

Exh. NLK-1Tr
Docket UE-230172
Witness: Nikki L. Koblaha

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PACIFICORP dba
PACIFIC POWER & LIGHT COMPANY

Respondent.

Docket UE-230172

PACIFICORP

DIRECT TESTIMONY OF NIKKI L. KOBLIHA

March 2023 (REVISED April 4, 2023, and REFILED April 19, 2023)

TABLE OF CONTENTS

I. QUALIFICATIONS..... 1

II. PURPOSE OF TESTIMONY..... 1

III. FINANCING OVERVIEW 4

 A. Credit Ratings..... 7

IV. CAPITAL STRUCTURE DETERMINATION 15

V. FINANCING COST CALCULATIONS 17

 A. Embedded Cost of Long-Term Debt 21

 B. Embedded Cost of Preferred Stock 21

VI. CONCLUSION..... 22

ATTACHED EXHIBITS

- Exhibit No. NLK-2—Cost of Long-Term Debt
- Exhibit No. NLK-3—Arizona Public Service Company Letter
- Exhibit No. NLK-4—Impact of a Lower Credit Rating on Cost of Long-Term Debt
- Exhibit No. NLK-5—Variable Rate PCRB, Pollution Control Revenue Bond
- Exhibit No. NLK-6—Cost of Preferred Stock

1 **Q. Please state your name, business address, and present position with PacifiCorp**
2 **d/b/a Pacific Power & Light Company (PacifiCorp or Company).**

3 A. My name is Nikki L. Koblaha and my business address is 825 NE Multnomah Street,
4 Suite 1900, Portland, Oregon 97232. I am currently employed as Vice President,
5 Chief Financial Officer and Treasurer for PacifiCorp.

6 **I. QUALIFICATIONS**

7 **Q. Please describe your education and professional experience.**

8 A. I received a Bachelor of Business Administration with a concentration in Accounting
9 from the University of Portland in 1994. I became a Certified Public Accountant in
10 1996. I joined PacifiCorp in 1997 and have taken on roles of increasing responsibility
11 before being appointed Chief Financial Officer in 2015. I am responsible for all
12 aspects of PacifiCorp's finance, accounting, income tax, internal audit, Securities and
13 Exchange reporting, treasury, credit risk management, pension, and other investment
14 management activities.

15 **II. PURPOSE OF TESTIMONY**

16 **Q. What is the purpose of your testimony in this case?**

17 A. My testimony supports PacifiCorp's overall cost of capital recommendation in this
18 case. I sponsor the Company's proposed capital structure with a common equity level
19 of 51.27 percent. I provide evidence demonstrating how this meets the Washington
20 Utilities and Transportation Commission's (Commission) standard for capital
21 structure by balancing the financial integrity of the Company (safety) with its cost to
22 customers (economy). I explain why the recommended equity ratio is required to
23 maintain PacifiCorp's current credit ratings, which provides for a more competitive

1 cost of debt and overall cost of capital, and facilitates continued access by the
 2 Company to the capital markets over the long term. This capital structure is necessary
 3 to enable the Company’s continued investment in infrastructure to provide safe and
 4 reliable service from clean energy resources at reasonable costs. In addition, I support
 5 PacifiCorp’s proposed cost of long-term debt of 4.77 percent and cost of preferred
 6 stock of 6.75 percent.

7 **Q. What time period do your analyses cover?**

8 A. The rate effective dates proposed in this proceeding are March 1, 2024, and March 1,
 9 2025. Consistent with the methodology PacifiCorp has relied upon for several general
 10 rate cases in Washington and other jurisdictions, I determined the capital structure,
 11 costs of long-term debt, and costs of preferred stock using an average of the five
 12 quarter-ending balances for the twelve months ending December 31, 2024, based on
 13 known and measurable changes from June 30, 2022.

14 **Q. What overall cost of capital do you recommend for PacifiCorp?**

15 A. PacifiCorp is proposing an overall cost of capital of 7.60 percent. This cost includes
 16 the return on equity recommendation of 10.3 percent as discussed in the direct
 17 testimony of Company witness Ann E. Bulkley (Exhibit No. AEB-1T) and the capital
 18 structure and costs set forth in Table 1.

