



Good Morning. My name is Charles King. I am here representing Advocacy Staff on the subject of rate of return.

I recommend a rate of return on equity for NSP's North Dakota rate base of 9.0 percent. The basis of this recommendation is set forth in my testimony and exhibits. The reasons why I arrive at 9.0 percent while Ms. Bulkley comes up with 10.25 percent are listed in the last pages of my testimony. I will not repeat them here.

The Company's response to my recommendation essentially boils down to two points: first, that interest rates are increasing and second, that 9.0 percent is way below the return awards being granted to other utilities.

Ms. Bulkley would have you believe that interest rates are skyrocketing. That's something of an exaggeration. Here are the numbers: In July, the average yield on 30 year Treasury bonds was 3.61 percent, last week it was 3.87 percent, higher but hardly skyrocketing. In July Baa rated corporate bonds were yielding 5.32 percent; last week they at 5.55 percent, again hardly a skyrocketing increase. Ms. Bulkely admits that as interest rates increase, the spread between bond yields and stock returns narrows. If that is the case, then the 20 point increase in interest rates translates to a much smaller increase in ROE requirements.

Ms. Bulkley also points to forecasts of much higher interest rates, with long-term Treasuries over five percent in few years. The problem here is that analysts have been forecasting the interest rate increases for years, and they have yet to materialize. The Federal

Reserve has made clear that it will not allow interest rates to increase significantly until the unemployment rate falls below six percent. Sadly, we are still a long way from that goal.

The Company has placed its greatest emphasis on its second objection, that a 9.0 percent return would be lower than all but one return awarded in the last year and a half.

In my testimony, I guard against relying on other commissions' returns on the grounds that it makes regulation circular: decisions based on other decisions do not allow for objective evidence that departs from the conventional wisdom of the regulatory community.

My response to NSP's complaint is two-fold: first, objective evidence does indicate that the appropriate return is well below the average of allowed returns during the past year, and second, objective evidence suggests that the average awarded return is too high.

The objective evidence supporting a lower return is in my testimony. I did not invent a single number in that testimony and exhibit. Every number came from an outside, objective source that has no particular interest in skewing equity returns up or down. Those numbers show quite clearly that a return of approximately 9.0 percent is all that investors require at this time.

The objective evidence that currently allowed returns are unnecessarily high is found in my exhibit CWK-2, Schedule 4, page 2, column C. That column shows the ratios of the market price of each company's stock to the book value of that stock. ROE awards are applied to the book value of each utility's plant. If regulators are granting the exact return on book value that investors require, then the amount they are willing for the company's stock should equal that

book value. But it does not. In every case, the returns on book value are such that investors are bidding the market value of utility stocks will over the book value. In Xcel's case the market value of its stock is 153 percent of its book value, but they run as high as 225 percent. That persistent excess of market over book value indicates fairly clearly that the utility returns exceed considerably the minimum requirements of investors. The 10 percent that regulators have been granting is clearly excessive.

You have been told that a nine percent return award will result in North Dakota being downgraded as an investor unfriendly regulatory environment. This challenge raises the question of your responsibility. Are you responsible to the investor community to provide an ROE award you make pleases them? Or, are you responsible to the citizens of North Dakota to ensure that they pay rates sufficient, but no more than sufficient, to allow the Company attract capital and maintain credit? If your responsibility is to the citizens of North Dakota, then you will award a 9.0 percent regardless of what the investment community thinks.