart from the immediate impact that the fixed obligation of purchased power costs has on the utility's financial risk, higher fixed charges also reduce ongoing financial flexibility, and the utility may face other uncertainties, such as potential replacement power costs in the event of supply disruption.

1 as well its specific needs to access the capital markets.
2 A public utility with an obligation to serve must maintain
3 ready access to capital under reasonable terms so that it
4 can meet the service requirements of its customers.
5 Moody's recently concluded that the electric utility sector
6 "is entering a major period of capital-raising needs, and
7 will need to attract a significant amount of new equity
8 capital in order to maintain existing ratings."⁵⁵ Moody's
9 also observed that its ratings for Avista anticipate
10 "conservative financing strategies."⁵⁶

11 Avista's capital structure reflects the challenges
12 posed by its resource mix, the burden of significant
13 capital spending requirements, and the Company's ongoing
14 efforts to strengthen its credit standing and support
15 access to capital on reasonable terms. The need for access
16 becomes even more important when the company has capital
17 requirements over a period of years, and financing must be
18 continuously available, even during unfavorable capital
19 market conditions.

⁵⁵ Moody's Investors Service, "U.S. Investor-Owned Electric Utilities: Six-Month Industry Update," *Industry Outlook* (July 2008).

⁵⁶ Moody's Investors Service, "Credit Opinion: Avista Corp.," *Global Credit Research* (Dec. 3, 2008).

1 **IV. CAPITAL MARKET ESTIMATES**

2 **Q. What is the purpose of this section?**

3 A. This section presents capital market estimates of
4 the cost of equity. The details of my quantitative
5 analyses are contained in Exhibit 3, Schedule 2, with the
6 results being summarized below.

7 **A. Overview**

8 **Q. What role does the rate of return on common**
9 **equity play in a utility's rates?**

10 A. The return on common equity is the cost of
11 inducing and retaining investment in the utility's physical
12 plant and assets. This investment is necessary to finance
13 the asset base needed to provide utility service.
14 Investors will commit money to a particular investment only
15 if they expect it to produce a return commensurate with
16 those from other investments with comparable risks.
17 Moreover, the return on common equity is integral in
18 achieving the sound regulatory objectives of rates that are
19 sufficient to: 1) fairly compensate capital investment in
20 the utility, 2) enable the utility to offer a return
21 adequate to attract new capital on reasonable terms, and 3)
22 maintain the utility's financial integrity. Meeting these
23 objectives allows the utility to fulfill its obligation to
24 provide reliable service while meeting the needs of
25 customers through necessary system expansion.

1 **Q. Did you rely on a single method to estimate the**
2 **cost of equity for Avista?**

3 A. No. In my opinion, no single method or model
4 should be relied upon to determine a utility's cost of
5 equity because no single approach can be regarded as wholly
6 reliable. For example, a publication of the Society of
7 Utility and Financial Analysts (formerly the National
8 Society of Rate of Return Analysts), concluded that:

9 Each model requires the exercise of judgment as
10 to the reasonableness of the underlying
11 assumptions of the methodology and on the
12 reasonableness of the proxies used to validate
13 the theory. Each model has its own way of
14 examining investor behavior, its own premises,
15 and its own set of simplifications of reality.
16 Each method proceeds from different fundamental
17 premises, most of which cannot be validated
18 empirically. Investors clearly do not subscribe
19 to any singular method, nor does the stock price
20 reflect the application of any one single method
21 by investors.⁵⁷

22 Therefore, I used both the DCF and CAPM methods to estimate
23 the cost of equity. In addition, I also evaluated a fair
24 ROE return using an earnings approach based on investors'
25 current expectations in the capital markets. In my
26 opinion, comparing estimates produced by one method with
27 those produced by other approaches ensures that the
28 estimates of the cost of equity pass fundamental tests of
29 reasonableness and economic logic.

⁵⁷ Parcell, David C., "The Cost of Capital - A Practitioner's Guide,"
Society of Utility and Regulatory Financial Analysts (1997) at Part 2,
p. 4.

1 **Q. What was your conclusion regarding a fair rate of**
2 **return on equity for the proxy companies?**

3 A. Based on the results of my quantitative analyses,
4 and my assessment of the relative strengths and weaknesses
5 inherent in each method, I concluded that the cost of
6 equity for the proxy companies is in the 11.3 percent to
7 13.3 percent range.

8 **B. Results of Quantitative Analyses**

9 **Q. How did you define the comparable risk proxy**
10 **groups you used to implement the DCF model?**

11 A. In estimating the cost of equity, the DCF model
12 is typically applied to publicly traded firms engaged in
13 similar business activities or with comparable investment
14 risks. As described in detail in Exhibit 3, Schedule 2, I
15 applied the DCF model to a utility proxy group composed of
16 those dividend-paying companies included by Value Line in
17 its Electric Utilities Industry groups with: (1) S&P
18 corporate credit ratings of "BBB-" or "BBB," (2) a Value
19 Line Safety Rank of "2" or "3", and (3) a Value Line
20 Financial Strength Rating of "B+" to "B++". I excluded
21 three firms that otherwise would have been in the proxy
22 group, but are not appropriate for inclusion because they
23 either do not pay common dividends or were in the process
24 of being acquired.

25 Under the regulatory standards established by *Hope* and
26 *Bluefield*, the salient criteria in establishing a

1 meaningful benchmark to evaluate a fair rate of return is
 2 relative risk, not the particular business activity or
 3 degree of regulation. Consistent with this accepted
 4 regulatory standard, I also applied the DCF model to a
 5 reference group of comparable risk companies in the non-
 6 utility sector of the economy. My non-utility proxy group
 7 was composed of those U.S. companies followed by Value Line
 8 that 1) pay common dividends, 2) have a Safety Rank of "1",
 9 3) have a Financial Strength Rating of "A" or above, and 4)
 10 have investment grade bond ratings.⁵⁸

11 **Q. How do the overall risks of your proxy groups**
 12 **compare with Avista?**

13 A. As shown below, Table 1 compares the non-utility
 14 proxy group with the utility proxy group and Avista across
 15 four key indicators of investment risk:

16 **TABLE 1**
 17 **COMPARISON OF RISK INDICATORS**

	S&P	Value Line		
	Credit	Safety	Financial	
	Rating	Rank	Strength	Beta
Non-Utility Group	A+	1	A+	0.84
Utility Proxy Group	BBB	3	B++	0.82
Avista Corp.	BBB-	3	B+	0.85

18

⁵⁸ In addition, I also included only those firms with at least two published growth estimates from Value Line, IBES, First Call, or Zacks.

1 Considered together, a comparison of these objective
2 measures indicates that the risks investors associate with
3 Avista generally exceed those of the proxy groups. As a
4 result, the cost of equity estimates indicated by my
5 analyses provide a conservative estimate of investors'
6 required rate of return for Avista.

7 **Q. What cost of equity is implied by your DCF**
8 **results for the utility proxy group?**

9 A. My application of the DCF model, which is
10 discussed in greater detail in Exhibit 3, Schedule 2,
11 considered four alternative measures of expected earnings
12 growth, as well as the sustainable growth rate based on the
13 relationship between expected retained earnings and earned
14 rates of return ("br + sv"). As shown on Exhibit 3,
15 Schedule 4 and summarized below in Table 2, after
16 eliminating illogical low- and high-end values, application
17 of the constant growth DCF model resulted in the following
18 cost of equity estimates:

19 **TABLE 2**
20 **DCF RESULTS - UTILITY PROXY GROUP**

<u>Growth Rate</u>	<u>Average Cost of Equity</u>
Value Line	13.4%
IBES	12.3%
First Call	11.5%
Zacks	11.8%
br+sv	11.9%

1 **Q. What were the results of your DCF analysis for**
2 **the non-utility reference group?**

3 A. As shown on Exhibit 3, Schedule 6, I applied the
4 DCF model to the non-utility companies in exactly the same
5 manner described earlier for the utility proxy group. As
6 summarized below in Table 3, after eliminating illogical
7 low- and high-end values, application of the constant
8 growth DCF model resulted in the following cost of equity
9 estimates:

10
11

TABLE 3
DCF RESULTS - NON-UTILITY GROUP

<u>Growth Rate</u>	<u>Average Cost of Equity</u>
Value Line	13.1%
IBES	13.4%
First Call	13.2%
Zacks	13.5%
br+sv	13.3%

12 **Q. Do you believe the constant growth DCF model**
13 **should be relied on exclusively to evaluate a reasonable**
14 **ROE for Avista?**

15 A. No. As noted earlier, because the cost of equity is
16 unobservable, no single method should be viewed in
17 isolation. Moreover, evidence suggests that reliance on
18 the DCF model as a tool for estimating investors' required
19 rate of return has declined outside the regulatory sphere,

1 with the CAPM being "the dominant model for estimating the
2 cost of equity."⁵⁹

3 **Q. How did you apply the CAPM to estimate the cost**
4 **of equity?**

5 A. Like the DCF model, the CAPM is an *ex-ante*, or
6 forward-looking model based on expectations of the future.
7 As a result, in order to produce a meaningful estimate of
8 investors' required rate of return, the CAPM is best
9 applied using estimates that reflect the expectations of
10 actual investors in the market, not with backward-looking,
11 historical data. Accordingly, I applied the CAPM to the
12 utility proxy group based on a forward-looking estimate for
13 investors' required rate of return from common stocks.
14 Because this forward-looking application of the CAPM looks
15 directly at investors' expectations in the capital markets,
16 it provides a more meaningful guide to the expected rate of
17 return required to implement the CAPM.

18 **Q. What cost of equity was indicated by the CAPM**
19 **approach?**

20 A. As shown on Exhibit 3, Schedule 8, my forward-
21 looking application of the CAPM model indicated an ROE of
22 approximately 11.2 percent for the utility proxy group.
23 Applying the CAPM approach to the firms in the non-utility

⁵⁹See, e.g., Bruner, R.F., Eades, K.M., Harris, R.S., and Higgins, R.C., "Best Practices in Estimating Cost of Capital: Survey and Synthesis," Financial Practice and Education (1998).

1 proxy group (Exhibit 3, Schedule 9) implied a cost of
2 equity of 11.5 percent.

3 **Q. What other analyses did you conduct to estimate**
4 **the cost of equity?**

5 A. As I noted earlier, I also evaluated the cost of
6 equity using the comparable earnings method. Reference to
7 rates of return available from alternative investments of
8 comparable risk can provide an important benchmark in
9 assessing the return necessary to assure confidence in the
10 financial integrity of a firm and its ability to attract
11 capital. This comparable earnings approach is consistent
12 with the economic underpinnings for a fair rate of return
13 established by the U.S. Supreme Court. Moreover, it avoids
14 the complexities and limitations of capital market methods
15 and instead focuses on the returns earned on book equity,
16 which are readily available to investors.

17 **Q. What rates of return on equity are indicated for**
18 **utilities based on the comparable earnings approach?**

19 A. Value Line reports that its analysts anticipate
20 an average rate of return on common equity for the electric
21 utility industry of 11.5 percent in 2009 and over its 2011-
22 2013 forecast horizon,⁶⁰ with natural gas distribution
23 utilities expected to earn an average rate of return on

⁶⁰ The Value Line Investment Survey at 148 (Dec. 26, 2008). The capital structure corresponding with this expected return reflects an equity ratio of 50 percent.

1 common equity of 11.5 percent to 12.0 percent.⁶¹ As shown
2 on Exhibit 3, Schedule 10, Value Line's projections for the
3 utility proxy group suggested an average ROE of 11.4
4 percent after eliminating potential outliers.⁶² Based on
5 the results discussed above, I concluded that the
6 comparable earnings approach implies a fair rate of return
7 on equity of at least 11.4 percent.

8 **Q. What did you conclude with respect to the cost of**
9 **equity implied by your analyses for the proxy groups?**

10 A. The cost of equity estimates implied by my
11 quantitative analyses are summarized in Table 4, below:

12 **TABLE 4**
13 **SUMMARY OF QUANTITATIVE RESULTS**

<u>Method</u>	<u>Cost of Equity Estimates</u>	
	<u>Utility Proxy Group</u>	<u>Non-Utility Proxy Group</u>
DCF	11.5% - 13.4%	13.1% - 13.5%
CAPM	11.2%	11.5%
Comparable Earnings	11.4%	--

14 Based on the results of my quantitative analyses, and
15 my assessment of the relative strengths and weaknesses
16 inherent in each method, I concluded that the cost of
17 equity is in the 11.3 percent to 13.3 percent range.

⁶¹ The Value Line Investment Survey 446 (Dec. 12, 2008). The capital structure corresponding with this expected return reflects an equity ratio of 46 percent.

⁶² As highlighted on Schedule WEA-12, I eliminated six extreme low- and high-end outliers. While these Value Line projections may accurately reflect expectations for actual earned rates of return on common equity over the forecast horizon, they are unlikely to be representative of investors' required rate of return.

1 **C. Flotation Costs**

2 **Q. What other considerations are relevant in setting**
3 **the return on equity for a utility?**

4 A. The common equity used to finance the investment
5 in utility assets is provided from either the sale of stock
6 in the capital markets or from retained earnings not paid
7 out as dividends. When equity is raised through the sale
8 of common stock, there are costs associated with "floating"
9 the new equity securities. These flotation costs include
10 services such as legal, accounting, and printing, as well
11 as the fees and discounts paid to compensate brokers for
12 selling the stock to the public. Also, some argue that the
13 "market pressure" from the additional supply of common
14 stock and other market factors may further reduce the
15 amount of funds a utility nets when it issues common
16 equity.

17 **Q. Is there an established mechanism for a utility**
18 **to recognize equity issuance costs?**

19 A. No. While debt flotation costs are recorded on
20 the books of the utility, amortized over the life of the
21 issue, and thus increase the effective cost of debt
22 capital, there is no similar accounting treatment to ensure
23 that equity flotation costs are recorded and ultimately
24 recognized. No rate of return is authorized on flotation
25 costs necessarily incurred to obtain a portion of the equity
26 capital used to finance plant. In other words, equity

1 flotation costs are not included in a utility's rate base
2 because neither that portion of the gross proceeds from the
3 sale of common stock used to pay flotation costs is
4 available to invest in plant and equipment, nor are
5 flotation costs capitalized as an intangible asset. Unless
6 some provision is made to recognize these issuance costs, a
7 utility's revenue requirements will not fully reflect all of
8 the costs incurred for the use of investors' funds. Because
9 there is no accounting convention to accumulate the
10 flotation costs associated with equity issues, they must be
11 accounted for indirectly, with an upward adjustment to the
12 cost of equity being the most logical mechanism.

13 **Q. What is the magnitude of the adjustment to the**
14 **"bare bones" cost of equity to account for issuance costs?**

15 A. There are any number of ways in which a flotation
16 cost adjustment can be calculated, and the adjustment can
17 range from just a few basis points to more than a full
18 percent. One of the most common methods used to account
19 for flotation costs in regulatory proceedings is to apply
20 an average flotation-cost percentage to a utility's
21 dividend yield. Based on a review of the finance
22 literature, *Regulatory Finance: Utilities' Cost of Capital*
23 concluded:

24 The flotation cost allowance requires an
25 estimated adjustment to the return on equity of

1 approximately 5% to 10%, depending on the size
2 and risk of the issue.⁶³

3 Alternatively, a study of data from Morgan Stanley
4 regarding issuance costs associated with utility common
5 stock issuances suggests an average flotation cost
6 percentage of 3.6%.⁶⁴ Applying these expense percentages to
7 a representative dividend yield for a utility of 5.3
8 percent implies a flotation cost adjustment on the order of
9 19 to 50 basis points.

10 **Q. Has the IPUC Staff previously considered**
11 **flotation costs in estimating a fair ROE?**

12 A. Yes. For example, in Case No. IPC-E-07-8, IPUC
13 Staff witness Terri Carlock noted that she had adjusted her
14 DCF analysis to incorporate an allowance for flotation
15 costs.⁶⁵ While issuance costs are a legitimate
16 consideration in setting the return on equity for a
17 utility, a specific adjustment for flotation costs was not
18 included in defining my recommended ROE range.

⁶³ Roger A. Morin, *Regulatory Finance: Utilities' Cost of Capital*, 1994, at 166.

⁶⁴ *Application of Yankee Gas Services Company for a Rate Increase*, DPUC Docket No. 04-06-01, Direct Testimony of George J. Eckenroth (Jul. 2, 2004) at Exhibit GJE-11.1. Updating the results presented by Mr. Eckenroth through April 2005 also resulted in an average flotation cost percentage of 3.6%.

⁶⁵ Case No. IPC-E-07-8, *Direct Testimony of Terri Carlock* at 10 (Dec. 10, 2007).

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V. RETURN ON EQUITY FOR AVISTA CORP.

Q. What is the purpose of this section?

A. In addition to presenting the conclusions of my evaluation of a fair rate of return on equity range for Avista, this section also discusses the relationship between ROE and preservation of a utility's financial integrity and the ability to attract capital under reasonable terms on a sustainable basis.

A. Implications for Financial Integrity

Q. Why is it important to allow Avista an adequate return on equity?

A. Given the importance of the utility industry to the economy and society, it is essential to maintain reliable and economical service to all consumers. While Avista remains committed to provide reliable utility service, a utility's ability to fulfill its mandate can be compromised if it lacks the necessary financial wherewithal or is unable to earn a return sufficient to attract capital. Coupled with the ongoing potential for energy market volatility, Avista's exposure to variations in hydroelectric generation and natural gas price volatility, along with plans for significant infrastructure investment, pose a number of potential challenges that might require the relatively swift commitment of significant capital resources in order to maintain the high level of service that customers have come to expect. Investors' increased

1 reticence to supply additional capital during times of
2 crisis highlights the necessity of preserving the
3 flexibility necessary to overcome periods of adverse
4 capital market conditions. These considerations heighten
5 the importance of allowing Avista an adequate return on the
6 fair value of its investment.

