1 **Q. Please state your name, business address and present position with**
2 **PacifiCorp (the Company).**
3 A. My name is Bruce N. Williams. My business address is PacifiCorp, 825 NE
4 Multnomah, Suite 1900, Portland, Oregon 97232. I was elected Treasurer by the
5 Board of Directors in February, 2000. Prior to my election as Treasurer, I served
6 as Assistant Treasurer for several years.
7 **Qualifications**
8 **Q. Mr. Williams, please briefly describe your education and business**
9 **experience.**
10 A. I received a Bachelor of Science degree in Business Administration with a
11 concentration in Finance from Oregon State University in June 1980. I also
12 received the Chartered Financial Analyst designation upon passing the
13 examination in September 1986. I have been employed by PacifiCorp for 19
14 years. My business experience has included financing of PacifiCorp's electric
15 operations and non-utility activities, investment management, investor relations
16 and responsibility for certain non-regulated activities.
17 **Q. Please describe your present duties.**
18 A. I am responsible for the Company's treasury, pension and other investment
19 management and certain non-regulated affiliate activities. In this proceeding, I
20 am responsible for the preparation of the Company's embedded cost of debt and
21 preferred equity and the testimony related to the Company's capital structure.
22

1 **Purpose of Testimony**

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

3 A. I will first present a financing overview of the Company. Next, I will discuss the
4 planned amounts of common equity, debt, and preferred stock to be included in
5 the Company's planned capital structure. I will then analyze the embedded cost
6 of debt and preferred stock supporting PacifiCorp's electric operations in the state
7 of Washington as of February 2005, forecasted through September 30, 2006 (the
8 mid-point of the rate effective period). This analysis includes the use of forward
9 interest rates, historical relationship of security trading patterns, and known and
10 measurable changes to the debt and preferred stock portfolios.

11 **Q. What time period does your analysis cover?**

12 A. The historical test period in this proceeding is the twelve months ending
13 September 30, 2004, and the rate-effective period is the twelve months ending
14 March 31, 2007. The analysis supporting the embedded cost of debt and
15 preferred stock was conducted using the most currently available information and
16 relies on information from the Company's financial planning process. At the time
17 this filing was prepared, the Company had forecasted capital structure numbers
18 through Fiscal Year 2006 (the twelve-month period ending March 31, 2006) and I
19 have utilized this information in this filing.

20 **Q. What is the overall cost of capital that you are proposing in this proceeding?**

21 A. PacifiCorp is proposing an overall cost of capital of 8.754%. This cost includes
22 the Return on Equity recommendation from Dr. Hadaway and the following
23 capital structure and costs:

PacifiCorp

Overall Cost of Capital

March 31, 2006

Component	Percent of Total	% Cost	Weighted Average
Long Term Debt	49.40%	6.427%	3.175%
Preferred Stock	1.10%	6.590%	0.072%
Common Stock Equity	49.50%	11.125%	5.507%
Total	100.00%		8.754%

Financing Overview

Q. How does PacifiCorp finance its electric utility operations?

A. PacifiCorp finances the cash flow requirements of its regulated utility operations utilizing a reasonable mix of debt and equity securities designed to provide a competitive cost of capital and predictable capital market access.

Q. How does PacifiCorp meet its debt and preferred equity financing requirements?

A. PacifiCorp relies on a mix of first mortgage bonds, other secured debt, tax exempt debt, unsecured debt and preferred stock to meet its long-term debt and preferred stock financing requirements.

