

PREPARED TESTIMONY OF
BRIAN B. BIRD
ON BEHALF OF NORTHWESTERN ENERGY

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1 **Witness Information**

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

3 A. My name is Brian B. Bird, and my business address is 3010 W. 69th Street,
4 Sioux Falls, South Dakota 57108.

5 **Q. By whom are you employed and in what capacity?**

6 A. I am employed by NorthWestern Energy (NorthWestern or NWE) as the Chief
7 Financial Officer and Treasurer.

8 **Q. How long have you been employed in your current position?**

9 A. I have been the Chief Financial Officer since December 2003. I also
10 assumed the Treasurer title in May 2009.

11 **Q. What are your responsibilities and duties in your current position?**

12 A. I am responsible for the areas of Accounting, Treasury, Tax, Financial
13 Planning, Investor Relations, Internal Audit, and Information Technology.

14 **Q. Please state your educational background and experience.**

15 A. I have 23 years of experience within the fields of corporate finance, treasury,
16 tax, audit and accounting. I have an MBA – Finance from University of
17 Minnesota. I have a BBA from the University of Wisconsin – Eau Claire with
18 a double major in Accounting and Finance. I also have my CPA certificate.

19
20 **Purpose of Testimony**

21 **Q. What is the purpose of your testimony?**

22 A. My testimony will discuss the Electric and Natural Gas Utilities' capitalization,
23 cost of debt, and cost of equity requested by NorthWestern in this proceeding.

1 **Q. How is your testimony organized?**

2 **A.** I will: (1) explain how NorthWestern derived the capital structure, (2) discuss
3 the cost of debt, (3) discuss the cost of equity, and (4) combine the cost of
4 debt and the cost of equity with their relative weightings in the capital
5 structure to arrive at the overall rates of return for the Electric and Natural
6 Gas Utilities in Montana.

7 **Q. What are your conclusions?**

8 **A.** The following is a summary of my conclusions:

- 9 • The capital structure recommended for both the Electric and Natural Gas
10 Utilities in Montana is 50.55% debt and 49.45% equity;
- 11 • The cost of debt for both the Electric and Natural Gas Utilities in Montana
12 is 5.76%;
- 13 • The cost of equity recommended for both the Electric and Natural Gas
14 Utilities in Montana is 10.90%; and
- 15 • The cost of capital recommended for both the Electric and Natural Gas
16 Utilities in Montana is 8.30%;

17 This summary is shown on Exhibit_(BBB-1).

18

19

Capitalization

20 **Q. Please explain the capitalization methodology that you have presented**
21 **in this case.**

22 **A.** Consistent with the PSC's final order in NorthWestern's last general rate case
23 (Docket No. D2007.7.82, Final Order No. 6852f – Phase 1 Revenue

1 Requirements, Paragraph 73) where the PSC evaluated NWE's regulated
2 Montana capital structure by using Montana regulated assets and liabilities to
3 derive the Montana regulated equity, I am proposing a capital structure of
4 50.55% debt and 49.45% equity. The Montana regulated electric and gas
5 rate base I have used is \$952.0 million, which represents the adjusted 13-
6 month average rate base at December 31, 2008, excluding a) the \$38.8
7 million rate base reduction agreed to in the Stipulation Agreement in Docket
8 D2007.7.82 and b) the deduction for total gross cash requirement of \$25.1
9 million. This calculation is shown on Exhibit_(BBB-3) lines 2 and 8 relating to
10 the Stipulation Agreement and lines 3 and 9 for the gross cash requirement.
11 Montana debt is defined as all long-term debt secured by the physical assets
12 in the Montana Electric and Natural Gas Utilities' rate base (excluding
13 generation assets) and was equal to \$481.2 million as of 12/31/08 (see
14 Exhibit_(BBB-2)). The equity is then derived from deducting the Montana
15 long-term debt from the Montana regulated electric and gas rate base (\$952.0
16 million total Montana rate base less \$481.2 million of debt equals \$470.7
17 million of derived equity). The 50.55% debt to capitalization, therefore,
18 represents the ratio of Montana long-term debt to the total Montana rate base
19 assets.