7 **Q. What role does regulation play in ensuring that**
8 **Avista has access to capital under reasonable terms and on**
9 **a sustainable basis?**

10 A. Investors recognize that constructive regulation
11 is a key ingredient in supporting utility credit ratings
12 and financial integrity, particularly during times of
13 adverse conditions. Fitch noted that:

14 Regulatory risk remains a recurring theme for
15 this year's outlook, as the pressure of a weak
16 economic backdrop could result in political push-
17 back to rate increase requests.⁶⁶

18 The report went on to conclude, "Fitch is concerned that
19 the recent rapid escalation in the cost of capital will not
20 be reflected on a timely basis in utility rates."⁶⁷ Moody's
21 has emphasized the need for regulatory support "in an era
22 of broadly rising costs," noting that as cost pressures
23 have escalated for electric utilities, so too has the
24 importance of timely recovery through the regulatory

⁶⁶ Fitch Ratings Ltd., "U.S. Utilities, Power and Gas 2009 Outlook,"
Global Power North America Special Report (Dec. 22, 2008).

⁶⁷ *Id.*

1 process and the risks associated with regulatory lag.⁶⁸ S&P
2 concluded "the quality of regulation is at the forefront of
3 our analysis of utility creditworthiness,"⁶⁹ and recently
4 observed that its risk analysis focuses on the utility's
5 ability to consistently earn a reasonable return:

6 Notably, the analysis does not revolve
7 around "authorized" returns, but rather
8 on actual earned returns. We note the
9 many examples of utilities with healthy
10 authorized returns that, we believe,
11 have no meaningful expectation of
12 actually earning that return because of
13 rate case lag, expense disallowances,
14 etc.⁷⁰

15 Similarly, with respect to Avista specifically, the
16 major bond rating agencies have explicitly cited the
17 potential that adverse regulatory rulings could compromise
18 the Company's credit standing. Of particular concern to
19 investors is the impact of regulatory lag and cost-recovery
20 on Avista's ability to earn its authorized ROE and maintain
21 its financial metrics, with Moody's concluding that:

22 Failure to obtain adequate and timely support for
23 recovery of and return on core utility
24 investments through pending and expected future
25 regulatory proceedings ... could have negative
26 ratings implications.⁷¹

⁶⁸ Moody's Investors Service, "Regulatory Pressures Increase For U.S. Electric Utilities," *Special Comment* (March 2007).

⁶⁹ Standard & Poor's Corporation, "Assessing U.S. Utility Regulatory Environments," *RatingsDirect* (Nov. 7, 2008).

⁷⁰ Standard & Poor's Corporation, "Assessing U.S. Regulatory Environments," *RatingsDirect* (Nov. 7, 2008).

⁷¹ Moody's Investors Service, "Credit Opinion: Avista Corp.," *Global Credit Research* (Dec. 3, 2008).

1 S&P observed that rate relief will remain critical to
2 Avista's credit outlook,⁷² and concluded that "regulatory
3 lag will continue to be a drag on the company's ability to
4 earn its authorized ROE."⁷³

5 For Avista, these concerns are magnified by the fact
6 that its credit standing is poised on the precipice between
7 investment and speculative grade ratings. While the
8 Company's efforts to regain an investment grade credit
9 rating have been successful, Avista's financial metrics
10 remain pressured. As Mr. Thies confirms in his testimony,
11 regulatory support will be a key driver in securing
12 additional improvement in the Company's financial health.
13 Further strengthening Avista's financial integrity is
14 imperative to ensure that the Company has the capability to
15 maintain an investment grade rating while confronting
16 potential challenges.

17 **Q. Do customers benefit by enhancing the utility's**
18 **financial flexibility?**

19 A. Yes. While providing an ROE that is sufficient
20 to maintain Avista's ability to attract capital, even in
21 times of financial and market stress, is consistent with
22 the economic requirements embodied in the U.S. Supreme

⁷² Standard & Poor's Corporation, "U.S. Electric Utility Credit Quality Remains Strong Amid Continuing Economic Downturn," *RatingsDirect* (Dec. 19, 2008).

⁷³ Standard & Poor's Corporation, "Avista Corp.'s Corporate Credit Rating Raised One Notch To 'BBB-', " *RatingsDirect* (Feb. 7, 2008).

1 Court's *Hope* and *Bluefield* decisions, it is also in
2 customers' best interests. Ultimately, it is customers and
3 the service area economy that enjoy the benefits that come
4 from ensuring that the utility has the financial
5 wherewithal to take whatever actions are required to ensure
6 reliable service. By the same token, customers also bear a
7 significant burden when the ability of the utility to
8 attract necessary capital is impaired and service quality
9 is compromised.

10 **B. Return on Equity Recommendation**

11 **Q. What then is your conclusion as to a fair rate of**
12 **return on equity range for Avista?**

13 A. As explained above, based on the capital market
14 oriented analyses for the utility and non-utility proxy
15 groups described in my testimony, I concluded that the fair
16 rate of return on equity range was 11.3 percent to 13.3
17 percent. Considering capital market expectations, the
18 potential exposures faced by Avista, and the economic
19 requirements necessary to maintain financial integrity and
20 support additional capital investment even under adverse
21 circumstances, it is my opinion that this represents a fair
22 and reasonable ROE range for Avista.

1 **Q. Based on the results of your evaluation, what is**
2 **your opinion regarding the reasonableness of the ROE**
3 **requested by Avista in this case?**

4 A. My evaluation indicates that Avista's requested
5 ROE of 11.0 percent represents a conservative estimate of
6 investors' required rate of return. Given the fact that
7 the Company's requested ROE falls below the lower bound of
8 my recommended range, it should be viewed as floor in
9 establishing rates for Avista. This conclusion is
10 reinforced by the need to buttress the Company's credit
11 standing, which remains relatively weak, as well as the
12 pressures of funding significant capital expenditures and
13 meeting increased operating risks, including those
14 associated with Avista's reliance on hydroelectric
15 generation and exposure to volatility in natural gas and
16 wholesale power markets. The reasonableness of a minimum
17 11.0 percent ROE for Avista is also supported by the
18 Company's relatively greater risks as compared with the
19 proxy groups, the higher uncertainties associated with
20 Avista's relatively small size, and the fact that my
21 recommended ROE range does not consider flotation costs.

22 **Q. Does this conclude your pre-filed direct**
23 **testimony?**

24 A. Yes.

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IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION)	CASE NO. AVU-E-09-01
OF AVISTA CORPORATION FOR THE)	CASE NO. AVU-G-09-01
AUTHORITY TO INCREASE ITS RATES)	
AND CHARGES FOR ELECTRIC AND)	
NATURAL GAS SERVICE TO ELECTRIC)	EXHIBIT NO. 3
AND NATURAL GAS CUSTOMERS IN THE)	
STATE OF IDAHO)	WILLIAM E. AVERA
)	

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

EXHIBIT 3, SCHEDULE 1

QUALIFICATIONS OF WILLIAM E. AVERA

1 Q. What is the purpose of this exhibit?

2 A. This exhibit describes my background and experience
3 and contains the details of my qualifications.

4 Q. What are your qualifications?

5 A. I received a B.A. degree with a major in economics
6 from Emory University. After serving in the U.S. Navy, I
7 entered the doctoral program in economics at the University
8 of North Carolina at Chapel Hill. Upon receiving my Ph.D., I
9 joined the faculty at the University of North Carolina and
10 taught finance in the Graduate School of Business. I
11 subsequently accepted a position at the University of Texas
12 at Austin where I taught courses in financial management and
13 investment analysis. I then went to work for International
14 Paper Company in New York City as Manager of Financial
15 Education, a position in which I had responsibility for all
16 corporate education programs in finance, accounting, and
17 economics.

18 In 1977, I joined the staff of the Public Utility
19 Commission of Texas (PUCT) as Director of the Economic
20 Research Division. During my tenure at the PUCT, I managed a
21 division responsible for financial analysis, cost allocation
22 and rate design, economic and financial research, and data
23 processing systems, and I testified in cases on a variety of

1 financial and economic issues. Since leaving the PUCT, I
2 have been engaged as a consultant. I have participated in a
3 wide range of assignments involving utility-related matters
4 on behalf of utilities, industrial customers, municipalities,
5 and regulatory commissions. I have previously testified
6 before the Federal Energy Regulatory Commission ("FERC"), as
7 well as the Federal Communications Commission ("FCC"), the
8 Surface Transportation Board (and its predecessor, the
9 Interstate Commerce Commission), the Canadian Radio-
10 Television and Telecommunications Commission, and regulatory
11 agencies, courts, and legislative committees in 39 states.

12 In 1995, I was appointed by the PUCT to the Synchronous
13 Interconnection Committee to advise the Texas legislature on
14 the costs and benefits of connecting Texas to the national
15 electric transmission grid. In addition, I served as an
16 outside director of Georgia System Operations Corporation,
17 the system operator for electric cooperatives in Georgia.

18 I have served as Lecturer in the Finance Department at
19 the University of Texas at Austin and taught in the evening
20 graduate program at St. Edward's University for twenty years.

21 In addition, I have lectured on economic and regulatory
22 topics in programs sponsored by universities and industry
23 groups. I have taught in hundreds of educational programs
24 for financial analysts in programs sponsored by the
25 Association for Investment Management and Research, the

1 Financial Analysts Review, and local financial analysts
2 societies. These programs have been presented in Asia,
3 Europe, and North America, including the Financial Analysts
4 Seminar at Northwestern University. I hold the Chartered
5 Financial Analyst (CFA[®]) designation and have served as Vice
6 President for Membership of the Financial Management
7 Association. I have also served on the Board of Directors of
8 the North Carolina Society of Financial Analysts. I was
9 elected Vice Chairman of the National Association of
10 Regulatory Commissioners ("NARUC") Subcommittee on Economics
11 and appointed to NARUC's Technical Subcommittee on the
12 National Energy Act. I have also served as an officer of
13 various other professional organizations and societies. A
14 resume containing the details of my experience and
15 qualifications is attached.

WILLIAM E. AVERA

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Summary of Qualifications

Ph.D. in economics and finance; Chartered Financial Analyst (CFA[®]) designation; extensive expert witness testimony before courts, alternative dispute resolution panels, regulatory agencies and legislative committees; lectured in executive education programs around the world on ethics, investment analysis, and regulation; undergraduate and graduate teaching in business and economics; appointed to leadership positions in government, industry, academia, and the military.

Employment

Principal,
FINCAP, Inc.
(Sep. 1979 to present)

Financial, economic and policy consulting to business and government. Perform business and public policy research, cost/benefit analyses and financial modeling, valuation of businesses (over 150 entities valued), estimation of damages, statistical and industry studies. Provide strategy advice and educational services in public and private sectors, and serve as expert witness before regulatory agencies, legislative committees, arbitration panels, and courts.

*Director, Economic
Research Division,
Public Utility
Commission of Texas*
(Dec. 1977 to Aug. 1979)

Responsible for research and testimony preparation on rate of return, rate structure, and econometric analysis dealing with energy, telecommunications, water and sewer utilities. Testified in major rate cases and appeared before legislative committees and served as Chief Economist for agency. Administered state and federal grant funds. Communicated frequently with political leaders and representatives from consumer groups, media, and investment community.

Manager, Financial

Directed corporate education programs

Education,
International Paper
Company
New York City
(Feb. 1977 to Nov. 1977)

in accounting, finance, and economics.
Developed course materials, recruited
and trained instructors, liaison
within the company and with academic
institutions. Prepared operating
budget and designed financial controls
for corporate professional development
program.

Lecturer in Finance,
The University of Texas
at Austin
(Sep. 1979 to May 1981)
Assistant Professor of
Finance,
(Sep. 1975 to May 1977)

Taught graduate and undergraduate
courses in financial management and
investment theory. Conducted research
in business and public policy. Named
Outstanding Graduate Business
Professor and received various
administrative appointments.

*Assistant Professor of
Business,*
University of North
Carolina at Chapel
Hill
(Sep. 1972 to Jul. 1975)

Taught in BBA, MBA, and Ph.D.
programs. Created project course in
finance, Financial Management for
Women, and participated in developing
Small Business Management sequence.
Organized the North Carolina Institute
for Investment Research, a group of
financial institutions that supported
academic research. Faculty advisor to
the Media Board, which funds student
publications and broadcast stations.

Education

*Ph.D., Economics and
Finance,*
University of North
Carolina at Chapel
Hill
(Jan. 1969 to Aug. 1972)

Elective courses included financial
management, public finance, monetary
theory, and econometrics. Awarded the
Stonier Fellowship by the American
Bankers' Association and University
Teaching Fellowship. Taught
statistics, macroeconomics, and
microeconomics.

Dissertation: *The Geometric Mean
Strategy as a Theory of Multiperiod
Portfolio Choice*

B.A., Economics,
Emory University,
Atlanta, Georgia
(Sep. 1961 to Jun. 1965)

Active in extracurricular activities,
President of the Barkley Forum (debate
team), Emory Religious Association,
and Delta Tau Delta chapter.
Individual awards and team
championships at national collegiate
debate tournaments.

Professional Associations

Received Chartered Financial Analyst (CFA) designation in 1977; Vice President for Membership, Financial Management Association; President, Austin Chapter of Planning Executives Institute; Board of Directors, North Carolina Society of Financial Analysts; Candidate Curriculum Committee, Association for Investment Management and Research; Executive Committee of Southern Finance Association; Vice Chair, Staff Subcommittee on Economics and National Association of Regulatory Utility Commissioners (NARUC); Appointed to NARUC Technical Subcommittee on the National Energy Act.

Teaching in Executive Education Programs

University-Sponsored Programs: Central Michigan University, Duke University, Louisiana State University, National Defense University, National University of Singapore, Texas A&M University, University of Kansas, University of North Carolina, University of Texas.

Business and Government-Sponsored Programs: Advanced Seminar on Earnings Regulation, American Public Welfare Association, Association for Investment Management and Research, Congressional Fellows Program, Cost of Capital Workshop, Electricity Consumers Resource Council, Financial Analysts Association of Indonesia, Financial Analysts Review, Financial Analysts Seminar at Northwestern University, Governor's Executive Development Program of Texas, Louisiana Association of Business and Industry, National Association of Purchasing Management, National Association of Tire Dealers, Planning Executives Institute, School of Banking of the South, State of Wisconsin Investment Board, Stock Exchange of Thailand, Texas Association of State Sponsored Computer Centers, Texas Bankers' Association, Texas Bar Association, Texas Savings and Loan League, Texas Society of CPAs, Tokyo Association of Foreign Banks, Union Bank of Switzerland, U.S. Department of State, U.S. Navy, U.S. Veterans Administration, in addition to Texas state agencies and major corporations.

Presented papers for Mills B. Lane Lecture Series at the University of Georgia and Heubner Lectures at the University of Pennsylvania. Taught graduate courses in finance and economics in evening program at St. Edward's University in Austin from January 1979 through 1998.

Expert Witness Testimony

Testified in over 250 cases before regulatory agencies addressing cost of capital, regulatory policy, rate design, and other economic and financial issues.

Federal Agencies: Federal Communications Commission, Federal Energy Regulatory Commission, Surface Transportation Board, Interstate Commerce Commission, and the Canadian Radio-Television and Telecommunications Commission.

State Regulatory Agencies: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Kansas, Maryland, Michigan, Missouri, Nevada, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South

Carolina, South Dakota, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

Testified in 41 cases before federal and state courts, arbitration panels, and alternative dispute tribunals (86 depositions given) regarding damages, valuation, antitrust liability, fiduciary duties, and other economic and financial issues.

Board Positions and Other Professional Activities

Audit Committee and Outside Director, Georgia System Operations Corporation (electric system operator for member-owned electric cooperatives in Georgia); Chairman, Board of Print Depot, Inc. and FINCAP, Inc.; Co-chair, Synchronous Interconnection Committee, appointed by Public Utility Commission of Texas and approved by governor; Appointed by Hays County Commission to Citizens Advisory Committee of Habitat Conservation Plan, Operator of AAA Ranch, a certified organic producer of agricultural products; Appointed to Organic Livestock Advisory Committee by Texas Agricultural Commissioner Susan Combs; Appointed by Texas Railroad Commissioners to study group for *The UP/SP Merger: An Assessment of the Impacts on the State of Texas*; Appointed by Hawaii Public Utilities Commission to team reviewing affiliate relationships of Hawaiian Electric Industries; Chairman, Energy Task Force, Greater Austin-San Antonio Corridor Council; Consultant to Public Utility Commission of Texas on cogeneration policy and other matters; Consultant to Public Service Commission of New Mexico on cogeneration policy; Evaluator of Energy Research Grant Proposals for Texas Higher Education Coordinating Board.

Community Activities

Board Member, Sustainable Food Center; Chair, Board of Deacons, Finance Committee, and Elder, Central Presbyterian Church of Austin; Founding Member, Orange-Chatham County (N.C.) Legal Aid Screening Committee.

Military

Captain, U.S. Naval Reserve (retired after 28 years service); Commanding Officer, Naval Special Warfare Engineering Support Unit; Officer-in-charge of SWIFT patrol boat in Vietnam; Enlisted service as weather analyst (advanced to second class petty officer).

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Book reviews in *Journal of Finance* and *Financial Review*. Abstracts for *CFA Digest*. Articles in *Carolina Financial Times*.

