

Exhibit No.____(BNW-1T)
Docket UE-13____
Witness: Bruce N. Williams

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

vs.

PACIFICORP dba
Pacific Power & Light Company

Respondent.

Docket UE-13____

PACIFICORP

DIRECT TESTIMONY OF BRUCE N. WILLIAMS

January 2013

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

3 A. My name is Bruce N. Williams. My business address is 825 NE Multnomah
4 Street, Suite 1900, Portland, Oregon 97232. My present position is Vice
5 President and Treasurer.

6 **Qualifications**

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

8 A. I received a Bachelor of Science degree in Business Administration with a
9 concentration in Finance from Oregon State University in June 1980. I also
10 received the Chartered Financial Analyst designation upon passing the
11 examination in September 1986. I have been employed by the Company for
12 27 years. My business experience has included financing of the Company's
13 electric operations and non-utility activities, responsibility for the investment
14 management of the Company's qualified and non-qualified retirement plan assets,
15 and investor relations.

16 **Q. Please describe your present duties.**

17 A. I am responsible for the Company's treasury, credit risk management, pension,
18 and other investment management activities. I am also responsible for the
19 preparation of PacifiCorp's embedded cost of debt and preferred equity and any
20 associated testimony related to capital structure for regulatory filings in all of
21 PacifiCorp's state and federal jurisdictions.

1 **Summary of Testimony**

2 **Q. Please provide a summary of your testimony.**

3 A. My testimony discusses the Company’s capital structure and costs of capital. It
4 supports the requested common equity level of 52.51 percent and provides
5 evidence of how the Company’s capital structure balances safety and economy
6 and benefits customers. These benefits include maintaining the Company’s
7 current credit ratings, which will facilitate continued access to the capital markets
8 for the Company, and providing a more competitive cost of debt and overall cost
9 of capital over the long term. I also support the Company’s cost of long-term debt
10 of 5.37 percent and cost of preferred stock of 5.43 percent.

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

12 A. PacifiCorp is proposing an overall cost of capital of 7.80 percent. This cost
13 includes the return on equity recommendation presented in the direct testimony of
14 Dr. Samuel C. Hadaway and the following capital structure and costs:

Overall Cost of Capital

Component	Percent of Total	Cost	Weighted Average
Long-Term Debt	47.21%	5.37%	2.54%
Preferred Stock	0.28%	5.43%	0.02%
Common Stock Equity	52.51%	10.00%	5.25%
Total	100.00%		7.80%

15 **Q. How does the proposed overall cost of capital compare to the Company’s**
16 **current authorized cost of capital?**

17 A. The proposed overall cost of capital is an increase of only six basis points
18 (0.06 percent) compared to the 7.74 percent currently reflected in rates and
19 adopted in Commission Order 07 in docket UE-111190. As I will discuss in more

1 detail later in this testimony, by maintaining its credit ratings and an actual equity
2 component in its capital structure exceeding 50 percent, the Company has been
3 able to continue to lower its cost of long-term debt and reduce costs to customers.
4 Absent this decrease in the long-term cost of debt, the proposed overall cost of
5 capital would be greater. This further demonstrates that the Company's capital
6 structure does benefit customers and provides an appropriate balance between
7 safety and economy.

8 **Q. How does the Company finance its regulated electric utility operations?**

9 A. The Company finances its regulated utility operations with a mix of debt and
10 common equity capital. During periods of significant capital expenditures such as
11 are currently occurring, the Company will need to maintain a common equity
12 component in excess of 50 percent of the capital structure in order to maintain its
13 credit rating and finance the debt component of the capital structure at the lowest
14 reasonable cost to customers. This provides more flexibility regarding the type
15 and timing of debt financing, better access to the capital markets, a more
16 competitive cost of debt and, over the long run, more stable credit ratings, all of
17 which assist in financing such expenditures.

18 In addition, all else being equal, the Company will need to have a greater
19 common equity component to offset various adjustments that rating agencies
20 make to the debt component of the Company's published financial statements.