Table 1: Overall Cost of Capital

Component	\$m	% of Total	Cost %	Weighted Ave Cost %
Long-Term Debt	\$11,285	48.72%	4.77%	2.32%
Preferred Stock	\$2	0.01%	6.75%	0.00%
Common Stock Equity	\$11,874	51.27%	10.30%	5.28%
	\$23,161	100.00%		7.60%

1 **Q. Why have you not included short-term debt as part of the capital structure?**

2 A. Short-term debt is an important source of liquidity for the Company, including
3 interim funding for long-term debt maturities and new capital spending, and provides
4 the Company a window of time to assess market conditions before using more
5 permanent long-term debt financing. However, short-term debt balances can move
6 dramatically, and the Company often has periods when there is little or no short-term
7 debt outstanding. For example, in the Company's last two Washington rate cases,
8 including short-term debt had no practical impact on the cost of capital rounded to
9 two decimal places.¹

10 Similarly, in the current rate case, if the Company were to include short-term
11 debt in the capital structure it would decrease the weighted average cost of capital by
12 only two basis points. Because short-term debt is not a permanent or material source
13 of financing rate base, it should not be imputed into PacifiCorp's capital structure. As
14 such, the Company respectfully proposes not to include any short-term debt
15 consistent with its currently authorized capital structure. As I explain below,
16 PacifiCorp is making major capital investments, including investments that will help
17 the Company meet Washington's Clean Energy Transformation Act (CETA).²
18 Including short-term debt in the Company's capital structure effectively double
19 counts short-term debt as financing both rate base and construction work in progress.

¹ *WUTC v. Pac. Power & Light Co., a Division of PacifiCorp*, Docket No. UE-152253, Order No. 12, ¶163 (Sept. 1, 2016) (approving capital structure with zero cost for short-term debt); *WUTC v. Pacific Power & Light Co., a Division of PacifiCorp*, Docket No. UE-140762, Order No. 08 ¶¶180, 183 (Mar. 25, 2015) (same).

² Senate Bill 5116, 66th Leg., 2019 Reg. Sess. (Wa. 2019). See <https://lawfilesexxt.leg.wa.gov/biennium/2019-20/Htm/Bills/Session%20Laws/Senate/5116-S2.SL.htm>.

1 **III. FINANCING OVERVIEW**

2 **Q. Please explain PacifiCorp's need for and sources of new capital.**

3 A. PacifiCorp requires capital to meet its customers' needs for new cost-effective,
4 transmission and generation, increased reliability, improved power delivery, and safe
5 operations. PacifiCorp also needs new capital to fund long-term debt maturities.

6 PacifiCorp expects to spend approximately \$10.6 billion in capital
7 expenditures from 2023 through 2025 with significant investments in renewable
8 energy projects and related transmission. This capital spending will require
9 PacifiCorp to raise funds by issuing new long-term debt in the debt capital markets,
10 retaining earnings, and if needed, obtaining new capital contributions from its parent
11 company, Berkshire Hathaway Energy Company (BHE). The investments in
12 renewable energy and transmission capacity are necessary to enable PacifiCorp to
13 move forward in meeting the requirements in CETA.

14 **Q. How does PacifiCorp finance its electric utility operations?**

15 A. Generally, PacifiCorp finances its regulated utility operations using a mix of debt and
16 common equity capital of approximately 48/52 percent, respectively. During periods
17 of significant capital expenditures, as expected to continue beyond the 2024/2025 test
18 period for potential new investments, which were identified in PacifiCorp's 2021
19 Integrated Resource Plan (IRP) action plan, the Company will need to maintain an
20 average common equity component in excess of 51 percent to maintain its credit
21 rating and finance the debt component of the capital structure at the lowest reasonable
22 cost to customers. This provides more flexibility on the type and timing of debt

1 financing, better access to capital markets, a more competitive cost of debt, and over
2 the long-run, more stable credit ratings.

3 The following quote from a finance textbook written by Roger Morin also
4 supports the Company's current position:

5 The optimal capital structure...suggests that long-term achievement of
6 a single A credit rating is in a utility company's and its ratepayers best
7 interests. Debt leverage targets should be set in the lower part of the
8 range required to attain this optimal rating. If the company maintains
9 its debt ratio close to the optimal range required for a single A bond
10 rating, its overall cost of capital should be minimized.³

11 PacifiCorp currently has a Moody/Standard & Poor's (S&P) bond issuer credit
12 rating of A3/A, which is considered a single A credit rating, and as suggested from the
13 textbook will minimize its overall cost of capital.

14 **Q. How does PacifiCorp determine the levels of common equity, debt, and preferred
15 stock to include in its capital structure?**

16 A. As a regulated public utility, PacifiCorp has a duty and an obligation to provide safe,
17 adequate, and reliable service to customers in its Washington service area while
18 prudently balancing cost and risk. Major capital expenditures are required in the near-
19 term for new plant investment to fulfill its service obligation, including capital
20 expenditures for repowering wind projects, new wind, and new transmission. These
21 capital investments also have associated operations and maintenance costs.

22 PacifiCorp reviews all of its estimated cash inflows and outflows to determine the
23 amount, timing, and type of new financing required to support these activities and
24 provide for financial results and credit ratings that balance the cost of capital with
25 continued access to the financial markets.