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- "The Who, What, When, How, and Why of Ethics", San Antonio Financial Analysts Society (Jan. 16, 2002). Similar presentation given to the Austin Society of Financial Analysts (Jan. 17, 2002)
- "Ethics for Financial Analysts," Sponsored by Canadian Council of Financial Analysts: delivered in Calgary, Edmonton, Regina, and Winnipeg, June 1997. Similar presentations given to Austin Society of Financial Analysts (Mar. 1994), San Antonio Society of Financial Analysts (Nov. 1985), and St. Louis Society of Financial Analysts (Feb. 1986)
- "Cost of Capital for Multi-Divisional Corporations," Financial Management Association, New Orleans, Louisiana (Oct. 1996)
- "Ethics and the Treasury Function," Government Treasurers Organization of Texas, Corpus Christi, Texas (Jun. 1996)
- "A Cooperative Future," Iowa Association of Electric Cooperatives, Des Moines (December 1995). Similar presentations given to National G & T Conference, Irving, Texas (June 1995), Kentucky Association of Electric Cooperatives Annual Meeting, Louisville (Nov. 1994), Virginia, Maryland, and Delaware Association of Electric Cooperatives Annual Meeting, Richmond (July 1994), and Carolina Electric Cooperatives Annual Meeting, Raleigh (Mar. 1994)
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EXHIBIT 3, SCHEDULE 2

DESCRIPTIONS OF QUANTITATIVE ANALYSES

1 **Q. What is the purpose of this schedule?**

2 A. Exhibit 3, Schedule 2 presents capital market
3 estimates of the cost of equity. First, I examine the
4 concept of the cost of equity, along with the risk-return
5 tradeoff principle fundamental to capital markets. Next, I
6 describe DCF, CAPM, and comparable earnings analyses
7 conducted to estimate the cost of equity for reference
8 groups of comparable risk firms.

A. Overview

9 **Q. What role does the rate of return on common**
10 **equity play in a utility's rates?**

11 A. The return on common equity is the cost of
12 inducing and retaining investment in the utility's physical
13 plant and assets. This investment is necessary to finance
14 the asset base needed to provide utility service.
15 Investors will commit money to a particular investment only
16 if they expect it to produce a return commensurate with
17 those from other investments with comparable risks.
18 Moreover, the return on common equity is integral in
19 achieving the sound regulatory objectives of rates that are
20 sufficient to: 1) fairly compensate capital investment in
21 the utility, 2) enable the utility to offer a return
22 adequate to attract new capital on reasonable terms, and 3)
23 maintain the utility's financial integrity. Meeting these

1 objectives allows the utility to fulfill its obligation to
2 provide reliable service while meeting the needs of
3 customers through necessary system expansion.

4 **Q. What fundamental economic principle underlies any**
5 **evaluation of investors' required return on equity?**

6 A. The fundamental economic principle underlying the
7 cost of equity concept is the notion that investors are
8 risk averse. The required rate of return for a particular
9 asset at any point in time is a function of: 1) the yield
10 on risk-free assets, and 2) its relative risk, with
11 investors demanding correspondingly larger risk premiums
12 for assets bearing greater risk. Given this risk-return
13 tradeoff, the required rate of return (k) from an asset (i)
14 can be generally expressed as:

15
$$k_i = R_f + RP_i$$

16 where: R_f = Risk-free rate of return; and
17 RP_i = Risk premium required to hold
18 risky asset i.

19 Thus, the required rate of return for a particular asset at
20 any point in time is a function of: 1) the yield on risk-
21 free assets, and 2) its relative risk, with investors
22 demanding correspondingly larger risk premiums for assets
23 bearing greater risk.

24 Because common shareholders have the lowest priority
25 claim on a firm's cash flows, they receive only the
26 residual that remains after all other claimants (employees,

1 suppliers, governments, lenders) have been paid. As a
2 result, the rate of return that investors require from a
3 utility's common stock, the most junior and riskiest of its
4 securities, is considerably higher than the yield on the
5 utility's long-term debt.

6 **Q. Is the cost of equity observable in the capital**
7 **markets?**

8 A. No. Unlike debt capital, there is no
9 contractually guaranteed return on common equity capital
10 since shareholders are the residual owners of the utility.
11 Because it is unobservable, the cost of equity for a
12 particular utility must be estimated by analyzing
13 information about capital market conditions generally,
14 assessing the relative risks of the company specifically,
15 and employing various quantitative methods that focus on
16 investors' current required rates of return. These various
17 quantitative methods typically attempt to infer investors'
18 required rates of return from stock prices, interest rates,
19 or other capital market data.

B. Comparable Risk Proxy Groups

20 **Q. How did you implement these quantitative methods**
21 **to estimate the cost of common equity for Avista?**

22 A. Application of the DCF model and other
23 quantitative methods to estimate the cost of equity
24 requires observable capital market data, such as stock
25 prices. Moreover, even for a firm with publicly traded

1 stock, the cost of equity can only be estimated. As a
2 result, applying quantitative models using observable
3 market data only produces an estimate that inherently
4 includes some degree of observation error. Thus, the
5 accepted approach to increase confidence in the results is
6 to apply the DCF model and other quantitative methods to a
7 proxy group of publicly traded companies that investors
8 regard as risk comparable. The results of the analysis on
9 the sample of companies are relied upon to establish a
10 range of reasonableness for the cost of equity for the
11 specific company at issue.

12 **Q. What specific proxy group did you rely on for**
13 **your analysis?**

14 A. In order to reflect the risks and prospects
15 associated with Avista's jurisdictional utility operations,
16 my DCF analyses focused on a reference group of other
17 utilities composed of those companies included by The Value
18 Line Investment Survey ("Value Line") in its Electric
19 Utilities Industry groups with: (1) S&P corporate credit
20 ratings of "BBB-" or "BBB," (2) a Value Line Safety Rank of
21 "2" or "3", and (3) a Value Line Financial Strength Rating
22 of "B+" to "B++". I excluded three firms that otherwise
23 would have been in the proxy group, but are not appropriate
24 for inclusion because they either do not pay common
25 dividends or were in the process of being acquired. These
26 criteria resulted in a proxy group composed of 17

1 companies. I refer to this group as the "Utility Proxy
2 Group."

3 **Q. Do these criteria provide objective evidence that**
4 **investors would view the firms in your Utility Proxy Group**
5 **as risk-comparable to Avista?**

6 A. Yes. Credit ratings are assigned by independent
7 rating agencies for the purpose of providing investors with
8 a broad assessment of the creditworthiness of a firm.
9 Because the rating agencies' evaluation includes virtually
10 all of the factors normally considered important in
11 assessing a firm's relative credit standing, corporate
12 credit ratings provide a broad, objective measure of
13 overall investment risk that is readily available to
14 investors. Widely cited in the investment community and
15 referenced by investors, credit ratings are also frequently
16 used as a primary risk indicator in establishing proxy
17 groups to estimate the cost of equity.

18 While credit ratings provide the most widely
19 referenced benchmark for investment risks, other quality
20 rankings published by investment advisory services also
21 provide relative assessments of risk that are considered by
22 investors in forming their expectations. Value Line's
23 primary risk indicator is its Safety Rank, which ranges
24 from "1" (Safest) to "5" (Riskiest). This overall risk
25 measure is intended to capture the total risk of a stock,
26 and incorporates elements of stock price stability and

1 financial strength. Given that Value Line is perhaps the
2 most widely available source of investment advisory
3 information, its Safety Rank provides a useful guide to the
4 likely risk perceptions of investors.

5 The Financial Strength Rating is designed as a guide
6 to overall financial strength and creditworthiness, with
7 the key inputs including financial leverage, business
8 volatility measures, and company size. Value Line's
9 Financial Strength Ratings range from "A++" (strongest)
10 down to "C" (weakest) in nine steps.

11 As discussed in my direct testimony, Avista is rated
12 "BBB-" by S&P, with the average rating for the firms in the
13 Utility Proxy Group being slightly higher at "BBB".
14 Meanwhile, Value Line has assigned Avista a Safety Rank of
15 "3" and a Financial Strength Rating of "B+". For the
16 Utility Proxy Group, the average Safety Rank is identical
17 to that of Avista, while the Financial Strength Rating is
18 one notch higher than Avista at "B++". Based on these
19 criteria, which reflect objective, published indicators
20 that incorporate consideration of a broad spectrum of
21 risks, including financial and business position, relative
22 size, and exposure to company specific factors, investors
23 are likely to regard the risks and prospects of the Utility

1 Proxy Group as being comparable to, albeit somewhat lower
2 than, those of Avista.¹

3 **Q. What other proxy group did you consider in**
4 **evaluating a fair ROE for Avista?**

5 A. Under the regulatory standards established by
6 *Hope* and *Bluefield*, the salient criteria in establishing a
7 meaningful benchmark to evaluate a fair rate of return is
8 relative risk, not the particular business activity or
9 degree of regulation. Utilities must compete for capital,
10 not just against firms in their own industry, but with
11 other investment opportunities of comparable risk. With
12 regulation taking the place of competitive market forces,
13 required returns for utilities should be in line with those
14 of non-utility firms of comparable risk operating under the
15 constraints of free competition. Consistent with this
16 accepted regulatory standard, I also applied the DCF model
17 to a reference group of comparable risk companies in the
18 non-utility sectors of the economy. I refer to this group
19 as the "Non-Utility Proxy Group".

20 **Q. What criteria did you apply to develop the Non-**
21 **Utility Proxy Group?**

22 A. To reflect investors' risk perceptions in
23 developing the Non-Utility Proxy Group, my assessment of
24 comparable risk relied on the same two objective benchmarks

¹ While I did not reference beta as a selection criteria in identifying the Utility Proxy Group, Avista's beta of 0.85 is also slightly higher than the average of 0.82 for the Utility Proxy Group.

1 for the risks associated with common stocks discussed
2 earlier - Value Line's Safety Rank and Financial Strength
3 Rating. Given that Value Line is perhaps the most widely
4 available source of investment advisory information, its
5 Safety Rank and Financial Strength Rating provide useful
6 guidance regarding the risk perceptions of investors.
7 These objective, published indicators incorporate
8 consideration of a broad spectrum of risks, including
9 financial and business position, relative size, and
10 exposure to company-specific factors.

11 My comparable risk proxy group was composed of those
12 U.S. companies followed by Value Line that: 1) pay common
13 dividends; 2) have a Safety Rank of "1"; 3) have a
14 Financial Strength Rating of "A" or above, and 4) have
15 investment grade credit ratings from S&P. In addition, I
16 also included only those firms with at least two published
17 growth estimates from Value Line, IBES, First Call, or
18 Zacks.

19 **Q. How do the overall risks of your proxy groups**
20 **compare with Avista?**

21 A. As shown below, Table 1 compares the Non-Utility
22 Proxy Group with the Utility Proxy Group and Avista across
23 four key indicators of investment risk:

1
2

TABLE 1
COMPARISON OF RISK INDICATORS

	S&P Credit Rating	Value Line		
		Safety Rank	Financial Strength	Beta
Non-Utility Group	A+	1	A+	0.84
Utility Proxy Group	BBB	3	B++	0.82
Avista Corp.	BBB-	3	B+	0.85

3 Considered together, a comparison of these objective
 4 measures indicates that the risks investors associate with
 5 Avista generally exceed those of the proxy groups. As a
 6 result, the cost of equity estimates indicated by my
 7 analyses provide a conservative estimate of investors'
 8 required rate of return for Avista.

C. Discounted Cash Flow Analyses

9 **Q. How are DCF models used to estimate the cost of**
 10 **equity?**

11 A. DCF models attempt to replicate the market
 12 valuation process that sets the price investors are willing
 13 to pay for a share of a company's stock. The model rests
 14 on the assumption that investors evaluate the risks and
 15 expected rates of return from all securities in the capital
 16 markets. Given these expectations, the price of each stock
 17 is adjusted by the market until investors are adequately
 18 compensated for the risks they bear. Therefore, we can
 19 look to the market to determine what investors believe a
 20 share of common stock is worth. By estimating the cash
 21 flows investors expect to receive from the stock in the way

1 of future dividends and capital gains, we can calculate
2 their required rate of return. In other words, the cash
3 flows that investors expect from a stock are estimated, and
4 given its current market price, we can "back-into" the
5 discount rate, or cost of equity, that investors implicitly
6 used in bidding the stock to that price.

7 **Q. What market valuation process underlies DCF**
8 **models?**

9 A. DCF models assume that the price of a share of
10 common stock is equal to the present value of the expected
11 cash flows (i.e., future dividends and stock price) that
12 will be received while holding the stock, discounted at
13 investors' required rate of return. That is, the cost of
14 equity is the discount rate that equates the current price
15 of a share of stock with the present value of all expected
16 cash flows from the stock.

17 **Q. What form of the DCF model is customarily used to**
18 **estimate the cost of equity in rate cases?**

19 A. Rather than developing annual estimates of cash
20 flows into perpetuity, the DCF model can be simplified to a
21 "constant growth" form:²

² The constant growth DCF model is dependent on a number of strict assumptions, which in practice are never strictly met. These include a constant growth rate for both dividends and earnings; a stable dividend payout ratio; the discount rate exceeds the growth rate; a constant growth rate for book value and price; a constant earned rate of return on book value; no sales of stock at a price above or below book value; a constant price-earnings ratio; a constant discount rate (i.e., no changes in risk or interest rate levels and a flat yield curve); and all of the above extend to infinity.

1
$$P_0 = \frac{D_1}{k_e - g}$$

2 where: P_0 = Current price per share;
3 D_1 = Expected dividend per share in the
4 coming year;
5 k_e = Cost of equity;
6 g = Investors' long-term growth
7 expectations.

8 The cost of equity (K_e) can be isolated by rearranging
9 terms:

10
$$k_e = \frac{D_1}{P_0} + g$$

11 This constant growth form of the DCF model recognizes that
12 the rate of return to stockholders consists of two parts:
13 1) dividend yield (D_1/P_0), and 2) growth (g). In other
14 words, investors expect to receive a portion of their total
15 return in the form of current dividends and the remainder
16 through price appreciation.

17 **Q. What steps are required to apply the DCF model?**

18 A. The first step in implementing the constant
19 growth DCF model is to determine the expected dividend
20 yield (D_1/P_0) for the firm in question. This is usually
21 calculated based on an estimate of dividends to be paid in
22 the coming year divided by the current price of the stock.
23 The second, and more controversial, step is to estimate
24 investors' long-term growth expectations (g) for the firm.
25 The final step is to sum the firm's dividend yield and

1 estimated growth rate to arrive at an estimate of its cost
2 of equity.

3 **Q. How was the dividend yield for the Utility Proxy**
4 **Group determined?**

5 A. Estimates of dividends to be paid by each of
6 these utilities over the next twelve months, obtained from
7 Value Line, served as D_1 . This annual dividend was then
8 divided by the corresponding stock price for each utility
9 to arrive at the expected dividend yield. The expected
10 dividends, stock prices, and resulting dividend yields for
11 the firms in the Utility Proxy Group are presented on
12 Exhibit 3, Schedule 4.

13 **Q. What is the next step in applying the constant**
14 **growth DCF model?**

15 A. The next step is to evaluate long-term growth
16 expectations, or "g", for the firm in question. In
17 constant growth DCF theory, earnings, dividends, book
18 value, and market price are all assumed to grow in
19 lockstep, and the growth horizon of the DCF model is
20 infinite. But implementation of the DCF model is more than
21 just a theoretical exercise; it is an attempt to replicate
22 the mechanism investors used to arrive at observable stock
23 prices. A wide variety of techniques can be used to derive
24 growth rates, but the only "g" that matters in applying the
25 DCF model is the value that investors expect.

1 **Q. Are historical growth rates likely to be**
2 **representative of investors' expectations for utilities?**

3 A. No. If past trends in earnings, dividends, and
4 book value are to be representative of investors'
5 expectations for the future, then the historical conditions
6 giving rise to these growth rates should be expected to
7 continue. That is clearly not the case for utilities,
8 where structural and industry changes have led to declining
9 dividends, earnings pressure, and, in many cases,
10 significant write-offs. While these conditions serve to
11 depress historical growth measures, they are not
12 representative of long-term expectations for the utility
13 industry. Moreover, to the extent historical trends for
14 utilities are meaningful, they are also captured in
15 projected growth rates, since securities analysts also
16 routinely examine and assess the impact and continued
17 relevance (if any) of historical trends.

18 **Q. What are investors most likely to consider in**
19 **developing their long-term growth expectations?**

20 A. While the DCF model is technically concerned with
21 growth in dividend cash flows, implementation of this DCF
22 model is solely concerned with replicating the forward-
23 looking evaluation of real-world investors. In the case of
24 electric utilities, dividend growth rates are not likely to
25 provide a meaningful guide to investors' current growth
26 expectations. This is because utilities have significantly

1 altered their dividend policies in response to more
2 accentuated business risks in the industry.³ As a result
3 of this trend towards a more conservative payout ratio,
4 dividend growth in the utility industry has remained
5 largely stagnant as utilities conserve financial resources
6 to provide a hedge against heightened uncertainties.

7 As payout ratios for firms in the utility industry
8 trended downward, investors' focus has increasingly shifted
9 from dividends to earnings as a measure of long-term
10 growth. Future trends in earnings, which provide the
11 source for future dividends and ultimately support share
12 prices, play a pivotal role in determining investors' long-
13 term growth expectations. The importance of earnings in
14 evaluating investors' expectations and requirements is well
15 accepted in the investment community. As noted in *Finding*
16 *Reality in Reported Earnings* published by the Association
17 for Investment Management and Research:

18 [E]arnings, presumably, are the basis for the
19 investment benefits that we all seek. "Healthy
20 earnings equal healthy investment benefits" seems
21 a logical equation, but earnings are also a
22 scorecard by which we compare companies, a filter
23 through which we assess management, and a crystal
24 ball in which we try to foretell future
25 performance.⁴

³ For example, the payout ratio for electric utilities fell from approximately 80% historically to on the order of 60%. The Value Line Investment Survey (Sep. 15, 1995 at 161, Dec. 28, 2007 at 695).