21 I will discuss these adjustments in greater detail later in this testimony.

1 **Credit Ratings**

2 **Q. What are the Company's current credit ratings?**

3 A. The Company's current ratings are:

	Fitch	Moody's	Standard & Poor's
Senior Secured Debt	A-	A2	A
Senior Unsecured Debt	BBB+	Baa1	A-
Outlook	Stable	Stable	Stable

4 **Q. Why should this Commission be concerned about credit ratings and the**
5 **views expressed by rating agencies?**

6 A. Credit ratings and the views of rating agencies are important for several reasons.
7 First, the credit rating of a utility has a direct impact on the price that a utility pays
8 to attract the capital necessary to support its current and future operating needs.
9 Many institutional investors have fiduciary responsibilities to their clients and are
10 typically not permitted to purchase non-investment grade (*i.e.*, rated below BBB-)
11 securities or, in some cases, even securities rated below single A.

12 Second, credit ratings are an estimate of the probability of default by the
13 issuer on each rated security. Lower ratings equate to higher risks and higher
14 costs of debt. But even investment grade rated borrowers have experienced
15 problems accessing the capital markets or been shut out entirely. The financial
16 crisis of 2008 and 2009 provided clear and compelling evidence of the benefits of
17 the Company's credit rating as it was able to issue new long-term debt during the
18 midst of the financial turmoil. Other lower-rated utilities were simply shut out of
19 the market and could not obtain new capital regardless of how much they were
20 willing to pay.

1 Further, the Company has a near constant need for short-term liquidity, as
2 well as periodic long-term debt issuances. On a daily basis, the Company pays
3 significant amounts to suppliers to provide necessary goods and services, such as
4 fuel, spare parts, and inventory. Being unable to access funds can jeopardize the
5 successful completion of necessary capital infrastructure projects and would
6 increase the chance of outages and service failures over the long term.

7 **Q. Can regulatory actions or orders affect a company's credit rating?**

8 A. Yes, in a very significant way. Regulated utilities are fairly unique since they
9 cannot set their own prices for their services. The financial integrity of a
10 regulated utility is significantly impacted by how the utility is treated on cost
11 recovery issues and in the rates set by regulators. Rates are established by
12 regulators to permit the utility to recover prudently incurred operating expenses
13 and a reasonable opportunity to earn a fair return on the capital invested.
14 Therefore, rate decisions by utility commissions have a direct and significant
15 impact on the financial condition of utilities.

16 Rating agencies and investors have a keen understanding of the
17 importance of regulatory outcomes. For example, Standard & Poor's ("S&P")
18 writes:

19 The assessment of regulatory risk is perhaps the most important
20 factor in Standard & Poor's Ratings Services' analysis of a U.S.
21 regulated, investor-owned utility's business risk.¹

22 Similarly, Moody's has stated:

23 For a regulated utility, the predictability and supportiveness of the
24 regulatory framework in which it operates is a key credit

¹ Standard & Poor's Ratings Direct—Assessing U.S. Utility Regulation Environments (March 11, 2010).

1 consideration and the one that differentiates the industry from most
2 other corporate sectors. The most direct and obvious way that
3 regulation affects utility credit quality is through the establishment
4 of prices or rates for the electricity, gas and related services
5 provided (revenue requirements) and by determining a return on a
6 utility's investment, or shareholder return.²

7 **Q. How does maintaining the Company's current credit ratings benefit**
8 **customers?**

9 A. The Company is in the midst of a period of capital spending and investing in
10 infrastructure to provide for the needs of customers and to meet regulatory and
11 legislative mandates. If the Company does not have consistent access to the
12 capital markets at reasonable costs, these borrowings and the resulting costs of
13 building new facilities become more expensive than they otherwise would be.
14 The inability to access financial markets can threaten the completion of these
15 necessary projects, which will, in turn, affect system reliability and customer
16 safety. All of the resulting higher costs are ultimately borne by the customers.
17 Maintaining the current single-A credit rating for senior secured debt makes it
18 more likely the Company will have access to the capital markets at reasonable
19 costs, even during periods of financial turmoil. This rating will allow the
20 Company continued access to the capital markets, which will enable it to fulfill its
21 capital investments for the benefit of customers.

