

1 **Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

2

3 A. My name is Kimber Wichmann. My business address is 2515 Warren Avenue, Suite  
4 304, Cheyenne, WY, 82002. I am a Rate Analyst for the Wyoming Office of Consumer  
5 Advocate (OCA). The OCA is an independent consumer advocacy agency that was  
6 created by an act of the legislature in the 2003 general session.

7

8 **Q. ARE YOU THE SAME KIMBER WICHMANN THAT PREVIOUSLY FILED**  
9 **DIRECT TESTIMONY IN THIS PROCEEDING?**

10

11 A. Yes.

12

13 **Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY IN THIS**  
14 **PROCEEDING?**

15 A. The purpose of my testimony is to provide the Commission with supplemental analysis  
16 from the Office of Consumer Advocate (OCA) regarding the split credit rating and its  
17 influence to the risk premium in my analysis and to address the updated information that  
18 was introduced as part of Dr. Moyer's rebuttal testimony.

19

20 **Q. ARE YOU SPONSORING ANY ADDITIONAL EXHIBITS IN THIS**  
21 **PROCEEDING?**

22

23 A. Yes, I am sponsoring exhibits KMW6 through KMW7.

24

25 **Q. WHY AND HOW ARE YOU SUPPLEMENTING YOUR PREFILED**  
26 **TESTIMONY?**

27

28 A. I was impelled by the arguments made by the Company in its rebuttal testimony.  
29 SourceGas has a split credit rating of BBB-/Ba. The analysis in my prefiled testimony  
30 focused on the BBB portion side of that rating.

31

1 The arguments made by Ms. Martinez and Dr. Moyer in the rebuttal testimony made me  
2 dig deeper into Docket 30022-84-GA-06 to investigate if an imputed credit rating was a  
3 reasonable expectation on my part. Previously I was focused on the wording of the  
4 stipulation and the Commission's Order. However, once I peeled back the layers of the  
5 docket, including reading the filed testimony, it seemed that I was wrong not to recognize  
6 the below investment grade credit rating of Ba given to SourceGas by Moody's. I have  
7 rectified that with additional analysis.

8  
9 The testimony and analysis I am providing includes a high yield analysis that is weighted  
10 with my prefiled analysis to arrive at a recommended rate of return.

11  
12 **Q. WHAT RATE OF RETURN ARE YOU SUPPORTING WITH YOUR**  
13 **TESTIMONY?**

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15 A. By including the high yield analysis with my original BBB analysis I am recommending  
16 a Return on Equity of 9.9% with an overall Rate of Return of 7.98%. I have a table of the  
17 capital structure for the Company below.

	Balance	Ratio	Cost	Required Return
<b>SourceGas</b>				
LT Debt	\$450,000,000	49.66%	6.01%	2.98%
Common Equity	\$456,072,981	50.34%	9.92%	4.99%
Total	\$906,072,981	100.00%		7.98%

18  
19 **Q. WHAT WAS MISSING FROM YOUR PREFILED ANALYSIS?**

20  
21 A. My goal was to provide the Commission with a recommended rate of return based on a  
22 group of companies comparable to SourceGas' split credit rating of BBB-/Ba. I had the  
23 BBB portion of the analysis complete. I needed to conduct the Ba portion of the analysis  
24 and then combine that with my BBB analysis to provide a recommendation to the  
25 Commission.

1 Please note the Ba level is often referenced as below investment grade, high yield, or  
2 junk level. All the terms mentioned are synonymous and often used interchangeably.  
3

4 **Q. HOW HAVE YOU UPDATED YOUR ANALYSIS?**  
5

6 A. I used the same proxy group, methodology, and the Discounted Cash Flow (DCF), Non  
7 Constant Growth Discounted Cash Flow (NCDCF), and the Capital Asset Pricing Model  
8 (CAPM) calculations that were used in my prefiled testimony.  
9

10 I changed the risk premium index that I used in the high yield analysis to bring the proxy  
11 group to the Ba level for the Discounted Cash Flow (DCF) and Non Constant Growth  
12 Discounted Cash Flow (NCDCF) models. The results for the DCF and the NCDCF are  
13 available in Exhibits KMW6 and KMW7.  
14

15 I did not recalculate the CAPM since Beta provides the measure of risk between the  
16 proxy companies. The Beta data has not changed since my prefiled testimony thus the  
17 results would be the same.  
18