⁴ Association for Investment Management and Research, "Finding Reality in Reported Earnings: An Overview", p. 1 (Dec. 4, 1996).

1 Value Line's near-term projections and its Timeliness
2 Rank, which is the principal investment rating assigned to
3 each individual stock, are also based primarily on various
4 quantitative analyses of earnings. As Value Line
5 explained:

6 The future earnings rank accounts for 65% in the
7 determination of relative price change in the
8 future; the other two variables (current earnings
9 rank and current price rank) explain 35%.⁵

10 The fact that investment advisory services, such as Value
11 Line, Thompson, and Reuters, focus on growth in earnings
12 indicates that the investment community regards this as a
13 superior indicator of future long-term growth. Indeed, "A
14 Study of Financial Analysts: Practice and Theory,"
15 published in the *Financial Analysts Journal*, reported the
16 results of a survey conducted to determine what analytical
17 techniques investment analysts actually use.⁶ Respondents
18 were asked to rank the relative importance of earnings,
19 dividends, cash flow, and book value in analyzing
20 securities. Of the 297 analysts that responded, only 3
21 ranked dividends first while 276 ranked it last. The
22 article concluded:

23 Earnings and cash flow are considered far more
24 important than book value and dividends.⁷

⁵ The Value Line Investment Survey, *Subscriber's Guide*, p. 53.

⁶ Block, Stanley B., "A Study of Financial Analysts: Practice and Theory", *Financial Analysts Journal* (July/August 1999).

⁷ *Id.* at 88.

1 More recently, the *Financial Analysts Journal* reported
2 the results of a study of the relationship between
3 valuations based on alternative multiples and actual market
4 prices, which concluded, "In all cases studied, earnings
5 dominated operating cash flows and dividends."⁸

6 **Q. What are security analysts currently projecting**
7 **in the way of growth for the firms in the Utility Proxy**
8 **Group?**

9 A. The Value Line earnings growth projections for
10 each of the firms in the Utility Proxy Group are displayed
11 on Exhibit 3, Schedule 4. Also presented are the earnings
12 per share ("EPS") growth projections reported by Thomson
13 I/B/E/S ("IBES"), Thomson First Call Estimates ("First
14 Call"), and Zacks Investment Research ("Zacks").⁹

15 **Q. How else are investors' expectations of future**
16 **long-term growth prospects often estimated for use in the**
17 **constant growth DCF model?**

18 A. Based on the assumptions underlying constant
19 growth theory, conventional applications of the constant
20 growth DCF model often examine the relationship between
21 retained earnings and earned rates of return as an
22 indication of the sustainable growth investors might expect
23 from the reinvestment of earnings within a firm. The
24 sustainable growth rate is calculated by the formula, $g =$

⁸ Liu, Jing, Nissim, Doron, & Thomas, Jacob, "Is Cash Flow King in Valuations?," *Financial Analysts Journal*, Vol. 63, No. 2 (March/April 2007) at 56.

⁹ Thomson Financial, an arm of Thomson Reuters, separately compiles and publishes consensus securities analyst growth rates under the IBES and First Call brands.

1 br+sv, where "b" is the expected retention ratio, "r" is
2 the expected earned return on equity, "s" is the percent of
3 common equity expected to be issued annually as new common
4 stock, and "v" is the equity accretion rate.

5 **Q. What is the purpose of the "sv" term?**

6 A. Under DCF theory, the "sv" factor is a component
7 of the growth rate designed to capture the impact of
8 issuing new common stock at a price above, or below, book
9 value. When a company's stock price is greater than its
10 book value per share, the per-share contribution in excess
11 of book value associated with new stock issues will accrue
12 to the current shareholders. This increase to the book
13 value of existing shareholders leads to higher expected
14 earnings and dividends, with the "sv" factor incorporating
15 this additional growth component.

16 **Q. How did you apply the earnings retention method**
17 **for the proxy group of utilities?**

18 A. The sustainable, "br+sv" growth rates for each
19 firm in the Utility Proxy Group are summarized on Exhibit
20 3, Schedule 4, with the underlying details being presented
21 on Exhibit 3, Schedule 5. For each firm, the expected
22 retention ratio (b) was calculated based on Value Line's
23 projected dividends and earnings per share. Likewise, each
24 firm's expected earned rate of return (r) was computed by
25 dividing projected earnings per share by projected net book
26 value. Because Value Line reports end-of-year book values,

1 an adjustment was incorporated to compute an average rate
2 of return over the year, consistent with the theory
3 underlying this approach to estimating investors' growth
4 expectations. Meanwhile, the percent of common equity
5 expected to be issued annually as new common stock (s) was
6 equal to the product of the projected market-to-book ratio
7 and growth in common shares outstanding, while the equity
8 accretion rate (v) was computed as 1 minus the inverse of
9 the projected market-to-book ratio.

10 **Q. What cost of equity estimates were implied for**
11 **the Utility Proxy Group using the DCF model?**

12 A. After combining the dividend yields and
13 respective growth projections for each utility, the
14 resulting cost of equity estimates are shown on Exhibit 3,
15 Schedule 4.

16 **Q. In evaluating the results of the constant growth**
17 **DCF model, is it appropriate to eliminate cost of equity**
18 **estimates that fail to meet threshold tests of economic**
19 **logic?**

20 A. Yes. It is a basic economic principle that
21 investors can be induced to hold more risky assets only if
22 they expect to earn a return to compensate them for their
23 risk bearing. As a result, the rate of return that
24 investors require from a utility's common stock, the most
25 junior and riskiest of its securities, must be considerably
26 higher than the yield offered by senior, long-term debt.
27 Consistent with this principle, the DCF range for the

1 Utility Proxy Group must be adjusted to eliminate cost of
2 equity estimates that fail fundamental tests of economic
3 logic.

4 **Q. Have similar tests been applied by regulators?**

5 A. Yes. The FERC has noted that adjustments are
6 justified where applications of the DCF approach produce
7 illogical results. FERC evaluates DCF results against
8 observable yields on long-term public utility debt and has
9 recognized that it is appropriate to eliminate cost of
10 equity estimates that do not sufficiently exceed this
11 threshold. In a 2002 opinion establishing its current
12 precedent for determining ROEs for electric utilities, for
13 example, FERC concluded:

14 An adjustment to this data is appropriate in the
15 case of PG&E's low-end return of 8.42 percent,
16 which is comparable to the average Moody's "A"
17 grade public utility bond yield of 8.06 percent,
18 for October 1999. Because investors cannot be
19 expected to purchase stock if debt, which has
20 less risk than stock, yields essentially the same
21 return, this low-end return cannot be considered
22 reliable in this case.¹⁰

23 More recently, in its October 2006 decision in *Kern River*
24 *Gas Transmission Company*, FERC noted that:

25 [T]he 7.31 and 7.32 percent costs of equity for
26 El Paso and Williams found by the ALJ are only
27 110 and 122 basis points above that average yield
28 for public utility debt.¹¹

¹⁰ *Southern California Edison Company*, 92 FERC ¶ 61,070 (2000) at p. 22.

¹¹ *Kern River Gas Transmission Company*, Opinion No. 486, 117 FERC ¶ 61,077 at P 140 & n. 227 (2006).

1 FERC upheld the opinion of Staff and the Administrative Law
2 Judge that cost of equity estimates for these two proxy
3 group companies "were too low to be credible."¹²

4 **Q. What does this test of logic imply with respect**
5 **to the DCF results for the Utility Proxy Group?**

6 A. The average bond rating associated with the firms
7 in the Utility Proxy Group is triple-B, with Moody's
8 monthly yields on triple-B bonds averaging approximately
9 8.1 percent in December 2008.¹³ As highlighted on Exhibit
10 3, Schedule 4, eleven of the individual equity estimates
11 for the firms in the Utility Proxy Group exceeded this
12 threshold by 90 basis points or less.¹⁴ In light of the
13 risk-return tradeoff principle and the test applied in *Kern*
14 *River Gas Transmission Company*, it is inconceivable that
15 investors are not requiring a substantially higher rate of
16 return for holding common stock, which is the riskiest of a
17 utility's securities. As a result, these values provide
18 little guidance as to the returns investors require from
19 the common stock of an electric utility.

20 **Q. Do you also recommend excluding cost of equity**
21 **estimates at the high end of the range of DCF results?**

22 A. Yes. As highlighted on Exhibit 3, Schedule 4, I
23 also eliminated cost of equity estimates at the upper end
24 of the range of DCF results. Compared with the balance of

¹² *Id.*

¹³ Moody's Investors Service, *Credit Perspectives* (Jan. __, 2009).

¹⁴ As highlighted on Exhibit WEA-4, these DCF estimates ranged from 6.1 percent to 8.8 percent.

1 the remaining estimates, these values are extreme outliers
2 and should also be excluded in evaluating the results of
3 the DCF model for the Utility Proxy Group. This is also
4 consistent with the approach and threshold adopted by FERC,
5 which established that a 17.7 percent DCF estimate for an
6 electric utility was "an extreme outlier" and should be
7 disregarded.¹⁵

8 **Q. What cost of equity is implied by your DCF**
9 **results for the Utility Proxy Group?**

10 A. As shown on Exhibit 3, Schedule 4 and summarized
11 in Table 2, below, after eliminating illogical low- and
12 high-end values, application of the constant growth DCF
13 model resulted in the following cost of equity estimates:

14
15

TABLE 2
DCF RESULTS - UTILITY PROXY GROUP

<u>Growth Rate</u>	<u>Average Cost of Equity</u>
Value Line	13.4%
IBES	12.3%
First Call	11.5%
Zacks	11.8%
br+sv	11.9%

16 As shown above, the constant growth DCF results for the
17 Utility Proxy Group implied a cost of equity range of 11.5
18 percent to 13.4 percent.

19 **Q. What were the results of your DCF analysis for**
20 **the Non-Utility Proxy Group?**

21 A. As shown on Exhibit 3, Schedule 6, I applied the
22 DCF model to the Non-Utility Proxy Group in exactly the

¹⁵ *ISO New England, Inc.*, 109 FERC ¶ 61,147 at P 205 (2004).

1 same manner described earlier for the Utility Proxy Group.¹⁶
2 As summarized in Table 3, below, after eliminating
3 illogical low- and high-end values, application of the
4 constant growth DCF model resulted in the following cost of
5 equity estimates:

6 **TABLE 3**
7 **DCF RESULTS - NON-UTILITY PROXY GROUP**

<u>Growth Rate</u>	<u>Average Cost of Equity</u>
Value Line	13.1%
IBES	13.4%
First Call	13.2%
Zacks	13.5%
br+sv	13.3%

8 As discussed earlier, reference to the Non-Utility Proxy
9 Group is consistent with established regulatory principles
10 and required returns for utilities should be in line with
11 those of non-utility firms of comparable risk operating
12 under the constraints of free competition.

D. Capital Asset Pricing Model

13 **Q Please describe the CAPM.**

14 A. The CAPM is generally considered to be the most
15 widely referenced method for estimating the cost of equity
16 both among academicians and professional practitioners,
17 with the pioneering researchers of this method receiving
18 the Nobel Prize in 1990. The CAPM is a theory of market
19 equilibrium that measures risk using the beta coefficient.

¹⁶ Exhibit WEA-7 contains the details underlying the calculation of the br+sv growth rates for the Non-Utility Proxy Group.

1 Because investors are assumed to be fully diversified, the
2 relevant risk of an individual asset (e.g., common stock)
3 is its volatility relative to the market as a whole, with
4 beta reflecting the tendency of a stock's price to follow
5 changes in the market. The CAPM is mathematically
6 expressed as:

7
$$R_j = R_f + \beta_j (R_m - R_f)$$

8 where: R_j = required rate of return for stock j;
9 R_f = risk-free rate;
10 R_m = expected return on the market
11 portfolio; and,
12 β_j = beta, or systematic risk, for stock j.

13 Like the DCF model, the CAPM is an *ex-ante*, or
14 forward-looking model based on expectations of the future.
15 As a result, in order to produce a meaningful estimate of
16 investors' required rate of return, the CAPM must be
17 applied using estimates that reflect the expectations of
18 actual investors in the market, not with backward-looking,
19 historical data.

20 **Q. How did you apply the CAPM to estimate the cost**
21 **of equity?**

22 A. Application of the CAPM to the Utility Proxy
23 Group based on a forward-looking estimate for investors'
24 required rate of return from common stocks is presented on
25 Exhibit 3, Schedule 8. In order to capture the
26 expectations of today's investors in current capital
27 markets, the expected market rate of return was estimated

1 by conducting a DCF analysis on the dividend paying firms
2 in the S&P 500.

3 The dividend yield for each firm was obtained from
4 Value Line, with the growth rate being equal to the average
5 of the earnings growth projections for each firm compiled
6 by IBES and Value Line, with each firm's dividend yield and
7 growth rate being weighted by its proportionate share of
8 total market value. Based on the weighted average of the
9 projections for the 346 individual firms, current estimates
10 imply an average growth rate over the next five years of
11 9.6 percent. Combining this average growth rate with a
12 dividend yield of 3.6 percent results in a current cost of
13 equity estimate for the market as a whole of approximately
14 13.2 percent. Subtracting a 3.2 percent risk-free rate
15 based on the average yield on 20-year Treasury bonds for
16 December 2008 produced a market equity risk premium of 10.0
17 percent. Multiplying this risk premium by the Value Line
18 beta values for the firms in the Utility Proxy Group, and
19 then adding the resulting risk premiums to the average
20 long-term Treasury bond yield, indicated an ROE in the 9.7
21 percent to 14.2 percent range, with the average being 11.2
22 percent.

1 **Q. What cost of equity was indicated for the Non-**
2 **Utility Proxy Group based on this forward-looking**
3 **application of the CAPM?**

4 A. As shown on Exhibit 3, Schedule 9, applying the
5 forward-looking CAPM approach to the firms in the Non-
6 Utility Proxy Group implied cost of equity estimates
7 ranging from 8.7 percent to 15.7 percent, with an average
8 of 11.5 percent.

E. Comparable Earnings Method

9 **Q. What other analyses did you conduct to estimate**
10 **the cost of equity?**

11 A. As I noted earlier, I also evaluated the ROE
12 using the comparable earnings method. Reference to rates
13 of return available from alternative investments of
14 comparable risk can provide an important benchmark in
15 assessing the return necessary to assure confidence in the
16 financial integrity of a firm and its ability to attract
17 capital. This comparable earnings approach is consistent
18 with the economic underpinnings for a fair rate of return
19 established by the Supreme Court in *Hope* and *Bluefield*.
20 Moreover, it avoids the complexities and limitations of
21 capital market methods and instead focuses on expected
22 earned returns on book equity, which are more readily
23 available to investors.

1 **Q. What rates of return are indicated for utilities**
2 **based on this approach?**

3 A. With respect to expectations for electric
4 utilities generally, Value Line reports that its analysts
5 anticipate an average rate of return on common equity for
6 the electric utility industry of 11.5 percent in 2009 and
7 over its 2011-2013 forecast horizon.¹⁷ Meanwhile, Value
8 Line expects that natural gas distribution utilities will
9 earn an average rate of return on common equity of 11.5
10 percent in 2009 and 12.0 percent over its three-to-five
11 year forecast horizon.¹⁸

12 For the firms in the Utility Proxy Group specifically,
13 the returns on common equity projected by Value Line over
14 its three-to-five year forecast horizon are shown on
15 Exhibit 3, Schedule 10. Consistent with the rationale
16 underlying the development of the br+sv growth rates, these
17 year-end values were converted to average returns using the
18 same adjustment factor discussed earlier. As shown on
19 Exhibit 3, Schedule 10, after eliminating potential
20 outliers, Value Line's projections suggested an average ROE
21 of 11.3 percent for the Utility Proxy Group.

¹⁷ The Value Line Investment Survey at 687 (Dec. 26, 2008).

¹⁸ The Value Line Investment Survey 446 (Dec. 12, 2008).

1 Q. What return on equity is indicated by the results
2 of the comparable earnings approach?

3 A. Based on the results discussed above, I concluded
4 that the comparable earnings approach implies a fair rate
5 of return on equity of at least 11.3 percent.

F. Summary of Quantitative Results

6 Q. Please summarize the results of your quantitative
7 analyses.

8 A. The cost of equity estimates implied by my
9 quantitative analyses are summarized in Table 3 below:

10
11

TABLE 3
SUMMARY OF QUANTITATIVE RESULTS

<u>Method</u>	<u>Cost of Equity Estimates</u>	
	<u>Utility Proxy Group</u>	<u>Non-Utility Proxy Group</u>
DCF	11.5% - 13.4%	13.1% - 13.5%
CAPM	11.2%	11.5%
Comparable Earnings	11.3%	--

CAPITAL STRUCTURE

UTILITY PROXY GROUP

Company	At Fiscal Year-End 2007 (a)			Value Line Projected (b)		
	Long-term		Common	Long-term		Common
	Debt	Preferred	Equity	Debt	Other	Equity
1 Allegheny Energy	61.3%	0.0%	38.7%	46.5%	0.0%	53.5%
2 American Elec Pwr	59.7%	0.2%	40.1%	57.5%	0.5%	42.0%
3 Avista Corp.	48.0%	5.7%	46.2%	47.5%	0.0%	52.5%
4 Black Hills Corp.	42.1%	0.0%	57.9%	35.0%	0.0%	65.0%
5 Cleco Corp.	46.2%	0.1%	53.7%	46.0%	0.0%	54.0%
6 DPL, Inc.	64.7%	0.9%	34.4%	50.0%	1.0%	49.0%
7 DTE Energy Co.	53.5%	2.2%	44.3%	55.5%	0.0%	44.5%
8 Edison International	48.3%	4.9%	46.8%	48.5%	3.5%	48.0%
9 Empire District Elec	50.1%	0.0%	49.9%	43.0%	0.0%	57.0%
10 Hawaiian Elec.	48.7%	1.3%	50.0%	45.0%	1.0%	54.0%
11 IDACORP, Inc.	50.6%	0.0%	49.4%	50.5%	0.0%	49.5%
12 Northeast Utilities	54.6%	1.7%	43.7%	53.5%	1.0%	45.5%
13 P S Enterprise Group	52.8%	0.5%	46.7%	43.0%	0.5%	56.5%
14 UIL Holdings	55.7%	0.0%	44.3%	49.0%	0.0%	51.0%
15 Westar Energy	50.6%	0.6%	48.9%	45.5%	0.5%	54.0%
Average	52.5%	1.2%	46.3%	47.7%	0.5%	51.7%

(a) Company Form 10-K and Annual Reports.