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

24 A. Yes. One example is the Company's ability to significantly reduce its cost of
25 long-term debt primarily through obtaining new financings at very attractive

² Moody's Investors Service Regulated Electric and Gas Utilities (August 2009).

1 interest rates. These lower debt costs benefit customers via lower overall rate of
2 return and lower revenue requirements.

3 The table below shows the reduction in the Company's cost of long-term
4 debt since March 2011.

	2013 GRC Proposed June 2013	UE-111190 Order March 2012	UE-100749 Order March 2011
Cost of Long-Term Debt	5.37%	5.76%	5.89%

5 Clearly, customers have benefitted from a 52 basis points (0.52 percent) reduction
6 in the Company's cost of long-term debt. Further, I understand the Company's
7 cost of long-term debt to be significantly lower than the other major Washington
8 investor-owned utilities.

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

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

16 In my opinion, maintaining the current single-A rating provides the best
17 balance between costs and the continued access to the capital markets that is
18 necessary to fund capital projects for the benefit of customers.

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

3 A. Yes. This capital structure is intended to enable the Company to deliver its
4 required capital expenditures and achieve financial metrics that will meet rating
5 agency expectations. S&P has stated very clearly its expectations for PacifiCorp:

6 The stable outlook on PacifiCorp reflects our expectation that
7 management will continue to focus on its core utility operations
8 and reach [constructive] regulatory outcomes to avoid any
9 meaningful business risk rise. The outlook also includes our
10 projection that cash flow measures will decrease as construction
11 project[s] move forward and bonus depreciation benefits decrease.
12 Our base forecast includes adjusted FFO to total debt of about
13 18%, adjusted debt to EBITDA of roughly 4x, and adjusted debt to
14 total capital hovering at 50%. These measures are consistent with
15 our expectations for the rating. We could lower ratings if financial
16 measures consistently underperform our base forecast and remain
17 at less credit-supportive levels.... We do not contemplate positive
18 rating actions because of near-term capital needs, but we could
19 raise ratings if financial measures strengthen and consistently
20 exceed our base forecast[.]³

21 **Q. Do the Company's credit ratings benefit because of MidAmerican Energy**
22 **Holdings Corporation (MEHC) and its parent Berkshire Hathaway?**

23 A. Yes. Although ring-fenced, historically the Company's credit ratios have been
24 weak for the ratings levels, and the Company has been able to sustain its ratings in
25 part through MEHC and its parent, Berkshire Hathaway. S&P was very clear on
26 this point in its recent assessment of PacifiCorp:

27 The company's significant financial profile is supported by modest
28 use of leverage to finance a large capital program and parent
29 MidAmerican Energy Holdings Co.'s willingness to deploy equity
30 into PacifiCorp as needed to support the company's capital
31 structure as it expands its rate base The cash credit metrics we

³ Standard & Poor's Ratings Direct (October 23, 2012), attached as Exhibit No.__(BNW-2).

1 expect the company to achieve after this year are just adequate, in
2 our view, to support the ratings, providing little cushion for the
3 company to deviate.⁴

* * *

4 PPW's ratings and outlook also reflect the benefits of affiliation
5 with ultimate corporate parent, Berkshire Hathaway (BRK)
6 Loss of the benefits of BRK ownership would have negative rating
7 implications.⁵

* * *

8 The rating also considers PacifiCorp's position as a subsidiary of
9 MEHC, a holding company whose subsidiaries are primarily
10 engaged in regulated activities, and the benefits from its affiliation
11 with BRK.⁶

12 Clearly, PacifiCorp and its customers have benefited from higher ratings
13 than the Company would otherwise likely have been awarded on a stand-alone
14 basis. Another important element supporting the Company's current ratings is the
15 rating agencies' expectations that PacifiCorp will receive supportive regulatory
16 treatment, including reasonable outcomes in rate proceedings and applications to
17 recover the full cost of large scale capital projects. Absent ownership by MEHC
18 and supportive regulatory treatment that permits a fair opportunity for the
19 Company to recover its reasonable and prudent costs—including a return on its
20 investment comparable to other similarly situated utilities—PacifiCorp's senior
21 secured and corporate credit ratings would have likely suffered a downgrade of at
22 least one rating level.

