DIRECT TESTIMONY

OF

ROCHELLE PHIPPS

FINANCE DEPARTMENT

FINANCIAL ANALYSIS DIVISION

ILLINOIS COMMERCE COMMISSION

MIDAMERICAN ENERGY COMPANY

APPLICATION FOR EXPEDITED APPROVAL OF

GAS UTILITY PORTION OF REORGANIZATION

DOCKET NO. 05-0506

OCTOBER 14, 2005

1. Q. Please state your name, employer and business address.

A. My name is Rochelle Phipps. I am employed by the Illinois Commerce Commission ("Commission"), 527 East Capitol Avenue, Springfield, Illinois 62701.

2. Q. What is your current position with the Commission?

A. I am currently employed as a Senior Financial Analyst in the Finance Department of the Financial Analysis Division.

3. Q. Please describe your qualifications and background.

A. In May 1998, I received a Bachelor of Arts degree in Finance from Illinois College in Jacksonville, Illinois. In May 2000, I received a Master of Business Administration degree from the University of Illinois at Springfield. I have been employed by the Commission since June 2000.

4. Q. What is the purpose of your testimony in this proceeding?

A. I will present my evaluation of the reorganization proposed by MidAmerican Energy Company ("MEC") under Sections 7-204(b)(4) and 6-103 of the Public Utilities Act ("Act"). Section 7-204(b)(4) pertains to the proposed reorganization's financial implications on MEC's ability to access the capital markets on reasonable terms and maintain a reasonable capital structure. Section 6-103 pertains to the amount of MEC's capitalization following the reorganization. I will also address whether the

Company met the minimum filing requirements specified in Section 7-204A(a)(7) of the Act.

5. Q. Please describe the proposed reorganization

A. MEC is a wholly owned subsidiary of MidAmerican Energy Holdings Company ("MEHC"). A private investor group that includes Berkshire Hathaway, Inc. ("Berkshire") currently owns MEHC.[1] The proposed reorganization is a stock conversion in which Berkshire would exchange its existing MEHC zero coupon convertible preferred stock for MEHC common stock. The proposed reorganization would change the relative voting interests of current MEHC shareholders to match the ownership interests of the same shareholders. That is, the proposed stock conversion would result in Berkshire having a voting interest in MEHC and its subsidiaries, including MEC.[2]

6. Q. Please summarize your findings and recommendations.

A. In my judgment, the proposed reorganization satisfies the requirements of Sections 7-204(b)(4) and 6-103 of the Act.

7. Q. Why is it necessary to evaluate the financial implications of the proposed reorganization?

A. Under Section 7-204(b)(4) of the Act, the Commission must find that the proposed reorganization "will not significantly impair the utility's ability to

[1] MidAmerican Exhibit No. 1, Schedule TBS-3, pp. 7-9.

raise necessary capital on reasonable terms or to maintain a reasonable capital structure."[3]

8. Q. How does MEC currently obtain capital?

A. MEC's current sources of capital are debt, preferred stock and retained earnings.[4] MEC has its own credit rating and has consistently gone to the capital markets and raised its own debt financing.[5] If necessary, equity contributions could also come from MEC's parent company, MEHC.[6]

9. Q. Does MEC currently have access to the capital markets on reasonable terms?

A. Yes. Standard & Poor's ("S&P") categorizes debt securities on the basis of the risk that a company will default on its interest or principal payment obligations. The resulting credit rating reflects both the operating and financial risks of a utility.[7] S&P rates MEC A-,[8] which is three notches above the credit rating of its parent company, MEHC, which S&P rates BBB-.[9] According to S&P, an A-rated utility has a strong capacity to meet its financial obligations.[10] S&P states the following regarding MEC and MEHC:

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2 Company's Application for Expedited Approval of Gas Utility Portion of Reorganization, pp. 3-4.
3 220 ILCS 5/7-204.
4 MidAmerican Exhibit No. 1, p. 12.
5 Company response to Staff data request FD 1.03.
6 MidAmerican Exhibit No. 1, p. 12.
7 Standard & Poor's, "Utilities Rating Criteria," May 20, 1996, p. 1.
8 Standard & Poor's, "Research: MidAmerican Energy Co.," September 7, 2005.
9 Standard & Poor's, "Research: MidAmerican Energy Holdings Co.," September 7, 2005.
10 Standard & Poor's, "Ratings Definitions," December 21, 2001, pp. 1-2.

> In most circumstances, Standard & Poor's will not rate the debt of a wholly owned subsidiary higher than the rating on the parent. Exceptions of up to three notches can be made, and were in this case, on the basis of the cumulative value provided by enhancements such as structural protections, covenants, a pledge of stock, and an independent director, assuming the stand-alone credit quality of the entity supports such elevation. These provisions serve to make MidAmerican Funding and MEC bankruptcy remote from MEHC, which has weaker credit quality.
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> Despite the weaker credit quality of MEC's parent, MEHC, the utility still has financial flexibility in terms of being able to access the capital markets. MEHC's frequent participation in the capital markets also enhances its utility's access. MEC benefits because it is part of a larger, more diverse company with strong ties to Berkshire Hathaway and still maintains its strong credit quality due to structural protection features.[11]

None of the enhancements referenced by S&P that insulate MEC from MEHC will be modified or cease to exist following the proposed reorganization.[12] Moreover, MEC has equivalent credit ratings from Moody's Investor's Service ("Moody's") and Fitch Ratings ("Fitch"). Similar to S&P, Moody's and Fitch rate MEHC three and two notches below MEC, respectively.[13]

10. Q. Will the proposed reorganization significantly impair MEC's access to the capital markets?

[11] Standard & Poor's, "Research: MidAmerican Energy Co.," September 7, 2005.
[12] Company response to Staff data request FD 1.02.
[13] Company's response to Staff data request FD 1.01, Attachments FD 1.01, A1, C1 and A3.

A. No. Following the proposed reorganization, there will be no change in the manner in which MEC obtains equity and debt capital.[14] Thus, the proposed reorganization will not significantly impair MEC's access to the capital markets.

11. Q. Did the Company include in its application for reorganization a forecast of MEC's capital requirements, as required by Section 7-204A(a)(7) of the Act?

A. Yes. Schedule TBS-5 provides MEC's forecasted capital requirements for years 2006 through 2010. In my judgment, that schedule meets the minimum information requirements specified in Section 7-204A(a)(7) of the Act.

12. Q. Why is it necessary to review the capitalization of a public utility following reorganization?

A. Section 6-103 of the Act requires that in any reorganization, the Commission shall authorize the amount of capitalization of a public utility formed by a reorganization, which shall not exceed the fair value of the property involved.[15]

13. Q. In your judgment, does the proposed reorganization satisfy the requirements of Section 6-103 of the Act?

[14] MidAmerican Exhibit No. 1, pp. 11-13 and Company response to Staff data request FD 1.03.
[15] 220 ILCS 5/6-103.

A. Yes. The balance sheet and capitalization of MEC will not change as a result of the proposed reorganization.[16] Thus, the proposed reorganization satisfies the requirements of Section 6-103 of the Act.

14. Q. Does this conclude your direct testimony?

A. Yes.

[16] MidAmerican Exhibit No. 1, p. 11.