(b) The Value Line Investment Survey (Nov. 7, Nov. 28, & Dec. 26, 2008).

CONSTANT GROWTH DCF MODEL

UTILITY PROXY GROUP

	(a)		(b)		(c)		(d)		(e)		(f)		(g)					
	Price	Dividends	Yield	V Line	IBES	First Call	Zacks	br+sv	V Line	IBES	First Call	Zacks	br+sv	V Line	IBES	First Call	Zacks	br+sv
1 Allegheny Energy	\$ 32.56	\$ 0.60	1.8%	15.0%	17.3%	20.0%	16.5%	11.8%	16.8%	19.2%	21.8%	18.3%	13.6%	16.8%	19.2%	21.8%	18.3%	13.6%
2 American Elec Pwr	\$ 30.26	\$ 1.66	5.5%	5.0%	5.4%	6.0%	4.8%	5.8%	10.5%	10.9%	11.5%	10.3%	11.2%	10.5%	10.9%	11.5%	10.3%	11.2%
3 Avista Corp.	\$ 18.43	\$ 0.75	4.1%	9.0%	4.5%	NA	5.0%	3.2%	13.1%	8.6%	NA	9.1%	7.3%	13.1%	8.6%	NA	9.1%	7.3%
4 Black Hills Corp.	\$ 26.30	\$ 1.44	5.5%	3.0%	7.0%	7.0%	6.0%	3.2%	8.5%	12.5%	12.5%	11.5%	8.7%	8.5%	12.5%	12.5%	11.5%	8.7%
5 Cleco Corp.	\$ 21.85	\$ 0.95	4.3%	10.5%	13.0%	13.0%	13.0%	5.3%	14.8%	17.3%	17.3%	17.3%	9.7%	14.8%	17.3%	17.3%	17.3%	9.7%
6 DPL, Inc.	\$ 21.49	\$ 1.10	5.1%	11.0%	10.3%	10.0%	10.3%	11.4%	16.1%	15.4%	15.1%	15.4%	16.5%	16.1%	15.4%	15.1%	15.4%	16.5%
7 DTE Energy Co.	\$ 35.29	\$ 2.18	6.2%	5.0%	6.5%	6.5%	6.5%	2.9%	11.2%	12.7%	12.7%	12.7%	9.1%	11.2%	12.7%	12.7%	12.7%	9.1%
8 Edison International	\$ 32.46	\$ 1.29	4.0%	5.0%	7.6%	7.1%	7.0%	7.6%	9.0%	11.5%	11.1%	11.0%	11.5%	9.0%	11.5%	11.1%	11.0%	11.5%
9 Empire District Elec	\$ 17.00	\$ 1.28	7.5%	10.0%	6.0%	NA	NA	4.3%	17.5%	13.5%	NA	NA	11.8%	17.5%	13.5%	NA	NA	11.8%
10 Hawaiian Elec.	\$ 22.78	\$ 1.24	5.4%	5.0%	4.5%	3.0%	4.5%	3.2%	10.4%	9.9%	8.4%	9.9%	8.6%	10.4%	9.9%	8.4%	9.9%	8.6%
11 IDACORP, Inc.	\$ 29.58	\$ 1.20	4.1%	2.0%	5.0%	5.0%	6.0%	3.8%	6.1%	9.1%	9.1%	10.1%	7.9%	6.1%	9.1%	9.1%	10.1%	7.9%
12 Northeast Utilities	\$ 23.16	\$ 0.88	3.8%	12.0%	6.8%	6.5%	10.0%	6.0%	15.8%	10.6%	10.3%	13.8%	9.8%	15.8%	10.6%	10.3%	13.8%	9.8%
13 P S Enterprise Group	\$ 30.03	\$ 1.41	4.7%	10.5%	3.0%	3.0%	9.0%	8.7%	15.2%	7.7%	7.7%	13.7%	13.4%	15.2%	7.7%	7.7%	13.7%	13.4%
14 UIL Holdings	\$ 30.16	\$ 1.73	5.7%	4.0%	8.0%	NA	6.0%	2.7%	9.7%	13.7%	NA	11.7%	8.4%	9.7%	13.7%	NA	11.7%	8.4%
15 Westar Energy	\$ 19.65	\$ 1.22	6.2%	2.0%	4.4%	4.0%	6.0%	2.2%	8.2%	10.6%	10.2%	12.2%	8.4%	8.2%	10.6%	10.2%	12.2%	8.4%
Average (h)									13.4%	12.3%	11.5%	11.8%	11.9%	13.4%	12.3%	11.5%	11.8%	11.9%

(a) Recent price and estimated dividend for next 12 mos. from The Value Line Investment Survey, Summary and Index (Dec. 26, 2008).

(b) The Value Line Investment Survey (Nov. 7, Nov. 28, & Dec. 26, 2008).

(c) www.finance.yahoo.com (retrieved Dec. 10, 2008).

(d) First Call Earnings Valuation Report (Dec. 10, 2008).

(e) http://www.zacks.com/research (retrieved Dec. 10, 2008)

(f) See Exhibit WEA-5.

(g) Sum of dividend yield and respective growth rate

(h) Excludes highlighted figures

SUSTAINABLE GROWTH RATE

UTILITY PROXY GROUP

	(a)	(a)	(b)	(a)	(a)	(a)	(c)	(d)
	2011-13 Market Price			2011-13 Projections				
<u>Company</u>	<u>High</u>	<u>Low</u>	<u>Avg.</u>	<u>EPS</u>	<u>DPS</u>	<u>BVPS</u>	<u>b</u>	<u>r</u>
1 Allegheny Energy	\$80.00	\$55.00	\$67.50	\$4.00	\$1.40	\$ 26.50	65.0%	15.1%
2 American Elec Pwr	\$50.00	\$35.00	\$42.50	\$3.75	\$1.90	\$ 34.25	49.3%	10.9%
3 Avista Corp.	\$30.00	\$20.00	\$25.00	\$1.75	\$1.15	\$ 21.00	34.3%	8.3%
4 Black Hills Corp.	\$45.00	\$30.00	\$37.50	\$2.75	\$1.60	\$ 37.00	41.8%	7.4%
5 Cleco Corp.	\$40.00	\$25.00	\$32.50	\$2.50	\$1.55	\$ 21.75	38.0%	11.5%
6 DPL, Inc.	\$35.00	\$25.00	\$30.00	\$2.35	\$1.34	\$ 12.10	43.0%	19.4%
7 DTE Energy Co.	\$60.00	\$40.00	\$50.00	\$3.75	\$2.55	\$ 41.75	32.0%	9.0%
8 Edison International	\$55.00	\$35.00	\$45.00	\$4.50	\$1.64	\$ 39.45	63.6%	11.4%
9 Empire District Elec	\$30.00	\$20.00	\$25.00	\$2.00	\$1.40	\$ 18.50	30.0%	10.8%
10 Hawaiian Elec.	\$25.00	\$20.00	\$22.50	\$1.75	\$1.30	\$ 16.75	25.7%	10.4%
11 IDACORP, Inc.	\$35.00	\$25.00	\$30.00	\$2.25	\$1.20	\$ 28.90	46.7%	7.8%
12 Northeast Utilities	\$40.00	\$25.00	\$32.50	\$2.25	\$1.10	\$ 25.75	51.1%	8.7%
13 P S Enterprise Group	\$55.00	\$35.00	\$45.00	\$3.75	\$1.65	\$ 22.50	56.0%	16.7%
14 UIL Holdings	\$35.00	\$25.00	\$30.00	\$2.10	\$1.73	\$ 18.80	17.6%	11.2%
15 Westar Energy	\$30.00	\$20.00	\$25.00	\$2.00	\$1.36	\$ 27.50	32.0%	7.3%

SUSTAINABLE GROWTH RATE

UTILITY PROXY GROUP

	(a)	(a)	(e)	(a)	(a)	(e)	(f)	(g)	(h)
		2007		2011-13			Adjusted "r"		
<u>Company</u>	<u>BVPS</u>	<u>No. Shares</u>	<u>Common Equity</u>	<u>BVPS</u>	<u>No. Shares</u>	<u>Common Equity</u>	<u>Chg in Equity</u>	<u>Adj. Factor</u>	<u>Adj. r</u>
1 Allegheny Energy	\$15.15	167.30	\$2,535	\$26.50	175.00	\$4,638	12.8%	1.0603	16.0%
2 American Elec Pwr	\$25.17	400.43	\$10,079	\$34.25	415.00	\$14,214	7.1%	1.0344	11.3%
3 Avista Corp.	\$17.27	52.91	\$914	\$21.00	56.50	\$1,187	5.4%	1.0261	8.6%
4 Black Hills Corp.	\$25.66	37.80	\$970	\$37.00	39.50	\$1,462	8.5%	1.0410	7.7%
5 Cleco Corp.	\$16.85	59.94	\$1,010	\$21.75	65.00	\$1,414	7.0%	1.0336	11.9%
6 DPL, Inc.	\$7.69	113.60	\$874	\$12.10	124.00	\$1,500	11.4%	1.0540	20.5%
7 DTE Energy Co.	\$35.86	163.23	\$5,853	\$41.75	163.00	\$6,805	3.1%	1.0151	9.1%
8 Edison International	\$25.92	325.81	\$8,445	\$39.45	326.00	\$12,861	8.8%	1.0420	11.9%
9 Empire District Elec	\$16.04	33.61	\$539	\$18.50	38.50	\$712	5.7%	1.0278	11.1%
10 Hawaiian Elec.	\$15.29	83.43	\$1,276	\$16.75	89.00	\$1,491	3.2%	1.0156	10.6%
11 IDACORP, Inc.	\$26.79	45.06	\$1,207	\$28.90	51.60	\$1,491	4.3%	1.0211	7.9%
12 Northeast Utilities	\$18.65	156.22	\$2,914	\$25.75	200.00	\$5,150	12.1%	1.0569	9.2%
13 P S Enterprise Group	\$14.35	508.52	\$7,297	\$22.50	484.00	\$10,890	8.3%	1.0400	17.3%
14 UIL Holdings	\$18.55	25.03	\$464	\$18.80	26.50	\$498	1.4%	1.0070	11.2%
15 Westar Energy	\$19.14	95.46	\$1,827	\$27.50	112.00	\$3,080	11.0%	1.0522	7.7%

SUSTAINABLE GROWTH RATE

UTILITY PROXY GROUP

Company	(a)	(a)	(f)	(i)	(j)	(k)	(l)	(m)
	Common Shares			M/B	"sv" Factor			br + sv
	Outstanding				Ratio	s	v	
	2007	2011-13	Change					
1 Allegheny Energy	167.30	175.00	0.90%	2.55	0.0230	0.6074	1.40%	11.8%
2 American Elec Pwr	400.43	415.00	0.72%	1.24	0.0089	0.1941	0.17%	5.8%
3 Avista Corp.	52.91	56.50	1.32%	1.19	0.0157	0.1600	0.25%	3.2%
4 Black Hills Corp.	37.80	39.50	0.88%	1.01	0.0090	0.0133	0.01%	3.2%
5 Cleco Corp.	59.94	65.00	1.63%	1.49	0.0244	0.3308	0.81%	5.3%
6 DPL, Inc.	113.60	124.00	1.77%	2.48	0.0438	0.5967	2.61%	11.4%
7 DTE Energy Co.	163.23	163.00	-0.03%	1.20	(0.0003)	0.1650	-0.01%	2.9%
8 Edison International	325.81	326.00	0.01%	1.14	0.0001	0.1233	0.00%	7.6%
9 Empire District Elec	33.61	38.50	2.75%	1.35	0.0372	0.2600	0.97%	4.3%
10 Hawaiian Elec.	83.43	89.00	1.30%	1.34	0.0175	0.2556	0.45%	3.2%
11 IDACORP, Inc.	45.06	51.60	2.75%	1.04	0.0285	0.0367	0.10%	3.8%
12 Northeast Utilities	156.22	200.00	5.07%	1.26	0.0639	0.2077	1.33%	6.0%
13 P S Enterprise Group	508.52	484.00	-0.98%	2.00	(0.0197)	0.5000	-0.98%	8.7%
14 UIL Holdings	25.03	26.50	1.15%	1.60	0.0183	0.3733	0.68%	2.7%
15 Westar Energy	95.46	112.00	3.25%	0.91	0.0295	(0.1000)	-0.30%	2.2%

- (a) The Value Line Investment Survey (Nov. 7, Nov. 28, & Dec. 26, 2008).
- (b) Average of High and Low expected market prices.
- (c) Computed at (EPS - DPS) / EPS.
- (d) Computed as EPS / BVPS.
- (e) Product of BVPS and No. Shares Outstanding.
- (f) Five-year rate of change.
- (g) Computed using the formula $2 \times (1 + 5\text{-Yr. Change in Equity}) / (2 + 5 \text{ Yr. Change in Equity})$.
- (h) Product of year-end "r" for 2011-13 and Adjustment Factor.
- (i) Average of High and Low expected market prices divided by 2011-13 BVPS.
- (j) Product of change in common shares outstanding and M/B Ratio.
- (k) Computed as 1 - B/M Ratio.
- (l) Product of "s" and "v".
- (m) Product of average "b" and adjusted "r", plus "sv".