The Company has concluded the majority of its long-term financing utilizing secured first mortgage bonds issued under the PacifiCorp Mortgage Indenture dated January 9, 1989. Exhibit No. ___(BNW-2) shows that, as of September 30, 2006, PacifiCorp is projected to have approximately $3.3 billion of

1 first mortgage bonds outstanding, with an average cost of 6.78 percent and
2 average maturity of 11.1 years. Presently, all of PacifiCorp's first mortgage
3 bonds bear interest at fixed rates. Proceeds from the issuance of the first
4 mortgage bonds (and other financing instruments) are used to finance the
5 combined utility operation and are not allocated on a divisional basis.
6 Another important source of financing has been the tax-exempt financing
7 associated with certain qualifying equipment at PacifiCorp's power generation
8 plants. Under arrangements with local counties and other tax-exempt entities,
9 PacifiCorp borrows the proceeds and guarantees the repayment of the long-term
10 debt in order to take advantage of their tax-exempt status in financings. As of
11 September 30, 2006, PacifiCorp's tax-exempt portfolio is projected to be $736
12 million in principal amount with an average cost of 4.85 percent (which includes
13 the cost of issuance and credit enhancement).
14 **Planned Capital Structure**
15 **Q. How did you determine the amount of common equity, debt, and preferred**
16 **stock to be included in the Company's planned capital structure?**
17 A. As a regulated utility, PacifiCorp has a duty and an obligation to provide safe,
18 adequate and reliable service to customers in its Washington service territory
19 while balancing cost and risk. Significant capital expenditures for plant and
20 network maintenance, power delivery infrastructure, clean air investments, and
21 hydro relicensing activities are required for PacifiCorp to fulfill this obligation.
22 Through its planning process, PacifiCorp determined the amounts of necessary
23 new financing needed to support these activities and calculated the required

1 equity and debt ratios required to maintain our current 'A-' credit rating for senior
2 secured debt.
3 **Q. Please describe the changes to the level of equity financing.**
4 A. Beginning in June 2005, PacifiCorp is planning to receive four quarterly cash
5 infusions of $125 million from PHI, its parent company. Based on the latest
6 approved budgets and plans, these amounts will be required to support the A-
7 credit rating. PHI will be requested to inject the equity and PacifiCorp will, in
8 turn, issue new shares of common equity to PHI. This will result in an additional
9 $500 million of new common equity in PacifiCorp at the end of our fiscal year
10 2006. During this same period, the Company will also secure additional debt
11 financing.
12 **Q. Please describe the changes to the Company's levels of debt financing.**
13 A. Over the period ending September 30, 2006, the balance of the outstanding long-
14 term debt will change through maturities, principal amortization and sinking fund
15 requirements, and issuance of new securities. Based upon the long-term debt
16 series outstanding at February 28, 2005, I have calculated the reduction to the
17 outstanding balances for maturities, principal amortization and sinking fund
18 requirements, which are scheduled to occur during the period ending
19 September 30, 2006. The total long-term debt maturities and principal amortized
20 over this period is $269.7 million. Then I added $400.0 million of long-term debt
21 issuances necessary to fund our operations and to refinance the debt maturing
22 through September 30, 2006. The $400.0 million reflects the refinancing of
23 matured debt as well as $130.3 million of additional debt financing. This debt

1 issuance is consistent with PacifiCorp's budget and is necessary to fund our
2 ongoing operations. This increase in debt financing is also consistent with, and
3 balanced by, the projected increase in equity provided through a series of cash
4 infusions from PacifiCorp's parent company, as discussed above, as well as
5 increased retained earnings.

6 **Q. Please describe the changes to the Company's level of preferred equity**
7 **financing.**

8 A. For preferred stock, I started with the balance outstanding at February 28, 2005
9 and made a reduction of $7.5 million of preferred stock to reflect the sinking fund
10 requirements of the $7.48 Series No Par Serial Preferred stock. A sinking fund
11 payment of $3.75 million will occur on June 15, 2005 and June15, 2006.

12 **Q. How does this projected capital structure compare to comparable electric**
13 **utilities?**

14 A. The projected capital structure is consistent with the comparable group that Dr.
15 Hadaway has selected in his estimate of Return on Equity. Both PacifiCorp and
16 the group of comparable companies show an increasing percentage of common
17 equity in their capital structures. The Value Line estimate of common equity ratio
18 for the comparable group is 53.2 percent.