³ Roger A. Morin, PhD, *New Regulatory Finance, Public Utilities Reports, Inc, Virginia 2006, p.471.*

1 **Q. How does PacifiCorp manage its dividends to BHE?**

2 A. PacifiCorp benefits from its affiliation with BHE as there is no dividend requirement.
3 PacifiCorp pays dividends to BHE to manage the common equity component of the
4 capital structure and to keep the Company's overall cost of capital at a prudent level.
5 In major capital investment periods, PacifiCorp is able to retain earnings to help
6 finance capital investments and forego paying dividends to BHE. For example,
7 following BHE's acquisition of PacifiCorp in 2006, PacifiCorp managed the capital
8 structure through the timing and amount of long-term debt issuances and capital
9 contributions, while forgoing any common dividends for nearly five years. At other
10 times, absent the payment of dividends, retention of earnings could cause the
11 percentage of common equity to grow beyond the level necessary to support the
12 current credit ratings. Accordingly, dividend payments can be necessary, in
13 combination with debt issuances, to maintain the appropriate percentage of equity in
14 PacifiCorp's capital structure.

15 **Q. What type of debt does PacifiCorp use in meeting its financing requirements?**

16 A. PacifiCorp has completed the majority of its recent long-term financing using secured
17 first mortgage bonds issued under the Mortgage Indenture dated January 9, 1989.
18 Exhibit No. NLK-2, Cost of Long-Term Debt, shows that, over the test period,
19 PacifiCorp is projected to have an average of approximately \$11.1 billion of first
20 mortgage bonds outstanding, with an average cost of 4.79 percent. Presently, all
21 outstanding first mortgage bonds bear interest at fixed rates. Proceeds from the
22 issuance of the first mortgage bonds (and other financing instruments) are used to
23 finance the utility operation.

1 Another important source of financing in the past has been the tax-exempt
2 financing associated with certain qualifying equipment at power generation plants.
3 Under arrangements with local counties and other tax-exempt entities, these entities
4 issue securities, PacifiCorp borrows the proceeds of these issuances and pledges its
5 credit quality to repay the debt to take advantage of the tax-exempt status of the
6 financing. During the 12 months ending December 31, 2024, PacifiCorp's tax-exempt
7 portfolio is projected to average approximately \$185 million, with an average cost of
8 3.71 percent, including the cost of issuance and remarketing.

9 **A. Credit Ratings**

10 **Q. What are PacifiCorp's current credit ratings?**

11 A. PacifiCorp's current ratings are shown in Table 2.

Table 2: PacifiCorp Credit Ratings

	Moody's	Standard & Poor's
Senior Secured Debt	A1	A+
Senior Unsecured Debt	A3	A
Outlook	Stable	Stable

12 **Q. How does the maintenance of PacifiCorp's current credit rating benefit**
13 **customers?**

14 A. First, the credit rating of a utility has a direct impact on the price that a utility pays to
15 attract the capital necessary to support its current and future operating needs. Many
16 institutional investors have fiduciary responsibilities to their clients, and are typically
17 not permitted to purchase non-investment grade (*i.e.*, rated below Baa3/BBB-)
18 securities or in some cases even securities rated below a single A rating. A solid credit
19 rating directly benefits customers by reducing the immediate and future borrowing
20 costs related to the financing needed to support regulatory obligations.

1 Second, credit ratings are an estimate of the probability of default by the
2 issuer on each rated security. Lower ratings equate to higher risks and higher costs of
3 debt. The Great Recession of 2008-2009 provides a clear and compelling example of
4 the benefits of the Company's credit rating because PacifiCorp was able to issue new
5 long-term debt during the midst of the financial turmoil. Other lower-rated utilities
6 were shut out of the market and could not obtain new capital.

7 Third, PacifiCorp has a near constant need for short-term liquidity as well as
8 periodic long-term debt issuances. PacifiCorp pays significant amounts daily to
9 suppliers whom we count on to provide necessary goods and services such as fuel,
10 energy, and inventory. Being unable to access funds can risk the successful
11 completion of necessary capital infrastructure projects and would increase the chance
12 of outages and service failures over the long term.

13 PacifiCorp's creditworthiness, as reflected in its credit ratings, will strongly
14 influence its ability to attract capital in the competitive markets and the resulting costs
15 of that capital.

16 **Q. Please provide examples where lower credit ratings hurt a utility's flexibility in**
17 **the credit markets.**

18 A. During the financial turmoil of 2008, Arizona Public Service Company (rated
19 Baa2/BBB- at that time) filed a letter with the Arizona Corporation Commission in
20 October 2008 stating that the commercial paper market was completely closed to it
21 and it likely could not successfully issue long-term debt. *See* Exhibit No. NLK-3.