CONSTANT GROWTH DCF MODEL
NON-UTILITY PROXY GROUP

	(a) Dividend Yield	(b) Growth Rates			(c) Growth Rates			(d) Growth Rates			(e) Growth Rates			(f) Cost of Equity Estimates		
		V Line	IBES	First Call	Zacks	brs-y	V Line	IBES	First Call	Zacks	brs-y	V Line	IBES	First Call	Zacks	brs-y
1	3M Company	4.0%	11.3%	11.0%	10.3%	16.0%	7.4%	14.7%	14.4%	13.7%	19.4%	14.7%	14.4%	13.7%	19.4%	
2	Abbott Labs.	2.77%	11.5%	13.0%	11.8%	13.3%	14.3%	14.7%	15.8%	14.6%	16.1%	14.3%	14.7%	15.8%	14.6%	16.1%
3	Aflac Inc.	2.30%	14.5%	15.0%	15.2%	10.7%	16.8%	17.3%	17.3%	17.5%	13.0%	16.8%	17.3%	17.3%	17.5%	13.0%
4	Allergan, Inc.	0.55%	15.5%	15.0%	14.9%	15.4%	16.1%	15.0%	15.6%	15.5%	15.9%	16.1%	15.0%	15.6%	15.5%	15.9%
5	Allstate Corp.	6.80%	7.5%	8.0%	8.6%	10.0%	14.3%	13.8%	14.8%	15.4%	16.8%	14.3%	13.8%	14.8%	15.4%	16.8%
6	AT&T Inc.	5.68%	12.0%	6.5%	17.9%	4.1%	17.7%	12.2%	12.2%	23.6%	9.8%	17.7%	12.2%	12.2%	23.6%	9.8%
7	Bard (C.R.)	0.78%	13.5%	14.0%	14.0%	13.1%	14.3%	15.0%	14.8%	14.8%	13.9%	14.3%	15.0%	14.8%	14.8%	13.9%
8	Baxter Int'l Inc.	1.67%	16.5%	12.9%	13.6%	14.1%	18.2%	14.1%	14.6%	15.3%	15.7%	18.2%	14.1%	14.6%	15.3%	15.7%
9	Becton, Dickinson	1.82%	11.5%	12.0%	12.3%	14.0%	13.3%	14.3%	13.8%	14.1%	15.8%	13.3%	14.3%	13.8%	14.1%	15.8%
10	Bemis Co.	3.49%	5.0%	9.0%	10.5%	6.0%	8.5%	12.8%	12.5%	14.0%	9.4%	8.5%	12.8%	12.5%	14.0%	9.4%
11	Boeing	4.08%	15.5%	10.0%	9.4%	16.6%	19.6%	15.5%	14.1%	13.5%	20.7%	19.6%	15.5%	14.1%	13.5%	20.7%
12	Brown-Forman B'	2.48%	7.5%	7.3%	10.5%	11.9%	10.0%	10.9%	9.8%	13.0%	14.4%	10.0%	10.9%	9.8%	13.0%	14.4%
13	Chevron Corp.	3.62%	8.5%	7.3%	10.3%	13.2%	12.1%	6.7%	10.9%	13.9%	16.8%	12.1%	6.7%	10.9%	13.9%	16.8%
14	Chubb Corp.	2.76%	2.0%	10.0%	9.3%	5.8%	4.8%	12.8%	12.8%	12.1%	8.5%	4.8%	12.8%	12.8%	12.1%	8.5%
15	Coca-Cola	3.40%	8.5%	8.5%	8.7%	11.0%	11.9%	12.0%	11.9%	12.1%	14.4%	11.9%	12.0%	11.9%	12.1%	14.4%
16	Colgate-Palmolive	2.59%	12.0%	11.0%	10.0%	18.9%	14.6%	13.0%	13.6%	12.6%	21.5%	14.6%	13.0%	13.6%	12.6%	21.5%
17	Commerce Bancshs.	2.51%	4.5%	5.7%	6.5%	8.7%	7.0%	8.7%	8.2%	9.0%	11.2%	7.0%	8.7%	8.2%	9.0%	11.2%
18	ConocoPhillips	4.06%	6.5%	5.7%	9.2%	15.8%	10.6%	3.5%	9.8%	13.3%	19.9%	10.6%	3.5%	9.8%	13.3%	19.9%
19	Du Pont	6.92%	6.5%	5.3%	9.5%	9.3%	13.4%	10.1%	12.2%	16.4%	16.3%	13.4%	10.1%	12.2%	16.4%	16.3%
20	Eaton Corp.	4.81%	11.5%	11.0%	11.5%	15.8%	16.3%	14.2%	15.8%	16.3%	20.6%	16.3%	14.2%	15.8%	16.3%	20.6%
21	Ecolab Inc.	1.47%	13.0%	13.0%	13.5%	15.4%	14.5%	14.3%	14.5%	15.0%	16.9%	14.5%	14.3%	14.5%	15.0%	16.9%
22	Emerson Electric	4.18%	11.0%	12.0%	11.8%	7.2%	15.2%	16.5%	16.2%	16.0%	11.4%	15.2%	16.5%	16.2%	16.0%	11.4%
23	Everest Re Group Ltd.	2.59%	14.5%	10.0%	15.0%	10.6%	17.1%	12.6%	12.6%	17.6%	13.2%	17.1%	12.6%	12.6%	17.6%	13.2%
24	Exxon Mobil Corp.	2.10%	8.5%	6.6%	8.6%	12.9%	10.6%	4.4%	8.7%	10.7%	15.0%	10.6%	4.4%	8.7%	10.7%	15.0%
25	Fortune Brands	4.67%	5.5%	10.0%	9.4%	8.6%	10.2%	14.7%	14.7%	14.1%	13.2%	10.2%	14.7%	14.7%	14.1%	13.2%
26	Gallagher (Arthur J.)	5.35%	5.5%	6.0%	9.5%	9.3%	10.9%	11.4%	11.4%	14.9%	14.6%	10.9%	11.4%	11.4%	14.9%	14.6%
27	Gen'l Dynamics	2.80%	12.0%	10.0%	9.1%	10.7%	14.8%	11.8%	12.8%	11.9%	13.5%	14.8%	11.8%	12.8%	11.9%	13.5%
28	Gen'l Mills	2.79%	10.0%	10.0%	9.0%	8.4%	12.8%	12.8%	12.8%	11.8%	11.2%	12.8%	12.8%	12.8%	11.8%	11.2%
29	Genuine Parts	4.22%	9.0%	8.0%	9.0%	6.5%	13.2%	12.5%	12.2%	13.2%	10.7%	13.2%	12.5%	12.2%	13.2%	10.7%
30	Grainger (W.W.)	2.38%	12.5%	12.0%	11.3%	8.7%	14.9%	14.1%	14.4%	13.7%	11.0%	14.9%	14.1%	14.4%	13.7%	11.0%
31	Heinz (H.J.)	4.52%	10.0%	7.0%	NA	13.6%	14.5%	11.5%	11.5%	NA	18.2%	14.5%	11.5%	11.5%	NA	18.2%
32	Hewlett-Packard	0.96%	17.5%	12.0%	12.5%	10.3%	18.5%	13.6%	13.0%	13.5%	11.3%	18.5%	13.6%	13.0%	13.5%	11.3%
33	Home Depot	3.88%	-0.5%	9.8%	9.3%	8.2%	3.4%	13.6%	14.9%	13.2%	12.1%	3.4%	13.6%	14.9%	13.2%	12.1%
34	Honeywell Int'l	4.32%	13.0%	11.0%	11.8%	14.0%	17.3%	14.3%	15.3%	16.1%	18.4%	17.3%	14.3%	15.3%	16.1%	18.4%
35	Hormel Foods	2.81%	11.0%	8.5%	8.4%	11.3%	13.8%	11.6%	11.3%	11.2%	14.1%	13.8%	11.6%	11.3%	11.2%	14.1%
36	Illinois Tool Works	3.90%	10.5%	10.0%	9.4%	10.8%	14.4%	14.0%	13.9%	13.3%	14.7%	14.4%	14.0%	13.9%	13.3%	14.7%
37	Ingersoll-Rand	4.93%	18.5%	12.0%	12.3%	18.0%	23.4%	16.9%	16.9%	17.2%	22.9%	23.4%	16.9%	16.9%	17.2%	22.9%
38	Int'l Business Mach.	2.58%	14.5%	11.0%	10.5%	7.4%	17.1%	13.6%	12.6%	13.1%	10.0%	17.1%	13.6%	12.6%	13.1%	10.0%

CONSTANT GROWTH DCF MODEL
NON-UTILITY PROXY GROUP

Company	(a) Dividend		(b) Growth Rates			(c) Growth Rates			(d) Growth Rates			(e) Growth Rates			(f) Cost of Equity Estimates		
	Yield	V Line	IBES	First Call	Zacks	brvsy	Y Line	IBES	First Call	Zacks	brvsy	V Line	IBES	First Call	Zacks	brvsy	
39 ITT Corp.	1.71%	14.0%	13.0%	13.0%	12.1%	13.1%	15.7%	14.7%	14.7%	13.8%	14.8%	15.7%	14.7%	14.7%	13.8%	14.8%	
40 Johnson & Johnson	3.28%	8.0%	7.8%	7.5%	7.8%	10.1%	11.3%	11.1%	10.8%	11.1%	13.4%	11.3%	11.1%	10.8%	11.1%	13.4%	
41 Kimberly-Clark	4.24%	7.0%	7.7%	7.0%	7.3%	12.9%	11.2%	11.9%	11.2%	11.5%	17.1%	11.2%	11.9%	11.2%	11.5%	17.1%	
42 Kraft Foods	4.44%	6.5%	9.3%	7.3%	8.0%	4.8%	10.9%	13.8%	11.7%	12.4%	9.2%	10.9%	13.8%	11.7%	12.4%	9.2%	
43 Lilly (Eli)	5.55%	4.5%	5.9%	5.0%	6.4%	8.6%	10.1%	11.5%	10.6%	12.0%	14.2%	10.1%	11.5%	10.6%	12.0%	14.2%	
44 Lincoln Nat'l Corp.	13.60%	9.5%	10.5%	11.2%	11.0%	8.4%	23.1%	24.1%	24.8%	24.6%	22.0%	23.1%	24.1%	24.8%	24.6%	22.0%	
45 Lockheed Martin	2.96%	15.5%	11.5%	10.0%	8.6%	13.2%	18.5%	14.5%	13.0%	11.6%	16.2%	18.5%	14.5%	13.0%	11.6%	16.2%	
46 Manulife Fin'l	6.78%	10.5%	12.8%	13.7%	11.0%	11.0%	17.3%	19.6%	20.5%	17.8%	17.8%	17.3%	19.6%	20.5%	17.8%	17.8%	
47 McDonald's Corp.	3.29%	12.0%	10.5%	9.0%	12.0%	2.3%	15.3%	13.8%	12.3%	15.3%	5.5%	15.3%	13.8%	12.3%	15.3%	5.5%	
48 Metronic, Inc.	2.46%	11.0%	12.2%	12.0%	13.4%	9.2%	13.5%	14.7%	14.5%	15.9%	11.7%	13.5%	14.7%	14.5%	15.9%	11.7%	
49 Microsoft Corp.	2.72%	15.5%	10.9%	11.0%	11.0%	-1.2%	18.2%	13.6%	13.7%	13.7%	1.5%	18.2%	13.6%	13.7%	13.7%	1.5%	
50 NIKE, Inc. 'B'	1.77%	11.5%	13.0%	14.0%	12.3%	9.5%	13.3%	14.8%	15.8%	14.1%	11.3%	13.3%	14.8%	15.8%	14.1%	11.3%	
51 Northrop Grumman	4.08%	11.5%	12.8%	10.0%	9.6%	8.2%	15.6%	16.9%	14.1%	13.7%	12.2%	15.6%	16.9%	14.1%	13.7%	12.2%	
52 PepsiCo, Inc.	3.25%	11.0%	9.4%	9.8%	10.3%	10.3%	14.3%	12.7%	13.1%	13.6%	13.5%	14.3%	12.7%	13.1%	13.6%	13.5%	
53 Pfizer, Inc.	7.87%	0.5%	1.0%	3.0%	3.9%	6.9%	8.4%	8.9%	10.9%	11.8%	14.7%	8.4%	8.9%	10.9%	11.8%	14.7%	
54 Procter & Gamble	2.61%	9.0%	10.0%	10.0%	10.2%	6.5%	11.6%	12.6%	12.6%	12.8%	9.1%	11.6%	12.6%	12.6%	12.8%	9.1%	
55 Raytheon Co.	2.32%	14.0%	12.4%	10.0%	10.6%	8.6%	16.3%	14.7%	12.3%	12.9%	10.9%	16.3%	14.7%	12.3%	12.9%	10.9%	
56 Reinsurance Group	1.00%	11.5%	10.1%	10.5%	11.5%	11.3%	12.5%	11.1%	11.5%	12.5%	12.3%	12.5%	11.1%	11.5%	12.5%	12.3%	
57 Sigma-Aldrich	1.39%	9.5%	9.0%	9.1%	9.0%	13.4%	10.9%	10.4%	10.5%	10.4%	14.8%	10.9%	10.4%	10.5%	10.4%	14.8%	
58 Sysco Corp.	4.00%	12.0%	12.0%	12.0%	12.5%	8.8%	16.0%	16.0%	16.0%	16.5%	12.8%	16.0%	16.0%	16.0%	16.5%	12.8%	
59 Torchmark Corp.	1.62%	8.0%	8.3%	8.0%	NA	10.6%	9.6%	9.9%	9.6%	NA	12.8%	9.6%	9.9%	9.6%	NA	12.8%	
60 United Parcel Serv.	3.17%	7.0%	11.7%	11.5%	11.8%	14.0%	10.2%	14.8%	14.7%	15.0%	17.2%	10.2%	14.8%	14.7%	15.0%	17.2%	
61 United Technologies	3.27%	12.5%	10.0%	10.0%	9.6%	11.8%	15.8%	13.3%	13.3%	12.9%	15.0%	15.8%	13.3%	13.3%	12.9%	15.0%	
62 Verizon Communic.	5.72%	6.0%	6.6%	7.0%	7.4%	8.6%	11.7%	12.3%	12.7%	13.1%	14.3%	11.7%	12.3%	12.7%	13.1%	14.3%	
63 Wal-Mart Stores	1.72%	9.5%	11.5%	11.0%	10.2%	10.0%	11.2%	13.2%	12.7%	11.9%	11.7%	11.2%	13.2%	12.7%	11.9%	11.7%	
64 Walgreen Co.	1.84%	11.0%	12.6%	14.0%	13.6%	11.8%	12.8%	14.4%	15.8%	15.4%	13.6%	12.8%	14.4%	15.8%	15.4%	13.6%	
65 Wells Fargo	4.94%	5.5%	8.5%	8.5%	8.2%	11.7%	10.4%	13.4%	13.4%	13.1%	16.6%	10.4%	13.4%	13.4%	13.1%	16.6%	
66 Wyeth	3.57%	6.0%	2.1%	2.0%	4.7%	14.2%	9.6%	5.7%	5.6%	8.3%	17.8%	9.6%	5.7%	5.6%	8.3%	17.8%	
Average (g)							13.1%	13.4%	13.2%	13.5%	13.3%	13.1%	13.4%	13.2%	13.5%	13.3%	

(a) www.valueine.com (retrieved Dec. 11, 2008).
 (b) www.finance.yahoo.com (retrieved Dec. 16, 2008).
 (c) First Call Earnings Valuation Report (retrieved Dec. 17, 2008).
 (d) http://www.zacks.com/research (retrieved Dec. 16, 2008).
 (e) See Exhibit WEA-4.
 (f) Sum of dividend yield and respective growth rate.
 (g) Excludes highlighted figures.

SUSTAINABLE GROWTH RATE

NON-UTILITY PROXY GROUP

	(a)	(a)	(b)	(a)	(a)	(a)	(c)	(d)
Company	2011-13 Market Price			2011-13 Projections			b	r
	High	Low	Avg.	EPS	DPS	BVPS		
1 3M Company	\$110.00	\$90.00	\$100.00	\$6.25	\$2.20	\$21.85	64.8%	28.6%
2 Abbott Labs.	\$100.00	\$80.00	\$90.00	\$5.05	\$2.10	\$21.45	58.4%	23.5%
3 Aflac Inc.	\$115.00	\$95.00	\$105.00	\$6.45	\$1.88	\$30.70	70.9%	21.0%
4 Allergan, Inc.	\$115.00	\$95.00	\$105.00	\$4.05	\$0.30	\$29.50	92.6%	13.7%
5 Allstate Corp.	\$90.00	\$75.00	\$82.50	\$8.35	\$2.25	\$59.45	73.1%	14.0%
6 AT&T Inc.	\$80.00	\$65.00	\$72.50	\$4.50	\$2.60	\$25.80	42.2%	17.4%
7 Bard (C.R.)	\$155.00	\$130.00	\$142.50	\$7.15	\$0.90	\$31.78	87.4%	22.5%
8 Baxter Int'l Inc.	\$105.00	\$85.00	\$95.00	\$5.40	\$1.55	\$23.85	71.3%	22.6%
9 Becton, Dickinson	\$115.00	\$90.00	\$102.50	\$6.40	\$1.75	\$34.25	72.7%	18.7%
10 Bemis Co.	\$45.00	\$35.00	\$40.00	\$2.30	\$1.04	\$21.50	54.8%	10.7%
11 Boeing	\$150.00	\$120.00	\$135.00	\$9.00	\$2.50	\$37.35	72.2%	24.1%
12 Brown-Forman 'B	\$75.00	\$60.00	\$67.50	\$4.00	\$1.32	\$20.70	67.0%	19.3%
13 Chevron Corp.	\$140.00	\$110.00	\$125.00	\$12.50	\$3.20	\$57.55	74.4%	21.7%
14 Chubb Corp.	\$85.00	\$70.00	\$77.50	\$6.30	\$2.80	\$56.25	55.6%	11.2%
15 Coca-Cola	\$90.00	\$75.00	\$82.50	\$3.85	\$1.88	\$17.30	51.2%	22.3%
16 Colgate-Palmolive	\$140.00	\$115.00	\$127.50	\$5.80	\$2.30	\$13.55	60.3%	42.8%
17 Commerce Bancshs.	\$55.00	\$45.00	\$50.00	\$3.70	\$1.20	\$33.35	67.6%	11.1%
18 ConocoPhillips	\$145.00	\$120.00	\$132.50	\$14.00	\$2.00	\$72.40	85.7%	19.3%
19 Du Pont	\$80.00	\$65.00	\$72.50	\$4.10	\$1.92	\$19.20	53.2%	21.4%
20 Eaton Corp.	\$210.00	\$170.00	\$190.00	\$11.90	\$3.10	\$55.90	73.9%	21.3%
21 Ecolab Inc.	\$65.00	\$55.00	\$60.00	\$3.00	\$0.75	\$15.10	75.0%	19.9%
22 Emerson Electric	\$90.00	\$75.00	\$82.50	\$4.15	\$1.80	\$15.80	56.6%	26.3%
23 Everest Re Group Ltd.	\$165.00	\$135.00	\$150.00	\$15.00	\$2.35	\$116.65	84.3%	12.9%
24 Exxon Mobil Corp.	\$140.00	\$115.00	\$127.50	\$10.50	\$1.90	\$38.55	81.9%	27.2%
25 Fortune Brands	\$115.00	\$95.00	\$105.00	\$7.00	\$1.86	\$55.15	73.4%	12.7%
26 Gallagher (Arthur J.)	\$40.00	\$35.00	\$37.50	\$2.20	\$1.44	\$10.35	34.5%	21.3%
27 Gen'l Dynamics	\$140.00	\$115.00	\$127.50	\$8.40	\$2.25	\$51.70	73.2%	16.2%
28 Gen'l Mills	\$95.00	\$80.00	\$87.50	\$5.10	\$2.25	\$23.50	55.9%	21.7%
29 Genuine Parts	\$80.00	\$65.00	\$72.50	\$4.65	\$2.16	\$24.65	53.5%	18.9%
30 Grainger (W.W.)	\$160.00	\$130.00	\$145.00	\$8.65	\$2.35	\$48.20	72.8%	17.9%
31 Heinz (H.J.)	\$80.00	\$65.00	\$72.50	\$4.30	\$2.08	\$12.25	51.6%	35.1%
32 Hewlett-Packard	\$95.00	\$80.00	\$87.50	\$5.50	\$0.60	\$23.75	89.1%	23.2%
33 Home Depot	\$50.00	\$40.00	\$45.00	\$2.50	\$1.10	\$17.25	56.0%	14.5%
34 Honeywell Int'l	\$85.00	\$70.00	\$77.50	\$5.35	\$1.60	\$25.95	70.1%	20.6%
35 Hormel Foods	\$75.00	\$60.00	\$67.50	\$3.75	\$1.20	\$23.35	68.0%	16.1%
36 Illinois Tool Works	\$100.00	\$80.00	\$90.00	\$5.50	\$1.40	\$24.30	74.5%	22.6%
37 Ingersoll-Rand	\$70.00	\$55.00	\$62.50	\$8.25	\$1.00	\$46.15	87.9%	17.9%
38 Int'l Business Mach.	\$245.00	\$200.00	\$222.50	\$14.00	\$3.25	\$27.35	76.8%	51.2%
39 ITT Corp.	\$115.00	\$95.00	\$105.00	\$6.60	\$1.06	\$42.50	83.9%	15.5%
40 Johnson & Johnson	\$120.00	\$95.00	\$107.50	\$6.00	\$2.40	\$26.25	60.0%	22.9%
41 Kimberly-Clark	\$100.00	\$80.00	\$90.00	\$6.00	\$2.95	\$19.00	50.8%	31.6%