1 **Q. Please explain why you excluded the \$38.8 million of rate base**
2 **reduction ordered in the Stipulation Agreement in Docket D2007.7.82 in**
3 **calculating the capitalization of the Montana utility businesses.**

4 **A.** Capitalization is often defined as the total debt and total equity used by a
5 business to finance its assets, hence, the use of rate base assets as a proxy
6 for determining a utility's capitalization is reasonable. The application of the
7 rate base reduction as intended by the Stipulation Agreement in Docket
8 D2007.7.82 is different from my purpose here of using rate base assets as a
9 proxy for determining the Montana Electric and Gas Utility business'
10 capitalization. To include the \$38.8 million of negotiated reduction to rate
11 base would, therefore, result in understating the true capitalization of the
12 Montana utility businesses. Furthermore, given that the Stipulation allowed
13 for the depreciation expense associated with this \$38.8 million of plant to be
14 included in cost of service, our treatment of including this \$38.8 million of
15 plant in rate base for determining total capitalization conforms to the intent of
16 the Stipulation.

17 **Q. Please explain why you are excluding the total gross cash requirement**
18 **from the calculation of the Montana utility businesses' total**
19 **capitalization.**

20 **A.** In the same vein as the question above, rate base asset is being used in my
21 calculation as a proxy for the total long-term capitalization of the Montana
22 utility businesses. To adjust the rate base asset by short-term cash sources
23 or needs would result in a capitalization amount that is more short-term in

1 nature, rather than long-term, which is more relevant in determining a
2 reasonable capital structure. Consistent with this approach, we have
3 excluded borrowings under our revolving credit facility in determining the
4 capital structure and cost of debt of the Montana utility businesses.

5 **Q. Is the calculated 50.55%/49.45% capital structure an appropriate capital**
6 **structure to use for this rate case?**

7 **A.** Yes, I believe the 50.55%/49.45% calculated capital structure most accurately
8 reflects the true capitalization of the Montana utility businesses and is also the
9 capital structure that will allow us to maintain our investment grade corporate
10 credit ratings.

11
12 **Cost of Debt**

13 **Q. How did you determine the total long-term debt?**

14 **A.** For the long-term debt existing as of December 31, 2008, I identified all debt
15 and capital lease obligations that are used to finance, and that are directly
16 secured by, assets of the combined Electric and Natural Gas Utilities in
17 Montana. Because these obligations are linked to physical assets in the
18 Montana Electric and Natural Gas Utilities rate base, it is straightforward to
19 allocate them appropriately to NorthWestern's Montana Electric and Natural
20 Gas utilities (see Exhibit_(BBB-2)).

21 In March 2009, NorthWestern issued \$250 million of 6.34% Montana first
22 mortgage bonds to re-capitalize the Colstrip asset, which was rate based on
23 January 1, 2009 per Order 6925f issued in Docket No. D2008.6.69 (the "CU4

1 Rate Basing Order”), and to finance the Mill Creek generation project. Of the
2 \$250 million, \$202 million is allocated to Colstrip and \$48 million is allocated
3 to Mill Creek. In October 2009, NorthWestern also issued \$55 million of
4 5.71% Montana first mortgage bonds to finance the remaining debt portion of
5 the Mill Creek generation project. Given that these debts belong to the
6 Montana generation assets and are covered under separate rate cases, we
7 have excluded them from the calculation of total long-term debt of the
8 Montana Electric and Natural Gas Utilities, which pertains to the transmission
9 and distribution businesses.

10 **Q. How did you determine the cost of debt?**

11 **A.** To derive the annual cost of long-term debt, I added the annual interest cost
12 and the annual amortization of debt discount and issuance expense
13 associated with each debt component. By dividing the total annual cost of
14 long-term debt by the long-term debt balance, I determined a cost of long-
15 term debt of 5.76% (see Exhibit_(BBB-2)).

16
17

Cost of Equity

18 **Q. How did you determine the cost of equity?**

19 **A.** I relied on the analysis performed by Dr. William Avera, which is explained in
20 his prepared direct testimony. Dr. Avera’s analysis shows a range of
21 reasonableness of ROE for a combined electric and gas distribution company
22 of 10.9% to 12.4%. Although NorthWestern’s current corporate credit rating
23 by Standard and Poor’s (S&P) of BBB coincides with the average credit rating
24 for Dr. Avera’s sample companies, I believe that NorthWestern’s corporate

1 credit ratings will continue to improve in the near term and will be in the high
2 triple BBB category in the long term. NorthWestern has made significant
3 progress in improving its financial profile in the last five years through debt
4 reduction, lowering its cost of debt and eliminating non-regulated assets. By
5 continuing to focus on growing its regulated businesses, and with good
6 regulatory support as evidenced by recent decisions, I believe there is room
7 for an upgrade in NorthWestern's credit ratings. As such, I would recommend
8 using 10.9%, which is at the low end of the range, for NorthWestern's cost of
9 equity.