22 Further, those issuers who could access the markets paid rates well above the
23 levels that PacifiCorp was able to obtain. For example, PacifiCorp issued new 10-year

1 and 30-year long-term debt in January 2009 with 5.50 percent and 6.00 percent
2 coupon rates, respectively. Subsequently, Puget Sound Energy (rated Baa2/A- at that
3 time) issued new seven-year debt at a credit spread over Treasuries of 480.3 basis
4 points resulting in a 6.75 percent coupon.

5 **Q. Can regulatory actions or orders affect PacifiCorp's credit rating?**

6 A. Yes. Regulated utilities such as PacifiCorp are unique in that they cannot unilaterally
7 set the price for their services. The financial integrity of a regulated utility is largely a
8 result of the prudence of utility operations and the corresponding prices set by
9 regulators. Rates are established by regulators to permit the utility to recover
10 prudently incurred operating expenses and a reasonable opportunity to earn a fair
11 return on the capital invested.

12 Rating agencies and investors have a keen understanding of the importance of
13 regulatory outcomes. For example, S&P has opined on the correlation between
14 regulatory outcomes and credit ratings, concluding:

15 Although not common, rate case outcomes can sometimes lead directly
16 to a change in our opinion of creditworthiness. Often it's a case that
17 takes on greater importance because of the issues being litigated. For
18 example, in 2010, we downgraded Florida Power & Light and its
19 affiliates following a Florida Public Service Commission rate ruling
20 that attracted attention due to drastic changes to settled practices on
21 rate case particulars like depreciation rates. More recently, in June
22 2016, we downgraded Central Hudson Electric & Gas due to our
23 revised opinion of regulatory risk. While that reflected the company's
24 own management of regulatory risk, it was prompted in part by other
25 rate case decisions in New York that highlighted the overall risk in the
26 state. S&P Ratings Direct - Assessing U.S. Investor-Owned Utility
27 Regulatory Environments (August 10, 2016).⁴

⁴ S&P Ratings Direct, *Assessing U.S. Investor-Owned Utility Regulatory Environments* (Aug. 10, 2016), at 4.

1 Similarly, Moody’s recently issued a credit opinion for PacifiCorp, concluding:

2 The stable outlook incorporates our expectation that PacifiCorp will
3 continue to receive reasonable regulatory treatment, and that funding
4 requirements will be financed in a manner consistent with
5 management's commitment to maintain a healthy financial profile.

6 The ratings could be downgraded if PacifiCorp's capital expenditures
7 are funded in a manner inconsistent with its current financial profile,
8 or if adverse regulatory rulings lower its credit metrics, as
9 demonstrated for example, by a ratio of CFO pre-WC to debt
10 remaining below 19%.⁵

11 In addition, the Company notes a downgrade of American Electric Power
12 Company, Inc. (AEP) and utility subsidiaries AEP Texas, Ohio Power, and Public
13 Service of Oklahoma by Moody’s.⁶ Drivers for the downgrades all reference
14 weakened financial profiles that are driven by large capital programs and an increased
15 use of leverage. The increased use of leverage combined with lower authorized
16 revenues would cause metrics to decline below current levels “as AEP plans to
17 increase leverage at AEP Texas to align more closely with its approved capital
18 structure.”⁷ An updated credit opinion on AEP specifically notes deterioration of its
19 previously strong credit metrics as the primary driver behind their downgrade. This
20 action further demonstrates the importance of the cash flow from operations
21 excluding changes in working capital or “CFO pre-W/C” to debt ratio to Moody’s
22 when determining ratings.

23 As discussed in the testimony of Company witness Bulkley, the regulatory
24 environment and the rate decisions by utility commissions have a direct and
25 significant impact on the financial condition of utilities.

⁵ Moody’s Credit Opinion, *PacifiCorp Update to Credit Analysis* (June 30, 2021), at 2.

⁶ Moody’s Investor Service, Ratings Action (August 6, 2020).

⁷ Moody’s Investor Service, Ratings Action (August 6, 2020).

1 **Q. How does the maintenance of PacifiCorp's current credit ratings benefit**
2 **customers?**

3 A. PacifiCorp is in the midst of a period of major capital spending and investing in cost-
4 effective infrastructure to provide electric service that is safe, reliable, and affordable.
5 In addition to being cost-effective resources, PacifiCorp's investments in its existing
6 wind fleet and new wind generation and transmission play a critical role in
7 PacifiCorp's ability to meet the energy policy objectives of the state of Washington on
8 a risk adjusted, least-cost basis. If PacifiCorp does not have consistent access to the
9 capital markets at reasonable costs, these borrowings and the resulting costs of
10 building new facilities become more expensive than they otherwise would be. The
11 inability to access financial markets can threaten the completion of necessary projects
12 and can impact system reliability and customer safety. Maintaining the current single
13 A credit rating makes it more likely PacifiCorp will have access to the capital markets
14 at reasonable costs even during periods of financial turmoil.