SUSTAINABLE GROWTH RATE

NON-UTILITY PROXY GROUP

Company	(a)	(a)	(b)	(a)	(a)	(a)	(c)	(d)
	2011-13 Market Price			2011-13 Projections			b	r
	High	Low	Avg.	EPS	DPS	BVPS		
42 Kraft Foods	\$65.00	\$50.00	\$57.50	\$2.75	\$1.40	\$26.20	49.1%	10.5%
43 Lilly (Eli)	\$70.00	\$55.00	\$62.50	\$4.15	\$2.16	\$21.45	48.0%	19.3%
44 Lincoln Nat'l Corp.	\$120.00	\$100.00	\$110.00	\$8.50	\$1.98	\$60.45	76.7%	14.1%
45 Lockheed Martin	\$210.00	\$170.00	\$190.00	\$12.70	\$2.65	\$46.75	79.1%	27.2%
46 Manulife Financial	\$60.00	\$50.00	\$55.00	\$4.00	\$1.20	\$23.15	70.0%	17.3%
47 McDonald's Corp.	\$90.00	\$70.00	\$80.00	\$4.70	\$2.80	\$16.50	40.4%	28.5%
48 Medtronic, Inc.	\$95.00	\$80.00	\$87.50	\$4.55	\$1.08	\$19.55	76.3%	23.3%
49 Microsoft Corp.	\$60.00	\$50.00	\$55.00	\$3.10	\$0.80	\$9.50	74.2%	32.6%
50 NIKE, Inc. 'B'	\$110.00	\$90.00	\$100.00	\$5.15	\$1.50	\$23.85	70.9%	21.6%
51 Northrop Grummar	\$140.00	\$115.00	\$127.50	\$8.35	\$2.10	\$71.00	74.9%	11.8%
52 PepsiCo, Inc.	\$125.00	\$100.00	\$112.50	\$5.60	\$2.12	\$15.95	62.1%	35.1%
53 Pfizer, Inc.	\$25.00	\$20.00	\$22.50	\$2.15	\$1.40	\$10.10	34.9%	21.3%
54 Procter & Gamble	\$110.00	\$90.00	\$100.00	\$4.75	\$1.95	\$32.30	58.9%	14.7%
55 Raytheon Co.	\$95.00	\$80.00	\$87.50	\$5.75	\$1.75	\$40.75	69.6%	14.1%
56 Reinsurance Group	\$70.00	\$55.00	\$62.50	\$8.85	\$0.50	\$75.35	94.4%	11.7%
57 Sigma-Aldrich	\$70.00	\$60.00	\$65.00	\$3.60	\$0.70	\$18.45	80.6%	19.5%
58 Sysco Corp.	\$65.00	\$55.00	\$60.00	\$2.80	\$1.25	\$7.70	55.4%	36.4%
59 Torchmark Corp.	\$100.00	\$85.00	\$92.50	\$8.00	\$0.75	\$56.00	90.6%	14.3%
60 United Parcel Serv.	\$135.00	\$110.00	\$122.50	\$5.65	\$2.25	\$16.90	60.2%	33.4%
61 United Technologies	\$130.00	\$105.00	\$117.50	\$7.40	\$1.85	\$42.50	75.0%	17.4%
62 Verizon Communic	\$65.00	\$55.00	\$60.00	\$3.50	\$1.84	\$18.75	47.4%	18.7%
63 Wal-Mart Stores	\$90.00	\$75.00	\$82.50	\$5.05	\$1.25	\$24.55	75.2%	20.6%
64 Walgreen Co.	\$75.00	\$65.00	\$70.00	\$3.25	\$0.70	\$21.65	78.5%	15.0%
65 Wells Fargo	\$50.00	\$40.00	\$45.00	\$3.25	\$1.60	\$19.20	50.8%	16.9%
66 Wyeth	\$75.00	\$60.00	\$67.50	\$4.60	\$1.35	\$24.25	70.7%	19.0%

SUSTAINABLE GROWTH RATE

NON-UTILITY PROXY GROUP

Company	(a)	(a)	(e)	(a)	(a)	(e)	(f)	(g)	(h)
		2007		2011-13			Adjusted "r"		
	<u>BVPS</u>	<u>No. Shares</u>	<u>Common Equity</u>	<u>BVPS</u>	<u>No. Shares</u>	<u>Common Equity</u>	<u>Chg in Equity</u>	<u>Adj. Factor</u>	<u>Adj. r</u>
1 3M Company	\$16.56	709.16	\$11,744	\$21.85	680.00	\$14,858	4.8%	1.0235	29.3%
2 Abbott Labs.	\$11.47	1549.90	\$17,777	\$21.45	1520.00	\$32,604	12.9%	1.0606	25.0%
3 Aflac Inc.	\$18.08	486.53	\$8,796	\$30.70	440.00	\$13,508	9.0%	1.0429	21.9%
4 Allergan, Inc.	\$12.22	305.91	\$3,738	\$29.50	315.00	\$9,293	20.0%	1.0908	15.0%
5 Allstate Corp.	\$38.81	563.00	\$21,850	\$59.45	520.00	\$30,914	7.2%	1.0347	14.5%
6 AT&T Inc.	\$19.09	6043.50	\$115,370	\$25.80	5500.00	\$141,900	4.2%	1.0207	17.8%
7 Bard (C.R.)	\$18.44	100.19	\$1,848	\$31.78	90.00	\$2,860	9.1%	1.0437	23.5%
8 Baxter Int'l Inc.	\$10.91	633.64	\$6,913	\$23.85	600.00	\$14,310	15.7%	1.0726	24.3%
9 Becton, Dickinson	\$17.89	243.84	\$4,362	\$34.25	241.00	\$8,254	13.6%	1.0637	19.9%
10 Bemis Co.	\$15.54	100.52	\$1,562	\$21.50	100.00	\$2,150	6.6%	1.0319	11.0%
11 Boeing	\$12.22	736.68	\$9,002	\$37.35	700.00	\$26,145	23.8%	1.1062	26.7%
12 Boeing	\$11.44	150.74	\$1,724	\$20.70	145.00	\$3,002	11.7%	1.0554	20.4%
13 Chevron Corp.	\$36.88	2090.40	\$77,094	\$57.55	1800.00	\$103,590	6.1%	1.0295	22.4%
14 Chubb Corp.	\$38.56	374.65	\$14,447	\$56.25	345.00	\$19,406	6.1%	1.0295	11.5%
15 Coca-Cola	\$9.38	2318.00	\$21,743	\$17.30	2285.00	\$39,531	12.7%	1.0597	23.6%
16 Colgate-Palmolive	\$4.10	509.03	\$2,087	\$13.55	480.00	\$6,504	25.5%	1.1132	47.6%
17 Commerce Bancshs.	\$21.25	71.89	\$1,528	\$33.35	78.00	\$2,601	11.2%	1.0532	11.7%
18 Du Pont	\$56.63	1571.40	\$88,988	\$72.40	1475.00	\$106,790	3.7%	1.0182	19.7%
19 Du Pont	\$12.38	899.30	\$11,133	\$19.20	860.00	\$16,512	8.2%	1.0394	22.2%
20 Eaton Corp.	\$35.42	146.00	\$5,171	\$55.90	144.00	\$8,050	9.3%	1.0442	22.2%
21 Ecolab Inc.	\$7.84	246.80	\$1,935	\$15.10	245.00	\$3,700	13.8%	1.0647	21.2%
22 Emerson Electric	\$11.14	787.23	\$8,770	\$15.80	715.00	\$11,297	5.2%	1.0253	26.9%
23 Everest Re Group Ltd.	\$86.92	65.40	\$5,685	\$116.65	60.00	\$6,999	4.2%	1.0208	13.1%
24 Exxon Mobil Corp.	\$22.62	5382.00	\$121,741	\$38.55	4300.00	\$165,765	6.4%	1.0309	28.1%
25 Fortune Brands	\$36.94	153.91	\$5,685	\$55.15	145.00	\$7,997	7.1%	1.0341	13.1%
26 Gallagher (Arthur J.)	\$7.78	92.00	\$716	\$10.35	95.00	\$983	6.6%	1.0317	21.9%
27 Gen'l Dynamics	\$29.13	403.98	\$11,768	\$51.70	380.00	\$19,646	10.8%	1.0512	17.1%
28 Gen'l Mills	\$15.64	340.00	\$5,318	\$23.50	315.00	\$7,403	6.8%	1.0331	22.4%
29 Genuine Parts	\$16.36	166.07	\$2,717	\$24.65	150.00	\$3,698	6.4%	1.0308	19.4%
30 Grainger (W.W.)	\$26.40	79.46	\$2,098	\$48.20	70.00	\$3,374	10.0%	1.0475	18.8%
31 Heinz (H.J.)	\$6.04	312.56	\$1,888	\$12.25	295.00	\$3,614	13.9%	1.0648	37.4%
32 Hewlett-Packard	\$14.93	2580.00	\$38,519	\$23.75	2100.00	\$49,875	5.3%	1.0258	23.8%
33 Home Depot	\$10.48	1690.00	\$17,711	\$17.25	1675.00	\$28,894	10.3%	1.0489	15.2%
34 Honeywell Int'l	\$12.35	746.55	\$9,220	\$25.95	720.00	\$18,684	15.2%	1.0705	22.1%
35 Hormel Foods	\$13.89	135.68	\$1,885	\$23.35	135.00	\$3,152	10.8%	1.0514	16.9%
36 Illinois Tool Works	\$17.64	530.10	\$9,351	\$24.30	470.00	\$11,421	4.1%	1.0200	23.1%
37 Ingersoll-Rand	\$29.01	272.61	\$7,908	\$46.15	325.00	\$14,999	13.7%	1.0639	19.0%
38 Int'l Business Mach.	\$20.55	1385.20	\$28,466	\$27.35	1100.00	\$30,085	1.1%	1.0055	51.5%
39 ITT Corp.	\$21.73	181.57	\$3,946	\$42.50	177.00	\$7,523	13.8%	1.0644	16.5%
40 Johnson & Johnson	\$15.25	2840.20	\$43,313	\$26.25	2650.00	\$69,563	9.9%	1.0473	23.9%
41 Kimberly-Clark	\$12.41	420.90	\$5,223	\$19.00	400.00	\$7,600	7.8%	1.0375	32.8%

SUSTAINABLE GROWTH RATE

NON-UTILITY PROXY GROUP

Company	(a)	(a)	(e)	(a)	(a)	(e)	(f)	(g)	(h)
		2007		2011-13			Adjusted "r"		
	BVPS	No. Shares	Common Equity	BVPS	No. Shares	Common Equity	Chg in Equity	Adj. Factor	Adj. r
42 Kraft Foods	\$17.80	1533.80	\$27,302	\$26.20	1500.00	\$39,300	7.6%	1.0364	10.9%
43 Lilly (Eli)	\$12.05	1134.30	\$13,668	\$21.45	1100.00	\$23,595	11.5%	1.0545	20.4%
44 Lincoln Nat'l Corp.	\$44.35	264.23	\$11,719	\$60.45	225.00	\$13,601	3.0%	1.0149	14.3%
45 Lockheed Martin	\$23.97	409.00	\$9,804	\$46.75	350.00	\$16,363	10.8%	1.0512	28.6%
46 M&T Bank Corp.	\$16.37	1501.00	\$24,571	\$23.15	1425.00	\$32,989	6.1%	1.0294	17.8%
47 McDonald's Corp.	\$13.11	1165.30	\$15,277	\$16.50	1030.00	\$16,995	2.2%	1.0107	28.8%
48 Medtronic, Inc.	\$10.25	1124.90	\$11,530	\$19.55	980.00	\$19,159	10.7%	1.0507	24.5%
49 Microsoft Corp.	\$3.32	9380.00	\$31,142	\$9.50	7000.00	\$66,500	16.4%	1.0757	35.1%
50 NIKE, Inc. 'B'	\$13.94	503.80	\$7,023	\$23.85	455.00	\$10,852	9.1%	1.0435	22.5%
51 Northrop Grummar	\$52.35	337.83	\$17,685	\$71.00	320.00	\$22,720	5.1%	1.0250	12.1%
52 PepsiCo, Inc.	\$10.71	1605.00	\$17,190	\$15.95	1450.00	\$23,128	6.1%	1.0297	36.2%
53 Pfizer, Inc.	\$9.60	6761.00	\$64,906	\$10.10	6600.00	\$66,660	0.5%	1.0027	21.3%
54 Procter & Gamble	\$20.87	3131.90	\$65,363	\$32.30	2950.00	\$95,285	7.8%	1.0377	15.3%
55 Raytheon Co.	\$29.43	426.20	\$12,543	\$40.75	400.00	\$16,300	5.4%	1.0262	14.5%
56 Raytheon Co.	\$51.42	62.03	\$3,190	\$75.35	67.00	\$5,048	9.6%	1.0459	12.3%
57 Sigma-Aldrich	\$12.21	132.41	\$1,617	\$18.45	125.00	\$2,306	7.4%	1.0355	20.2%
58 Sysco Corp.	\$5.36	611.84	\$3,279	\$7.70	560.00	\$4,312	5.6%	1.0274	37.4%
59 Sysco Corp.	\$36.07	92.18	\$3,325	\$56.00	75.00	\$4,200	4.8%	1.0234	14.6%
60 United Parcel Serv.	\$11.78	1034.40	\$12,185	\$16.90	980.00	\$16,562	6.3%	1.0307	34.5%
61 United Technologies	\$21.76	981.52	\$21,358	\$42.50	925.00	\$39,313	13.0%	1.0609	18.5%
62 Verizon Communic	\$17.62	2871.00	\$50,587	\$18.75	2850.00	\$53,438	1.1%	1.0055	18.8%
63 Wal-Mart Stores	\$16.26	3973.00	\$64,601	\$24.55	3500.00	\$85,925	5.9%	1.0285	21.2%
64 Walgreen Co.	\$11.20	991.14	\$11,101	\$21.65	975.00	\$21,109	13.7%	1.0642	16.0%
65 Wells Fargo	\$14.31	3297.10	\$47,182	\$19.20	3650.00	\$70,080	8.2%	1.0395	17.6%
66 Wyeth	\$13.61	1337.80	\$18,207	\$24.25	1340.00	\$32,495	12.3%	1.0579	20.1%