19 **Q. Is the proposed capital structure consistent with the Company's current**
20 **credit rating?**

21 A. Yes. This planned capital structure is intended to enable PacifiCorp to deliver its
22 required capital expenditures while maintaining credit ratios that support the
23 continuance of our current 'A-' credit rating.

1 **Q. Have previous equity infusions been made from PHI to the Company?**
2 A. Yes. In December 2002, PHI increased its investment in the Company with an
3 equity infusion of $150 million, shoring up PacifiCorp's capital structure. This
4 was in addition to the Company's elimination of dividends during fiscal year
5 2003. These actions significantly supported PacifiCorp's financial condition that
6 had deteriorated during and after the Western energy crisis and likely prevented
7 further downgrades of the Company's debt.
8 **Q. How does maintenance of a strong credit rating benefit customers?**
9 A. The credit rating given to a utility has a direct impact on the price that utility pays
10 to attract the capital necessary to support its current and future operating needs. A
11 strong credit rating directly benefits customers by reducing immediate and future
12 borrowing costs related to the financing needed to support regulatory operations.
13 **Q. Are there other benefits?**
14 A. Yes. During periods of capital market disruptions, higher-rated companies are
15 more likely to have on-going, uninterrupted access to capital. This is not always
16 the case with lower-rated companies, which during such periods find themselves
17 either unable to secure capital or able to secure capital only on unfavorable terms
18 and conditions. In addition, higher-rated companies have greater access to the
19 long-term markets for power purchases and sales. Such access provides these
20 companies with more alternatives when attempting to meet the current and future
21 load requirements of their customers. Finally, a company with strong ratings will
22 often avoid having to meet costly collateral requirements that are typically
23 imposed on lower-rated companies when securing power in these markets.

1 **Q. What steps has the Company taken to implement the financing strategy set**
2 **forth in its forecast?**
3 A. The Company has obtained PacifiCorp Board approval for debt and equity
4 issuances included in the plan. The Company has filed for regulatory approval to
5 increase the authorized amounts of equity and debt that it may issue. The planned
6 increased levels of debt and equity have also been included in presentations to
7 rating agencies. These agencies have used this information as part of their
8 determination of PacifiCorp's credit ratings.
9 **Q. Is PacifiCorp subject to rating agency debt imputation associated with**
10 **Purchased Power Agreements?**
11 A. Yes. Rating agencies and financial analysts consider Purchased Power
12 Agreements (PPAs) to be debt-like and will impute debt and related interest when
13 calculating financial ratios. For example, S&P will adjust PacifiCorp's published
14 results and add in debt and interest resulting from PPAs when assessing
15 PacifiCorp's creditworthiness. They do so in order to obtain a more accurate
16 assessment of a company's financial commitments and fixed payments. Exhibit
17 No.___(BNW-3) is the May 12, 2003 publication by S&P detailing its view of the
18 debt aspects of PPAs.
19 **Q. How does this impact PacifiCorp?**
20 A. During a recent ratings review, S&P evaluated our PPAs and other related long-
21 term commitments. This resulted in approximately $520 million of additional
22 debt and $52 million of interest expense being added to our debt and coverage
23 tests.

1 **Q. How would the inclusion of this PPA related debt affect the Company's**
2 **capital structure?**
3 A. By including the $520 million imputed debt resulting from PPAs, the Company's
4 capital structure would have a lower equity component as a corollary to the higher
5 debt component.
6 **Financing Cost Calculations**
7 **Q. How did you calculate the Company's embedded costs of long-term debt and**
8 **preferred stock?**
9 A. I calculated the embedded costs of debt and preferred stock using the
10 methodology relied upon in the Company's previous rate cases in Washington
11 and elsewhere.
12 **Q. Please explain the cost of debt calculation.**
13 A. I calculated the cost of debt by issue, based on each debt series' interest rate and
14 net proceeds at the issuance date, to produce a bond yield to maturity for each
15 series of debt. It should be noted that in the event a bond was issued to refinance
16 a higher cost bond, the pre-tax premium and unamortized costs, if any, associated
17 with the refinancing were subtracted from the net proceeds of the bonds that were
18 issued. The bond yield was then multiplied by the principal amount outstanding
19 of each debt issue, resulting in an annualized cost of each debt issue. Aggregating
20 the annual cost of each debt issue produces the total annualized cost of debt.
21 Dividing the total annualized cost of debt by the total principal amount of debt
22 outstanding produces the weighted average cost for all debt issues. This is the
23 Company's embedded cost of long-term debt.