15 **Q. Can you provide an example of how the current ratings have benefited**
16 **customers?**

17 A. Yes. One example is PacifiCorp's ability to significantly reduce its cost of long-term
18 debt primarily through obtaining new financings at very attractive interest rates. The
19 lower cost of debt benefits customers through a lower overall rate of return and lower
20 revenue requirements.

21 To determine the savings realized from maintaining a higher credit rating, in
22 Exhibit No. NLK-4, Impact of a Lower Credit Rating on Cost of Long-Term Debt,
23 I compare the actual effective interest rate on the Company's existing as well as pro-

1 forma long-term debt forecasted to be outstanding during the calendar year 2024 test
2 period, which was issued since its acquisition by BHE in 2006, comprising 20 series
3 of debt, to what the effective interest rate would have been with a BBB credit rating.
4 The spread of each issuance was changed to match what a BBB rated utility achieved
5 at about the same point in time that PacifiCorp issued the debt. The total result for the
6 20 series of debt averaging \$10.2 billion over the test period, would have been an
7 effective average interest rate of approximately 5.07 percent or 43 basis points higher
8 than the actual effective interest rate. Combined with the existing pre-acquisition
9 debt, the resulting overall cost of long-term debt would increase to 5.16 percent if the
10 Company had a BBB rating. PacifiCorp is currently projecting an overall cost of
11 long-term debt of 4.77 percent, or approximately 39 basis points lower than it might
12 have otherwise been under the scenario I described above. Table 3 below shows the
13 reduction in the Company’s cost of long-term debt since 2011.

Table 3: PacifiCorp’s Cost of Long-Term Debt

	Proposed	UE-191024 Dec 2020	UE-140762 Dec 2014	UE-130043 Dec 2013	UE-111190 Mar 2012	UE-100749 Mar 2011
Cost of Long-Term Debt	4.77%	4.92%	5.19%	5.29%	5.76%	5.89%

14 PacifiCorp’s customers have benefited from a 112 basis points reduction in the
15 Company’s cost of long-term debt. The Company estimates that this reduction in the
16 average cost of debt since 2011 results in a decrease of approximately \$6.3 million in
17 the revenue requirement in the current case. Customers have also benefited from the
18 Company’s ability to negotiate lower underwriting fees on long-term debt issuances
19 through BHE’s global underwriting fee position.

1 **Q. Are there other identifiable advantages to a favorable rating?**

2 A. Yes. Higher-rated companies have greater access to the long-term markets for power
3 purchases and sales. This access provides these companies with more alternatives to
4 meet the current and future load requirements of their customers. Additionally, a
5 company with strong ratings will often avoid having to meet costly collateral
6 requirements that are typically imposed on lower-rated companies when securing
7 power in these markets.

8 In my opinion, maintaining the current single A rating provides the best
9 balance between costs and continued access to the capital markets, which is necessary
10 to fund capital projects for the benefit of customers.

11 **Q. Is the proposed capital structure consistent with PacifiCorp's current credit
12 rating?**

13 A. Yes. This capital structure is intended to help the Company deliver its required capital
14 expenditures and achieve financial metrics that will meet rating agency expectations.

15 **Q. Does PacifiCorp's credit rating benefit because of BHE and its parent Berkshire
16 Hathaway Inc.?**

17 A. Yes. Although ring-fenced, PacifiCorp's credit ratios have been weak for the ratings
18 level. PacifiCorp has been able to sustain its ratings in part through the acquisition by
19 BHE and its parent, Berkshire Hathaway Inc. S&P was very clear on this point in its
20 June 2022 assessment of PacifiCorp:

21 Under our group rating methodology, we consider PacifiCorp to be a
22 core subsidiary of BHE with a group credit profile of 'a'. The core
23 status reflects our view that PacifiCorp is highly unlikely to be sold,
24 has strong long-term commitment from senior management, is
25 successful at what it does, and contributes meaningfully to the group.