19 **Q. WHY IS AN UPDATED RISK PREMIUM ANALYSIS NECESSARY?**  
20

21 A. An updated risk premium analysis is necessary due to the credit rating of SourceGas.  
22 Standards and Poor's gives SourceGas a credit rating of BBB- which is barely investment  
23 grade and Moody's rates the Company at Ba which is below investment grade. Thus  
24 SourceGas has a split bond rating of BBB-/Ba. Since there are no other natural gas  
25 companies in the proxy group in a split credit rating situation, a risk premium analysis is  
26 the best way to address a financial situation like this one.  
27

28 **Q. HOW DID YOU APPLY YOUR RISK PREMIUM TO YOUR ANALYSIS?**  
29

30 A. I conducted two full sets of the calculations. The first set represented the average cost of  
31 capital at the BBB level which was filed in my prefiled testimony. Using the same proxy

1 group I have filed a second set of the same calculations at the Ba level, which is often  
2 referred to as the high yield or junk level.

3  
4 I used the US Corporate High Yield Index from the Wall Street Journal<sup>1</sup> for the below  
5 investment grade rate for the comparable group. I then looked up the bond rate for each  
6 of the companies in my proxy group using the Mergent Bond Record<sup>2</sup>. I subtracted the  
7 bond rate from the high yield rate. The difference that resulted was the risk premium that  
8 was needed to adjust the company at that bond level in the proxy group to below  
9 investment grade status. I applied the appropriate risk premium in the table below to each  
10 company in the proxy group in the DCF and NCDCF calculations. These are detailed in  
11 the last columns on Exhibits KMW6 and KMW7.

High Yield Rate	Bond Grade	Bond Rate	Risk Premium
8.23	AA, AA-	5.62	2.61
8.23	A, A-	5.81	2.42
8.23	BBB, BBB-	6.19	2.04

12  
13 In my prefiled testimony I did the same application of the risk premium to adjust the  
14 proxy group to the BBB level.

BBB Bond	Bond Grade	Bond Rate	Risk Premium
6.19	AA, AA-	5.62	0.57
6.19	A, A-	5.81	0.38
6.19	BBB, BBB-	6.19	0

15  
16  
17 **Q. DOES IT MAKE A DIFFERENCE HOW THE RISK PREMIUM IS APPLIED TO**  
18 **THE PROXY GROUP?**

<sup>1</sup> Wall Street Journal online 08/27/2010 [http://online.wsj.com/mdc/public/page/2\\_3022-bondbnchmrk.html?mod=topnav\\_2\\_3021](http://online.wsj.com/mdc/public/page/2_3022-bondbnchmrk.html?mod=topnav_2_3021)

<sup>2</sup> Mergent Bond Record May 2010 p. 11

1 A. Yes. The risk premium is the main reason for the difference between Dr. Moyer and my  
2 recommendation to the Commission.

3

4 **Q. WHAT DO YOU MEAN THE RISK PREMIUM IS THE MAIN DIFFERENCE**  
5 **BETWEEN YOUR RECOMMENDATIONS TO THE COMMISSION?**

6

7 A. If you look at the resulting calculations from Dr. Moyer and my proxy groups and  
8 average them you will find that we are only separated by about 21 basis points. That is  
9 not very far apart. However, our **approach** and *application* of the risk premium is very  
10 different resulting in recommendations that are 210 basis points apart.

11

12 **Q. WHAT IS THE MAIN DIFFERENCE BETWEEN YOUR RISK PREMIUM AND**  
13 **DR. MOYER'S RISK PREMIUM?**

14

15 A. Let us take an example of the application of the risk premium in my high yield analysis.  
16 In my analysis, the high yield risk premium ranged from 2.61-2.04%. There are 7  
17 companies in my proxy group. Two were at the AA grade. Only the two AA rated  
18 companies in my proxy group would get the highest risk premium added to compensate  
19 for their higher rating in the calculation. Two companies in my proxy group were at the A  
20 grade and they got the mid risk premium and the remaining 3 BBB graded companies got  
21 the lowest risk premium added to their ROE. Thus my application of the risk premium is  
22 only compensating for the proportion of the bond yield that is lacking – no more and no  
23 less.

24

25 Dr. Moyer takes a different approach. In his prefiled testimony, he computes the average  
26 bond rating for the entire proxy group and determines that to be A/A- with a rate of  
27 5.85%. He then asserts SourceGas' *estimated* cost of long term debt rate of 8.62% from a  
28 private source in October of 2009. That source is a single bank quote with a rate for  
29 Sourcegas' split credit rating of BBB-/Ba for some future debt that is then applied to the  
30 proxy group. He then uses judgment to reduce the *expected* yield requirement to 8.5%.  
31 He then subtracts 8.5% from the 5.85% to get the 2.65% risk premium he adds to the end  
32 result of his DCF and CAPM calculations.