1 **Q. How did you calculate the embedded cost of preferred stock?**
2 A. The embedded cost of preferred stock was calculated by first determining the cost
3 of money for each issue. This is the result of dividing the annual dividend rate by
4 the per share net proceeds for each series of preferred stock. The cost associated
5 with each series was then multiplied by the stated value or principal amount
6 outstanding for each issue to yield the annualized cost for each issue. The sum of
7 annualized costs for each issue produces the total annual cost for the entire
8 preferred stock portfolio. I then divided the total annual cost by the total amount
9 of preferred stock outstanding to produce the weighted average cost of all issues.
10 This is the Company's embedded cost of preferred stock.
11 **Q. A portion of the securities in the Company's debt portfolio bears variable**
12 **rates. What is the basis for the projected interest rates used by the**
13 **Company?**
14 A. The majority of the Company's variable rate debt is in the form of tax-exempt
15 debt. Exhibit No.___(BNW-4) shows that these securities had been trading at
16 approximately 85 percent of the 30-day LIBOR (London Inter Bank Offer Rate)
17 for the period January 1999 through February 2005. Therefore, the Company has
18 applied a factor of 85 percent to the forward 30-day LIBOR Rate and added the
19 respective credit enhancement and remarketing fees for each floating rate tax-
20 exempt bond. Credit enhancement and remarketing fees are included in the
21 interest component because these are costs which contribute directly to the
22 interest rate on the securities.

1 **Q. Regarding the $400.0 million of new long-term debt issuances mentioned**
2 **above, how did you determine the interest rate for this new long-term debt?**
3 A. I assumed this debt would be issued at the Company's estimated February 2005
4 credit spreads over the projected twenty-year Treasury rates as of September 29,
5 2006. Finally, I added in the effect of issuance costs. This reflects the
6 Company's best estimate of the cost of new debt, assuming the Company's senior
7 secured long-term debt ratings remain unchanged. Currently the Company's
8 senior secured long-term debt is rated A- and A3 by Standard & Poor's and
9 Moody's respectively.
10 **Q. What is the resulting estimated interest rate for this new long-term debt?**
11 A. The Company's estimated February 2005 credit spread for twenty-year notes was
12 0.85 percent. The forward twenty-year Treasury rate for September 29, 2006 is
13 4.943 percent. Issuance costs for this type of note add approximately 9 basis
14 points (*i.e.*, 0.09 percent) to the all-in cost. In addition, there are costs related to
15 the refunding of previously outstanding higher cost debt retired prior to scheduled
16 maturity that add about 3 basis points. Therefore the projected cost of
17 replacement debt is (0.85% +4.94%+0.09% + 0.03%) = 5.91 percent.
18 **Q. How does this compare to the cost of the debt that is maturing through**
19 **September 30, 2006?**
20 A. That debt has an average cost of 7.10 percent.

1 **Embedded Cost of Long-Term Debt**

2 **Q. What is the Company's embedded cost of long-term debt?**

3 A. Exhibit No.___(BNW-2) shows the embedded cost of long-term debt at

4 September 30, 2006 at 6.427 %.

5 **Embedded Cost of Preferred Stock**

6 **Q. What is the Company's embedded cost of preferred stock?**

7 A. Exhibit No.___(BNW-5) shows the embedded cost of preferred stock at

8 September 30, 2006 at 6.590 %.

9 **Q. Does this conclude your testimony?**

10 A. Yes.