1 Accordingly, given its core status and BHE’s group credit profile of
2 ‘a’, the issuer credit rating on PacifiCorp is ‘A’.⁸

3 Moody’s states in their June 2021 credit opinion of PacifiCorp:

4 PacifiCorp benefits from its affiliation with Berkshire Hathaway
5 Inc., which requires no regular dividends from PacifiCorp or BHE.
6 From a credit perspective, the company’s ability to retain its
7 earnings as an entity that is privately held, particularly by a deep-
8 pocketed sponsor like Berkshire Hathaway Inc., is an advantage
9 over most other investor owned utilities that are typically held to a
10 regular dividend to their shareholders. PacifiCorp currently pays
11 dividends that are sized to manage its equity ratio (as measured by
12 unadjusted equity to equity plus long term debt) around its allowed
13 levels of slightly higher than 50% (regulations restrict dividends if
14 this ratio falls below 44%). As of December 2020, PacifiCorp
15 reports its actual equity percentage, as calculated under this test,
16 was 53%.⁹

17 These examples are evidence of the credit rating benefit resulting from BHE’s
18 ownership of PacifiCorp.

19 **Q. Does ownership by BHE, and ultimately Berkshire Hathaway Inc., mean**
20 **PacifiCorp is protected from a ratings downgrade if PacifiCorp does not manage**
21 **its own risks?**

22 A. No. As noted above PacifiCorp is part of a group rating methodology where S&P
23 considers PacifiCorp to be core to BHE, which has a group credit profile of ‘a’. The
24 core status reflects S&P’s view that PacifiCorp is highly unlikely to be sold, has a
25 strong long-term commitment from senior management, is successful at what it does,
26 and contributes significantly to the group. However, in a Research Update issued by
27 S&P on June 23, 2022, regarding PacifiCorp, S&P revised their assessment of
28 PacifiCorp’s business risk to reflect their view of PacifiCorp’s increasing

⁸ S&P Ratings Direct, *PacifiCorp Ratings Affirmed, Outlook Stable* (June 23, 2022), at 3.

⁹ Moody’s Credit Opinion, *PacifiCorp Update to Credit Analysis* (June 30, 2021), at 8.

1 susceptibility to wildfires that have intensified across the Western United States. S&P
2 revised their assessment of PacifiCorp's comparable ratings analysis modifier to
3 negative, which resulted in PacifiCorp's stand-alone credit profile (SACP) being
4 lowered from 'a-' to 'bbb+'. This action does not currently affect PacifiCorp's issuer
5 credit rating nor did it change the 'Excellent' business risk. What this action does is
6 show that although PacifiCorp is core to BHE and as such receives the group credit
7 profile of 'a', its wildfire risk is large enough that S&P lowered PacifiCorp's SACP
8 and said that "we could also lower PacifiCorp's ratings if there is a weakening of the
9 relationship between PacifiCorp and parent BHE."¹⁰ The statement that S&P could
10 lower PacifiCorp's ratings if the relationship between BHE and PacifiCorp weakens
11 is significant as it shows that PacifiCorp is not fully protected by the Berkshire
12 Hathaway Inc. halo and that it needs to manage its risk, earn a reasonable return and
13 maintain a solid credit rating to maintain access to the debt capital markets at a
14 reasonable cost. The equity component of the capital structure proposed in this case is
15 set at a level intended to support the credit metrics communicated to the rating
16 agencies and maintain that strong position.

17 IV. CAPITAL STRUCTURE DETERMINATION

18 **Q. How did the Company determine its recommended capital structure?**

19 A. The rate effective dates proposed in this case are March 1, 2024, and March 1, 2025.
20 The capital structure is based on the actual capital structure at June 30, 2022, and
21 forecasted capital activity, including known and measurable changes, through
22 December 31, 2024. PacifiCorp has averaged the five quarter-end capital structures

¹⁰ S&P Ratings Direct, *PacifiCorp Ratings Affirmed, Outlook Stable* (June 23, 2022), at 2.

1 measured beginning at December 31, 2023, and concluding with December 31, 2024.
2 The capital activity includes known maturities of certain debt issues that were
3 outstanding at June 30, 2022, subsequent issuances of long-term debt and any capital
4 contributions received or dividends paid. The known and measurable changes
5 represent actual and forecasted capital activity since June 30, 2022.

6 **Q. Why does your analysis of capital structure and costs of capital use average**
7 **period capital balances for the 12-month period ending December 31, 2024?**

8 A. This approach smooths volatility in the capital structure, which will fluctuate as the
9 Company expends capital, issues or retires debt, retains earnings, or declares
10 dividends. This is consistent with the way the Company calculated its capital
11 structure in its last several Washington general rate cases. This method is also
12 consistent with the approach to capital structure advocated by the Public Counsel Unit
13 of the Washington Attorney General's Office in docket UE-050684.

14 **Q. How does the Company's proposed capital structure compare to the equity ratio**
15 **of the utility operating company proxy group found in Exhibit AEB-5 of**
16 **Company witness Bulkley's testimony?**

17 A. Company witness Bulkley's exhibit shows the low, high, and median of the proxy
18 group average equity ratios are 45.95 percent, 61.06 percent and 53.18 percent,
19 respectively. The Company's proposed capital structure is well within this range.