1 **Q. DO YOU HAVE RESERVATIONS WITH HIS APPROACH?**

2

3 A. I do not agree with an average bond rating for a proxy group when the bond ratings for  
4 the companies are known. I do not agree with taking an *estimated* cost of debt when we  
5 know the cost of debt for SourceGas to be 6.01%. As 6.01% is much less than the 8.62%  
6 and the 8.5% that Dr. Moyer suggests from his testimony, I am concerned regarding the  
7 measure Dr. Moyer is using for his risk premium. Dr. Moyer is using an 8.5% Risk  
8 Premium represented as a split BBB-/Ba when it should really be represented a high yield  
9 rating when looking at the US corporate market indexes.

10

11 The Merrill Lynch High Yield Index is publically available and would have been a more  
12 acceptable measure for the Ba portion of the Credit rating. I did see that he had the rate  
13 for the High Yield Index on his exhibit RCM-2 and the rate was 7.68%. Had the high  
14 yield index been used the risk premium for the high yield portion would have been closer  
15 to 2.05% rather than the 2.65% used in Dr. Moyer's analysis.

16

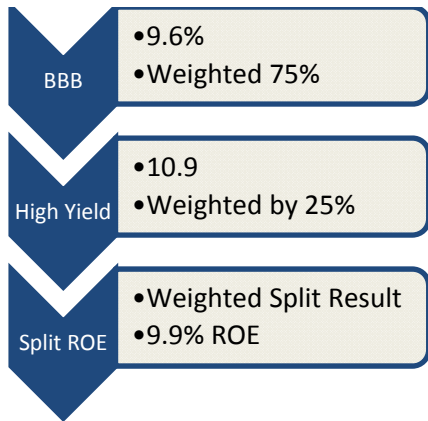
17 My reservation boil down to this, I believe a reasonable person would conclude that a  
18 split credit rating that includes some investment grade quality of credit should qualify for  
19 a rate better than that of junk. In essence, I have difficulty seeing where the investment  
20 grade portion of the Company's credit rating is applied in Dr. Moyer's analysis.

21

22 **Q. IS THERE A REASON THAT THE RISK PREMIUM IN DR. MOYER AND**  
23 **YOUR ANAYSIS ARE DIFFERENT?**

24

25 A. Yes. My analysis has not placed as much weight on the below investment grade rating as  
26 Dr. Moyer's analysis has because of how we see risk. My analysis gave a 75% weighting  
27 to the BBB side of the rating and a 25% weighting to the Ba side of the rating.



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**Q. WHY DID YOU WEIGHT THE RESULTS?**

A. Although SourceGas has a split credit rating from the credit agencies, its capital structure shows that the company is more reflective of an investment grade company than a non investment grade company. My analysis is based on the current conditions of the market and the Company’s capital structure.

**Q. WHAT DO YOU MEAN THE SOURCEGAS’ CAPITAL STRUCTURE IS MORE REFLECTIVE OF AN INVESTMENT GRADE COMPANY THAN A SUB INVESTMENT GRADE COMPANY?**

A. The capital structure of SourceGas has a cost of debt of 6.01%. Let us take the Company’s long term cost of debt and compare that to the current public utility bond rates in the US. Bond rates are a fair comparison for long term corporate financing in America.

Public Utility Bond Grade	Bond Rate <sup>3</sup>
AA, AA-	5.62
A, A-	5.81
BBB, BBB-	6.19

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<sup>3</sup> Mergent Bond Record Public Utility Bonds May 2010 P.11

1 Looking at the bond rates in the table above, 6.01% falls between a BBB and an A rated  
2 public utility bond. The Company does not have a cost of debt that reflects borderline  
3 investment grade standard or sub investment grade standard. Thus, the risk premium  
4 reflected at the BBB analysis level is more appropriate than the risk premium reflected at  
5 the junk level. Junk level is the high yield rate which was at 8.24%<sup>4</sup> on August 27, 2010.  
6 SourceGas' 6.01% long term debt is much closer to the investment grade bond rates than  
7 it is to the junk level high yield rates. Investors will see this information and in  
8 conjunction with the credit rating, thus the rating must be tempered with the current  
9 financial facts facing the company to arrive at the optimal risk premium.

10  
11 I also looked at the long term debt at the holding company level since the credit rating of  
12 SourceGas is actually at the holding company level. The company gave the OCA a  
13 clearer picture of the cost of debt at the holding company level in its response to data  
14 request 1.6 where it shows the weighted average cost of debt for the company to be  
15 5.974%. The *improved* cost of debt reveals an even stronger case toward investment  
16 grade quality.