SUSTAINABLE GROWTH RATE

NON-UTILITY PROXY GROUP

Company	(a)	(a)	(f)	(i)	(j)	(k)	(l)	(m)
	Common Shares			M/B	"sv" Factor			br + sv
	Outstanding				Ratio	s	v	
	2007	2011-13	Change					
1 3M Company	709.16	680.00	-0.84%	4.58	(0.0383)	0.7815	-2.99%	16.0%
2 Abbott Labs.	1549.90	1520.00	-0.39%	4.20	(0.0163)	0.7617	-1.24%	13.3%
3 Aflac Inc.	486.53	440.00	-1.99%	3.42	(0.0681)	0.7076	-4.82%	10.7%
4 Allergan, Inc.	305.91	315.00	0.59%	3.56	0.0209	0.7190	1.50%	15.4%
5 Allstate Corp.	563.00	520.00	-1.58%	1.39	(0.0219)	0.2794	-0.61%	10.0%
6 AT&T Inc.	6043.50	5500.00	-1.87%	2.81	(0.0525)	0.6441	-3.38%	4.1%
7 Bard (C.R.)	100.19	90.00	-2.12%	4.48	(0.0952)	0.7770	-7.39%	13.1%
8 Baxter Int'l Inc.	633.64	600.00	-1.09%	3.98	(0.0432)	0.7489	-3.24%	14.1%
9 Becton, Dickinson	243.84	241.00	-0.23%	2.99	(0.0070)	0.6659	-0.47%	14.0%
10 Bemis Co.	100.52	100.00	-0.10%	1.86	(0.0019)	0.4625	-0.09%	6.0%
11 Boeing	736.68	700.00	-1.02%	3.61	(0.0367)	0.7233	-2.66%	16.6%
12 Boeing	150.74	145.00	-0.77%	3.26	(0.0252)	0.6933	-1.75%	11.9%
13 Chevron Corp.	2090.40	1800.00	-2.95%	2.17	(0.0640)	0.5396	-3.45%	13.2%
14 Chubb Corp.	374.65	345.00	-1.64%	1.38	(0.0225)	0.2742	-0.62%	5.8%
15 Coca-Cola	2318.00	2285.00	-0.29%	4.77	(0.0137)	0.7903	-1.08%	11.0%
16 Colgate-Palmolive	509.03	480.00	-1.17%	9.41	(0.1099)	0.8937	-9.82%	18.9%
17 Commerce Bancshs.	71.89	78.00	1.64%	1.50	0.0247	0.3330	0.82%	8.7%
18 Du Pont	1571.40	1475.00	-1.26%	1.83	(0.0230)	0.4536	-1.04%	15.8%
19 Du Pont	899.30	860.00	-0.89%	3.78	(0.0336)	0.7352	-2.47%	9.3%
20 Eaton Corp.	146.00	144.00	-0.28%	3.40	(0.0094)	0.7058	-0.66%	15.8%
21 Ecolab Inc.	246.80	245.00	-0.15%	3.97	(0.0058)	0.7483	-0.44%	15.4%
22 Emerson Electric	787.23	715.00	-1.91%	5.22	(0.0995)	0.8085	-8.05%	7.2%
23 Everest Re Group Ltd.	65.40	60.00	-1.71%	1.29	(0.0220)	0.2223	-0.49%	10.6%
24 Exxon Mobil Corp.	5382.00	4300.00	-4.39%	3.31	(0.1452)	0.6976	-10.13%	12.9%
25 Fortune Brands	153.91	145.00	-1.19%	1.90	(0.0226)	0.4748	-1.07%	8.6%
26 Gallagher (Arthur J.)	92.00	95.00	0.64%	3.62	0.0233	0.7240	1.69%	9.3%
27 Gen'l Dynamics	403.98	380.00	-1.22%	2.47	(0.0300)	0.5945	-1.78%	10.7%
28 Gen'l Mills	340.00	315.00	-1.52%	3.72	(0.0564)	0.7314	-4.13%	8.4%
29 Genuine Parts	166.07	150.00	-2.01%	2.94	(0.0593)	0.6600	-3.91%	6.5%
30 Grainger (W.W.)	79.46	70.00	-2.50%	3.01	(0.0753)	0.6676	-5.03%	8.7%
31 Heinz (H.J.)	312.56	295.00	-1.15%	5.92	(0.0680)	0.8310	-5.65%	13.6%
32 Hewlett-Packard	2580.00	2100.00	-4.03%	3.68	(0.1486)	0.7286	-10.83%	10.3%
33 Home Depot	1690.00	1675.00	-0.18%	2.61	(0.0046)	0.6167	-0.29%	8.2%
34 Honeywell Int'l	746.55	720.00	-0.72%	2.99	(0.0216)	0.6652	-1.43%	14.0%
35 Hormel Foods	135.68	135.00	-0.10%	2.89	(0.0029)	0.6541	-0.19%	11.3%
36 Illinois Tool Works	530.10	470.00	-2.38%	3.70	(0.0881)	0.7300	-6.43%	10.8%
37 Ingersoll-Rand	272.61	325.00	3.58%	1.35	0.0485	0.2616	1.27%	18.0%
38 Int'l Business Mach.	1385.20	1100.00	-4.51%	8.14	(0.3666)	0.8771	-32.15%	7.4%
39 ITT Corp.	181.57	177.00	-0.51%	2.47	(0.0126)	0.5952	-0.75%	13.1%
40 Johnson & Johnson	2840.20	2650.00	-1.38%	4.10	(0.0564)	0.7558	-4.26%	10.1%
41 Kimberly-Clark	420.90	400.00	-1.01%	4.74	(0.0480)	0.7889	-3.79%	12.9%

SUSTAINABLE GROWTH RATE

NON-UTILITY PROXY GROUP

Company	(a)	(a)	(f)	(i)	(j)	(k)	(l)	(m)
	Common Shares			M/B	"sv" Factor			br + sv
	Outstanding				Ratio	s	v	
	2007	2011-13	Change					
42 Kraft Foods	1533.80	1500.00	-0.44%	2.19	(0.0098)	0.5443	-0.53%	4.8%
43 Lilly (Eli)	1134.30	1100.00	-0.61%	2.91	(0.0178)	0.6568	-1.17%	8.6%
44 Lincoln Nat'l Corp.	264.23	225.00	-3.16%	1.82	(0.0576)	0.4505	-2.59%	8.4%
45 Lockheed Martin	409.00	350.00	-3.07%	4.06	(0.1247)	0.7539	-9.40%	13.2%
46 M&T Bank Corp.	1501.00	1425.00	-1.03%	2.38	(0.0246)	0.5791	-1.42%	11.0%
47 McDonald's Corp.	1165.30	1030.00	-2.44%	4.85	(0.1182)	0.7938	-9.38%	2.3%
48 Medtronic, Inc.	1124.90	980.00	-2.72%	4.48	(0.1218)	0.7766	-9.45%	9.2%
49 Microsoft Corp.	9380.00	7000.00	-5.69%	5.79	(0.3292)	0.8273	-27.23%	-1.2%
50 NIKE, Inc. 'B'	503.80	455.00	-2.02%	4.19	(0.0846)	0.7615	-6.44%	9.5%
51 Northrop Grummar	337.83	320.00	-1.08%	1.80	(0.0194)	0.4431	-0.86%	8.2%
52 PepsiCo, Inc.	1605.00	1450.00	-2.01%	7.05	(0.1418)	0.8582	-12.17%	10.3%
53 Pfizer, Inc.	6761.00	6600.00	-0.48%	2.23	(0.0107)	0.5511	-0.59%	6.9%
54 Procter & Gamble	3131.90	2950.00	-1.19%	3.10	(0.0368)	0.6770	-2.49%	6.5%
55 Raytheon Co.	426.20	400.00	-1.26%	2.15	(0.0271)	0.5343	-1.45%	8.6%
56 Raytheon Co.	62.03	67.00	1.55%	0.83	0.0129	(0.2056)	-0.26%	11.3%
57 Sigma-Aldrich	132.41	125.00	-1.15%	3.52	(0.0403)	0.7162	-2.89%	13.4%
58 Sysco Corp.	611.84	560.00	-1.76%	7.79	(0.1368)	0.8717	-11.92%	8.8%
59 Sysco Corp.	92.18	75.00	-4.04%	1.65	(0.0668)	0.3946	-2.63%	10.6%
60 United Parcel Serv.	1034.40	980.00	-1.07%	7.25	(0.0779)	0.8620	-6.72%	14.0%
61 United Technologies	981.52	925.00	-1.18%	2.76	(0.0326)	0.6383	-2.08%	11.8%
62 Verizon Communic	2871.00	2850.00	-0.15%	3.20	(0.0047)	0.6875	-0.32%	8.6%
63 Wal-Mart Stores	3973.00	3500.00	-2.50%	3.36	(0.0841)	0.7024	-5.91%	10.0%
64 Walgreen Co.	991.14	975.00	-0.33%	3.23	(0.0106)	0.6907	-0.73%	11.8%
65 Wells Fargo	3297.10	3650.00	2.05%	2.34	0.0482	0.5733	2.76%	11.7%
66 Wyeth	1337.80	1340.00	0.03%	2.78	0.0009	0.6407	0.06%	14.2%

- (a) www.valueline.com (retrieved Dec. 11, 2008).
- (b) Average of High and Low expected market prices.
- (c) Computed at (EPS - DPS) / EPS.
- (d) Computed as EPS / BVPS.
- (e) Product of BVPS and No. Shares Outstanding.
- (f) Five-year rate of change.
- (g) Computed using the formula $2 * (1 + 5\text{-Yr. Change in Equity}) / (2 + 5 \text{ Yr. Change in Equity})$.
- (h) Product of year-end "r" for 2011-13 and Adjustment Factor.
- (i) Average of High and Low expected market prices divided by 2011-13 BVPS.
- (j) Product of change in common shares outstanding and M/B Ratio
- (k) Computed as $1 - B/M$ Ratio.
- (l) Product of "s" and "v".
- (m) Product of average "b" and adjusted "r", plus "sv".

FORWARD-LOOKING CAPM

UTILITY PROXY GROUP

	(a)	(b)	(c)	(d)	(e)	(f)	(g)
1 Allegheny Energy	3.6%	9.6%	13.2%	3.2%	10.0%	1.10	14.2%
2 American Elec Pwr	3.6%	9.6%	13.2%	3.2%	10.0%	0.75	10.7%
3 Avista Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
4 Black Hills Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
5 Cleco Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%
6 DPL, Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	0.65	9.7%
7 DTE Energy Co.	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%
8 Edison International	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
9 Empire District Elec	3.6%	9.6%	13.2%	3.2%	10.0%	0.75	10.7%
10 Hawaiian Elec.	3.6%	9.6%	13.2%	3.2%	10.0%	0.75	10.7%
11 IDACORP, Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
12 Northeast Utilities	3.6%	9.6%	13.2%	3.2%	10.0%	0.75	10.7%
13 P S Enterprise Group	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
14 UIL Holdings	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%
15 Westar Energy	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%
Range							9.7% -- 14.2%
Average							11.2%

- (a) Weighted average dividend yield for the dividend paying firms in the S&P 500 from www.valueline.com (retrieved Dec. 18, 2008)
- (b) Weighted average of Value Line, IBES, First Call, and Zacks earnings growth rates for the dividend paying firms in the S&P 500 based on data from www.valueline.com (retrieved Dec. 18, 2008), www.finance.yahoo.com (retrieved Dec. 19, 2008), First Call Valuation Report (retrieved Dec. 19, 2008), and www.zacks.com (retrieved Dec. 19, 2008).
- (c) (a) + (b).
- (d) Average yield on 20-year Treasury bonds for December 2008 from the Federal Reserve Board at <http://www.federalreserve.gov/releases/h15/data.htm>.
- (e) (c) - (d).
- (f) The Value Line Investment Survey (Nov. 28, Nov. 28, & Dec. 26, 2008).
- (g) (d) + (e) x (f).

FORWARD-LOOKING CAPM

NON-UTILITY PROXY GROUP

	Company	(a)	(b)	(c)	(d)	(e)	(f)	(g)
		Div Yield	Proj. Growth	S&P 500 Cost of Equity	Risk-Free Rate	Risk Premium	Beta	Implied Cost of Equity
1	3M Company	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%
2	Abbott Labs.	3.6%	9.6%	13.2%	3.2%	10.0%	0.60	9.2%
3	Aflac Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	0.95	12.7%
4	Allergan, Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	1.00	13.2%
5	Allstate Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	1.05	13.7%
6	AT&T Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%
7	Bard (C.R.)	3.6%	9.6%	13.2%	3.2%	10.0%	0.60	9.2%
8	Baxter Int'l Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%
9	Becton, Dickinson	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%
10	Bemis Co.	3.6%	9.6%	13.2%	3.2%	10.0%	0.90	12.2%
11	Boeing	3.6%	9.6%	13.2%	3.2%	10.0%	0.90	12.2%
12	Brown-Forman 'B'	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%
13	Chevron Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.90	12.2%
14	Chubb Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.95	12.7%
15	Coca-Cola	3.6%	9.6%	13.2%	3.2%	10.0%	0.55	8.7%
16	Colgate-Palmolive	3.6%	9.6%	13.2%	3.2%	10.0%	0.60	9.2%
17	Commerce Bancshs.	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%
18	ConocoPhillips	3.6%	9.6%	13.2%	3.2%	10.0%	1.10	14.2%
19	Du Pont	3.6%	9.6%	13.2%	3.2%	10.0%	1.00	13.2%
20	Eaton Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	1.10	14.2%
21	Ecolab Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	0.90	12.2%
22	Emerson Electric	3.6%	9.6%	13.2%	3.2%	10.0%	1.00	13.2%
23	Everest Re Group Ltd.	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
24	Exxon Mobil Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%

FORWARD-LOOKING CAPM

NON-UTILITY PROXY GROUP

Company	(a)	(b)	(c)	(d)	(e)	(f)	(g)
	Div Yield	Proj. Growth	Cost of Equity	Risk-Free Rate	Risk Premium	Beta	Implied Cost of Equity
25 Fortune Brands	3.6%	9.6%	13.2%	3.2%	10.0%	1.00	13.2%
26 Gallagher (Arthur J.)	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%
27 Gen'l Dynamics	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
28 Gen'l Mills	3.6%	9.6%	13.2%	3.2%	10.0%	0.55	8.7%
29 Genuine Parts	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
30 Grainger (W.W.)	3.6%	9.6%	13.2%	3.2%	10.0%	1.00	13.2%
31 Heinz (H.J.)	3.6%	9.6%	13.2%	3.2%	10.0%	0.65	9.7%
32 Hewlett-Packard	3.6%	9.6%	13.2%	3.2%	10.0%	1.00	13.2%
33 Home Depot	3.6%	9.6%	13.2%	3.2%	10.0%	0.95	12.7%
34 Honeywell Int'l	3.6%	9.6%	13.2%	3.2%	10.0%	1.10	14.2%
35 Hormel Foods	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%
36 Illinois Tool Works	3.6%	9.6%	13.2%	3.2%	10.0%	1.05	13.7%
37 Ingersoll-Rand	3.6%	9.6%	13.2%	3.2%	10.0%	1.20	15.2%
38 Int'l Business Mach.	3.6%	9.6%	13.2%	3.2%	10.0%	0.90	12.2%
39 ITT Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.95	12.7%
40 Johnson & Johnson	3.6%	9.6%	13.2%	3.2%	10.0%	0.55	8.7%
41 Kimberly-Clark	3.6%	9.6%	13.2%	3.2%	10.0%	0.60	9.2%
42 Kraft Foods	3.6%	9.6%	13.2%	3.2%	10.0%	0.65	9.7%
43 Lilly (Eli)	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%
44 Lincoln Nat'l Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	1.40	17.1%
45 Lockheed Martin	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%
46 Manulife Fin'l	3.6%	9.6%	13.2%	3.2%	10.0%	1.25	15.7%
47 McDonald's Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.75	10.7%
48 Medtronic, Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	0.65	9.7%

FORWARD-LOOKING CAPM

NON-UTILITY PROXY GROUP

Company	(a)	(b)	(c)	(d)	(e)	(f)	(g)
	Div Yield	Proj. Growth	Cost of Equity	Risk-Free Rate	Risk Premium	Beta	Implied Cost of Equity
49 Microsoft Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%
50 NIKE, Inc. 'B'	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
51 Northrop Grumman	3.6%	9.6%	13.2%	3.2%	10.0%	0.75	10.7%
52 PepsiCo, Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	0.60	9.2%
53 Pfizer, Inc.	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%
54 Procter & Gamble	3.6%	9.6%	13.2%	3.2%	10.0%	0.55	8.7%
55 Raytheon Co.	3.6%	9.6%	13.2%	3.2%	10.0%	0.75	10.7%
56 Reinsurance Group	3.6%	9.6%	13.2%	3.2%	10.0%	0.85	11.7%
57 Sigma-Aldrich	3.6%	9.6%	13.2%	3.2%	10.0%	1.00	13.2%
58 Sysco Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	0.65	9.7%
59 Torchmark Corp.	3.6%	9.6%	13.2%	3.2%	10.0%	1.00	13.2%
60 United Parcel Serv.	3.6%	9.6%	13.2%	3.2%	10.0%	0.80	11.2%
61 United Technologies	3.6%	9.6%	13.2%	3.2%	10.0%	1.00	13.2%
62 Verizon Communic.	3.6%	9.6%	13.2%	3.2%	10.0%	0.75	10.7%
63 Wal-Mart Stores	3.6%	9.6%	13.2%	3.2%	10.0%	0.65	9.7%
64 Walgreen Co.	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%
65 Wells Fargo	3.6%	9.6%	13.2%	3.2%	10.0%	1.05	13.7%
66 Wyeth	3.6%	9.6%	13.2%	3.2%	10.0%	0.70	10.2%

Range

Average

8.7% -- 15.7%

11.5%

FORWARD-LOOKING CAPM

NON-UTILITY PROXY GROUP

(a)	(b)	(c)	(d)	(e)	(f)	(g)
S&P 500						
Company	Div Yield	Proj. Growth	Cost of Equity	Risk-Free Rate	Risk Premium	Beta

- (a) Weighted average dividend yield for the dividend paying firms in the S&P 500 from www.valueline.com (retrieved Dec. 18, 2008).
- (b) Weighted average of Value Line, IBES, First Call, and Zacks earnings growth rates for the dividend paying firms in the S&P 500 based on data from www.valueline.com (retrieved Dec. 18, 2008), www.finance.yahoo.com (retrieved Dec. 19, 2008), First CallValuation Report (retrieved Dec. 19, 2008), and www.zacks.com (retrieved Dec. 19, 2008).
- (c) (a) + (b).
- (d) Average yield on 20-year Treasury bonds for December 2008 from the Federal Reserve Board at <http://www.federalreserve.gov/releases/h15/data.htm>.
- (e) (c) - (d).
- (f) www.valueline.com (retrieved Dec. 11, 2008).
- (g) (d) + (e) x (f).
- (h) Excludes highlighted figures.

COMPARABLE EARNINGS APPROACH

UTILITY PROXY GROUP

	(a) Expected Return on Common Equity	(b) Adjustment Factor	(c) Adjusted Return on Common Equity
1 Allegheny Energy	15.0%	1.0603	15.9%
2 American Elec Pwr	10.5%	1.0344	10.9%
3 Avista Corp.	8.5%	1.0261	8.7%
4 Black Hills Corp.	7.5%	1.0410	7.8%
5 Cleco Corp.	11.5%	1.0336	11.9%
6 DPL, Inc.	20.0%	1.0540	21.1%
7 DTE Energy Co.	9.0%	1.0151	9.1%
8 Edison International	11.5%	1.0420	12.0%
9 Empire District Elec	10.5%	1.0278	10.8%
10 Hawaiian Elec.	11.0%	1.0156	11.2%
11 IDACORP, Inc.	7.5%	1.0211	7.7%
12 Northeast Utilities	9.0%	1.0569	9.5%
13 P S Enterprise Group	17.0%	1.0400	17.7%
14 UIL Holdings	11.0%	1.0070	11.1%
15 Westar Energy	7.5%	1.0522	7.9%
Average (d)			11.4%

(a) 3-5 year projections from The Value Line Investment Survey (Nov. 7, Nov. 28, & Dec. 26, 2008).

(b) Adjustment to convert year-end "r" to an average rate of return from Exhibit WEA-5.

(c) (a) x (b).

(d) Excludes highlighted figures.