20 **Q. How does the Company's proposed capital structure compare to recent actual**
21 **capital structures and to the capital structure authorized in the 2020 general rate**
22 **case, docket UE-191024 (2020 Rate Case)?**

23 A. The capital structures are compared in Table 4 below.

Table 4: Forecast and Actual Capital Structures

PacifiCorp's Comparison of % Capital Structures						
	Dec 31, 2024 Forecast w/o ST debt*	Dec 31, 2024 Forecast w/ ST debt*	Dec 31, 2023 Forecast*	Dec 31, 2022 Actual*	Dec 31, 2021 Actual*	UE-191024 Authorized Capital Structure
Short-Term Debt		0.73%	0.48%	0.00%	0.53%	0.00%
Long-Term Debt	48.72%	48.37%	48.31%	46.69%	47.44%	50.88%
Preferred Stock	0.01%	0.01%	0.01%	0.01%	0.01%	0.02%
Common Equity	51.27%	50.89%	51.19%	53.30%	52.02%	49.10%
Totals	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

*5QE Ave % Capital Structure calculated for trailing 12-month period ending

1 The Company's recent actual average capital structures for calendar years
2 2021 and 2022 have assisted the Company in maintaining its credit ratings and helped
3 to reduce the interest rate on new financings and reduced cost of debt for the benefit
4 of customers over these periods.

5 The percentage decrease in the common equity component of the capital
6 structure from the recent actual December 31, 2022 five-quarter average to that
7 projected for the 2024 test period is due to debt issuances in excess of maturities over
8 the period and common dividend payment in 2023. These steps are being taken to
9 manage the common equity percentage closer to what was approved by the
10 Commission in the 2020 Rate Case and ordered in the 2015 limited-issue rate case
11 docket UE-152253.

V. FINANCING COST CALCULATIONS

13 **Q. How did you calculate the Company's embedded costs of long-term debt and**
14 **preferred stock?**

15 A. I calculated the embedded costs of debt and preferred stock using the methodology
16 relied upon in the 2020 Rate Case and the Company's general rate cases in other
17 jurisdictions. Consistent with my determination of the percentage capital structure

1 discussed previously, I have similarly calculated the embedded costs of debt and
2 preferred stock as an average of the five quarter-end cost calculations spanning the
3 test period, beginning at December 31, 2023, and concluding with
4 December 31, 2024.

5 **Q. Please explain the cost of long-term debt calculation.**

6 A. I calculated the embedded cost of debt using the methodology relied upon in the
7 Company's previous rate cases in Washington and other jurisdictions. More
8 specifically, I calculated the cost of debt by issue, based on each debt series' interest
9 rate and net proceeds at the issuance date, to produce a bond yield to maturity for
10 each series of debt outstanding as of each of the five quarter-ending dates spanning
11 the 12-month calendar 2024 test period. It should be noted that in the event a bond
12 was issued to refinance a higher cost bond, the pre-tax premium and unamortized
13 costs, if any, associated with the refinancing were subtracted from the net proceeds of
14 the bonds that were issued. Each bond yield was then multiplied by the principal
15 amount outstanding of each debt issue, resulting in an annualized cost of each debt
16 issue. Aggregating the annual cost of each debt issue produces the total annualized
17 cost of debt. Dividing the total annualized cost of debt by the total principal amount
18 of debt outstanding produces the weighted average cost for all debt issues.

19 **Q. Please describe the changes to the amount of outstanding long-term debt
20 between June 30, 2022, and December 31, 2024?**

21 A. Approximately \$1,020 million and \$166 million of the Company's fixed rate and
22 variable rate long-term debt, respectively, will mature during this period and I have
23 therefore removed this debt when appropriate in the determination of the proposed

1 average cost of debt. In December 2022, the Company issued \$1.1 billion of its new
2 5.350 percent First Mortgage Bond series maturing December 2053 and I have
3 therefore added this debt in the determination of the proposed average cost of debt.
4 Also, as reflected in Exhibit No. NLK-2, Cost of Long-Term Debt, the Company
5 anticipates new fixed rate long-term debt during the period, a 10- and 30-year split
6 term issuances totaling \$1.2 billion in 2023 and \$1.7 billion in 2024.

7 **Q. Regarding the \$1.2 billion of new long-term issuances in 2023, how did you**
8 **determine the interest rate and resulting cost for this new long-term debt?**

9 A. The Company's current estimated credit spread for 10-year and 30-year debt is
10 1.05 and 1.30 percent, respectively. The recent forward 10-year and 30-year U.S.
11 Treasury rates for June 2023 are approximately 3.33 and 3.47 percent, respectively.
12 Issuance costs for 10-year and 30-year debt of this type adds approximately 0.08 and
13 0.05 percent to the all-in cost, respectively. Therefore, as reflected in Exhibit No.
14 NLK-2, Cost of Long-Term Debt, the Company projects a total all-in cost of long-
15 term debt of 4.46 percent and 4.82 percent, respectively, for each of the \$600 million
16 projected new 10-year and 30-year long-term debt issuances in June 2023.