10
11 **Rate of Return**

12 **Q. How did you determine the overall rate of return required for the Electric
13 and Natural Gas Utilities in Montana?**

14 **A.** The overall rate of return required for the Electric and Natural Gas Utilities in
15 Montana is simply the cost of debt and cost of equity appropriate for each
16 utility weighted by the percentage of debt and rate base-derived equity. The
17 resulting rate of return for both the Electric and Natural Gas utilities is 8.30%.
18 This calculation is shown in Exhibit_(BBB-1).

19 **Q. Does this complete your testimony?**

20 **A.** Yes, it does.

NORTHWESTERN ENERGY
 Capital Structure and Rate of Return

December 31, 2008

(Thousands of Dollars)

MONTANA ELECTRIC UTILITY

	Amount	Percent of Capitalization	Rate	Rate of Return
Total Utility Long-Term Debt	\$481,228	50.55%	5.76%	2.91%
Derived Regulated Equity *	<u>470,748</u>	<u>49.45%</u>	10.90% **	<u>5.39%</u>
Electric and Natural Gas Rate Base	\$951,976	100.00%		8.30%

MONTANA GAS UTILITY

	Amount	Percent of Capitalization	Rate	Rate of Return
Total Utility Long-Term Debt	\$481,228	50.55%	5.76%	2.91%
Derived Regulated Equity *	<u>470,748</u>	<u>49.45%</u>	10.90% **	<u>5.39%</u>
Electric and Natural Gas Rate Base	\$951,976	100.00%		8.30%

* Regulated Equity is equal to Electric and Natural Gas Rate Base Asset as Capitalization (Exhibit_BBB-1) less Total Utility Long-Term Debt
 ** The rates of return on equity are based on analysis provided by Dr. William Avera.

NORTHWESTERN ENERGY
MONTANA UTILITY LONG-TERM DEBT

December 31, 2008

Jurisdiction	Type	Issue Title	Issue Date	Maturity Date	Interest Rate	Principal Amount	Gross Proceeds	Net Proceeds	Currently Outstanding	Yield to Maturity	Annual Interest Cost	Amortization of Debt Disc		Total Cost	Weighted Average Cost	Affiliate Ownership
												Premium	Expense			
MT	FMB	6.04% Series, Due 2016	9/13/2006	9/7/2016	6.040%	150,000,000	149,926,500	148,426,500	149,943,650	6.043%	9,060,000	248,114	9,308,114	6.21%	n/a	
MT	SSN	5.875% Sr Notes (\$225M), Due 2014	11/01/2004	11/01/2014	5.875%	161,000,000	161,000,000	157,699,148	161,000,000	5.875%	9,458,750	475,913	9,934,663	6.17%	n/a	
MT	PCBs	4.650% Series, Due 2023	04/28/2006	08/01/2023	4.650%	170,205,000	170,205,000	164,468,673	170,205,000	4.650%	7,914,633	553,322	8,467,955	4.98%	n/a	
MT	C.Lease	MTU Capital Leases				78,944			78,944		3,017		3,017	3.82%	n/a	
						\$481,283,944			\$481,227,594		\$26,436,300	\$1,277,349	\$27,713,649	5.76%		

¹ Of the \$225 million of senior notes outstanding, \$161 million is secured under the Montana mortgage indenture and \$64 million is secured under the South Dakota mortgage indenture.

* MT Utility Long Term Debt comprised of all debt with MT Jurisdiction, excluding the Basin Creek power purchase agreement which is classified as a capital lease per FAS 13.

NORTHWESTERN ENERGY
 Rate Base Asset as Capitalization

<u>LINE</u>	MONTANA 12/31/08 RATE BASE: (Source: Exhibit_(DRR-1))	
1	Electric Utility Rate Base (Line 34)	632,234,682
2	Add Back: Regulatory Plant Adjustment per Stipulation (Column	25,996,000
3	Add Back: Gross Cash Requirement (Line 30)	15,299,674
4	Adjusted Electric Utility Rate Base	<u>673,530,356</u>
5		
6		
7	Gas Utility Rate Base (Line 34)	256,551,045
8	Add Back: Regulatory Plant Adjustment per Stipulation (Column	12,804,000
9	Add Back: Gross Cash Requirement (Line 30)	9,090,449
10	Adjusted Gas Utility Rate Base	<u>278,445,494</u>
11		
12	TOTAL RATE BASE USED AS CAPITALIZATION	<u>951,975,850</u>