17  
18 The point of this discussion is to show that the Company's cost of debt is much closer to  
19 that of an investment grade company than that of a junk rated company.

20  
21 I put a heavier weight on the investment grade of the split credit grade in my risk  
22 premium analysis, rather than apply more emphasis on the risk portion as Dr. Moyer did  
23 in his analysis.

24  
25 **Q. WAS NEW INFORMATION INTRODUCED WITH DR. MOYER'S REBUTTAL**  
26 **TESTIMONY?**

27  
28 A. Yes. On page 2 line 15 Dr. Moyer states, "In June 2010 I filed cost of equity capital  
29 testimony in the Colorado jurisdiction on behalf of SourceGas. Using updated analysis  
30 similar to that used in this case, I concluded that the cost of equity capital for SourceGas

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<sup>4</sup> Wall Street Journal online 08/27/2010 [http://online.wsj.com/mdc/public/page/2\\_3022-bondbnchmrk.html?mod=topnav\\_2\\_3021](http://online.wsj.com/mdc/public/page/2_3022-bondbnchmrk.html?mod=topnav_2_3021)

1 at that time was 12%.” There are two factors that can be misleading with this statement  
2 of Dr. Moyer’s rebuttal testimony. The analysis that Dr. Moyer provided for SourceGas’  
3 Rate Case in Colorado was not the same as the analysis provided in his Wyoming filed  
4 case. Had the analysis been the same the resulting Cost of Capital would have been even  
5 lower. Second, his updated numbers are still not as current as the numbers filed in the  
6 OCA’s prefiled testimony.

7  
8 **Q. DID DR. MOYER’S RISK PREMIUM CHANGE WITH HIS UPDATED**  
9 **NUMBERS?**

10  
11 A. Yes. His risk premium changed from 2.65% to 2.29%.

12  
13 **Q. IF DR. MOYER HAD USED THE SAME ANALYSIS THAT HE PRESENTED IN**  
14 **THE WYOMING RATE CASE WITH UPDATED NUMBERS WOULD DR.**  
15 **MOYER’S COST OF EQUITY BE 12%?**

16  
17 A. No. Using Dr. Moyer’s exact same methodology that he originally applied with his  
18 updated data the average Return on Equity for his CAPM (9.11%+ Risk Premium 2.29%)  
19 and his DCF (8.61%+ Risk Premium 2.29%) is 11.15%. I admit I am backing into the  
20 numbers mentioned from a table on page 11 of the Colorado filed application. I show the  
21 Colorado table in my answer below.

22  
23 **Q. HOW DOES DR. MOYER’S ANALYSIS CHANGE IN HIS COLORADO**  
24 **FILING?**

25  
26 A. I have created two tables below to show a summary of Dr. Moyer’s Wyoming filing and  
27 his Colorado filing. As you can see the Colorado table factors in the Value Line  
28 prospective returns for ROE as part of the average with the other calculations. The  
29 Wyoming filing did not.

1

WY	Cost of Equity
CAPM	11.7%
DCF	13.0%
<b>Average</b>	<b>12.3%</b>
Value Line prospective returns - 2010	11.4%

CO	Cost of Equity
CAPM	11.4%
DCF	10.9%
Value Line prospective returns - 2011	13.8%
<b>Average</b>	<b>12.0%</b>

2

3 **Q. DO YOU AGREE WITH ALLOWING THE PROSPECTIVE RETURNS TO BE**  
4 **AVERAGED WITH THE DCF AND CAPM CALCULATIONS?**

5

6 A. No.

7

8 **Q. IF YOU AND DR. MOYER SIMPLY UPDATED YOUR ANALYSIS HOW FAR**  
9 **APART WOULD YOUR RECOMMENDATIONS BE?**

10

11 A. Updating Dr. Moyer's return using the same method he used originally results in a return  
12 of 11.15%. My updated return on equity is 9.9%. The difference between these two is  
13 125 basis points.

14

15 **Q. IN YOUR OPINION IS THE BULK OF THAT DIFFERENCE STILL DUE TO**  
16 **THE METHODOLOGY AND APPLICATION OF THE RISK PREMIUM IN**  
17 **THE CALCULATIONS?**

18

19 A. Yes.

20

21 **Q. IS THE DATA PROVIDED BY DR. MOYER MORE CURRENT THAN THE**  
22 **DATA IN YOUR ANALYSIS?**

23

1 A. No. Dr. Moyer's prefiled testimony was from Value Line December 2009. Although Dr.  
2 Moyer filed his testimony in Colorado in June 2010 his updated Value Line information  
3 is from March 2010. In contrast, my analysis is based on Value Line from June 11, 2010.  
4

5 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

6  
7 A. Yes.