17 **Q. Regarding the \$1.7 billion of new long-term issuances in 2024, how did you**
18 **determine the interest rate and resulting cost for this new long-term debt?**

19 A. The Company's current estimated credit spread for 10-year and 30-year debt is
20 1.05 and 1.30 percent, respectively. The recent forward 10-year and 30-year U.S.
21 Treasury rates for January 2024 are approximately 3.30 and 3.44 percent,
22 respectively. Issuance costs for 10-year and 30-year debt of this type adds
23 approximately 0.08 and 0.05 percent to the all-in cost, respectively. Therefore, as

1 reflected in Exhibit No. NLK-2, Cost of Long-Term Debt, the Company projects a
2 total all-in cost of long-term debt of 4.43 percent and 4.80 percent, respectively, for
3 each of the \$500 million projected new 10-year and 30-year long-term debt issuances
4 in January 2024. The recent forward 30-year U.S. Treasury rate for July 2024 is
5 approximately 3.43 percent and as reflected in Exhibit No. NLK-2, Cost of Long-
6 Term Debt, the Company projects a total all-in cost of long-term debt of
7 approximately 4.79 percent for this additional \$700 million projected new 30-year
8 long-term debt issuance in July 2024.

9 **Q. A portion of the securities in PacifiCorp's debt portfolio bears variable rates.**

10 **What is the basis for the projected interest rates used by PacifiCorp?**

11 A. The Company's variable rate long-term debt in this case is in the form of tax-exempt
12 debt. Exhibit No. NLK-6, Variable Rate PCRB, Pollution Control Revenue Bond
13 shows that, on average, these securities have been trading at approximately 85 percent
14 of the 30-day London Inter Bank Offer Rate (LIBOR) for the period January 2000
15 through October 2022 (beginning with January 2022, the Bloomberg One Month
16 Short Term Bank Yield Index rate replaced the 30-Day LIBOR as the referenced
17 short-term borrowing index rate). Therefore, the Company has applied a factor of 85
18 percent to the forward One Month Bloomberg Short Term Bank Yield Index rate at
19 each future quarter-end spanning the test period and then added the respective credit
20 facility and remarketing fees for each floating rate tax-exempt bond. Credit facility
21 and remarketing fees are included in the interest component because these are costs
22 that contribute directly to the interest rate on the securities and are charged to interest
23 expense. This method is consistent with the Company's past practices when

1 determining the cost of debt in previous Washington general rate cases as well as the
2 other states that regulate PacifiCorp.

3 **Q. How did you calculate the embedded cost of preferred stock?**

4 A. The embedded cost of preferred stock was calculated by first determining the cost of
5 money for each issue. I begin by dividing the annual dividend per share by the per
6 share net proceeds for each series of preferred stock. The resulting cost rate
7 associated with each series was then multiplied by the total par or stated value
8 outstanding for each issue to yield the annualized cost for each issue. The sum of
9 annualized costs for each issue produces the total annual cost for the entire preferred
10 stock portfolio. I then divided the total annual cost by the total amount of preferred
11 stock outstanding to produce the weighted average cost for all issues. The result is
12 PacifiCorp's embedded cost of preferred stock.

13 **A. Embedded Cost of Long-Term Debt**

14 **Q. What is PacifiCorp's embedded cost of long-term debt?**

15 A. The cost of long-term debt is 4.77 percent for the period ending December 31, 2024,
16 as shown in Exhibit No. NLK-2, Cost of Long-Term Debt.

17 **B. Embedded Cost of Preferred Stock**

18 **Q. What is PacifiCorp's embedded cost of preferred stock?**

19 A. Exhibit No. NLK-7, Cost of Preferred Stock, shows the embedded costs of preferred
20 stock for the period ending December 31, 2024, to be 6.75 percent.

1 **VI. CONCLUSION**

2 **Q. Please summarize your recommendations to the Commission.**

3 A. I respectfully request the Commission adopt PacifiCorp's proposed capital structure
4 with a common equity level of 51.27 percent. This capital structure balances the
5 financial integrity of the Company and costs to customers by reflecting the minimum
6 equity ratio necessary for PacifiCorp to maintain its ratings under current market
7 conditions. When combined with PacifiCorp's updated cost of long-term debt of 4.77
8 percent and the cost of equity of 10.30 percent recommended by Company witness
9 Bulkley, this produces a reasonable overall cost of capital of 7.60 percent.

10 **Q. Does this conclude your direct testimony?**

11 A. Yes.