⁴ Standard & Poor's Ratings Direct (April 26, 2012), attached as Exhibit No.__(BNW-3).

⁵ FitchRatings (November 16, 2011), attached as Exhibit No.__(BNW-4).

⁶ Moody's Investors Service (May 8, 2012), attached as Exhibit No.__(BNW-5).

1 **Q. Do rating agencies share a view concerning the need for supportive rate case**
2 **outcomes?**

3 A. Yes, quite clearly. Fitch stated: “Timely recovery of large capital investment
4 program[s] in rates is crucial to PPW’s credit quality in Fitch’s view. The ratings
5 assume recovery of capital and operating costs in rates will support credit metrics
6 consistent with the company’s ‘BBB’ [issuer default rating] and Stable Outlook.”⁷

7 Fitch further stated:

8 Given the size of its planned capital investment, timely recovery of
9 capital and related operating and maintenance costs is crucial for
10 PPW’s creditworthiness. Therefore, currently unanticipated
11 adverse developments in PPW’s six regulatory jurisdictions,
12 leading to greater regulatory lag or lower recoveries, and resulting
13 weaker coverage ratios compared with Fitch’s projections could
14 lead to future deterioration in PPW’s creditworthiness and lower
15 credit ratings.⁸

16 Likewise, Moody’s lists “Reasonably supportive regulatory environment” as one
17 of the ratings drivers, stating: “The stable outlook incorporates Moody’s
18 expectation that PacifiCorp will continue to receive reasonable regulatory
19 treatment for the recovery of its higher capital expenditures[.]”⁹ Moody’s further
20 stated that one of the factors that could cause the rating to be lowered is “adverse
21 regulatory rulings on current and future rate cases such that we would anticipate a
22 sustained deterioration in financial metrics[.]”¹⁰ S&P stated that “supportive rate

⁷ FitchRatings (November 16, 2011), Exhibit No.____(BNW-4).

⁸ FitchRatings (January 6, 2011), attached as Exhibit No.____(BNW-6).

⁹ Moody’s Investors Service (May 9, 2011), attached as Exhibit No.____(BNW-7).

¹⁰ Moody’s Investors Service (May 8, 2012), Exhibit No.____(BNW-5).

1 case outcomes remain key to maintaining and improving upon the company's
2 financial performance.”¹¹

3 **Q. Have the rating agencies commented on the Company's lack of a Power Cost**
4 **Adjustment Mechanism (PCAM) in Washington?**

5 A. Yes, they are very aware of it and have noted it as a risk in their reports on the
6 Company. For example, recent reports include the following:

7 Fuel adjustment mechanisms exist for all states but Washington.¹²

* * *

8 Over the past two years, the Company has now been granted
9 energy cost adjustment mechanisms in all its jurisdictions except
10 Washington. Such mechanisms to recover fuel and purchased
11 power costs—a large, volatile expense—are more established in
12 other parts of the country.¹³

* * *

13 [PacifiCorp] has power cost adjustment mechanisms in place in
14 five of six states in its service territory.¹⁴

15 **Q. PacifiCorp currently has investment grade credit ratings. That seems**
16 **to suggest there is no need for Washington to adopt a PCAM. Does**
17 **the Company agree?**

18 A. No. As detailed in the testimony of Mr. Gregory N. Duvall, the
19 Company's net power costs (NPC) are large, volatile, and largely outside
20 the control of the Company. This volatility has resulted in significant
21 under-recovery of costs; for example, nearly \$55 million in NPC have not
22 been recovered in Washington since 2007. This under-recovery has

¹¹ Standard & Poor's Ratings Direct (April 28, 2011), attached as Exhibit No.__(BNW-8).

¹² Standard & Poor's Ratings Direct (October 23, 2012), Exhibit No.__(BNW-2).

¹³ Moody's Investor Service (May 8, 2012), Exhibit No.__(BNW-5).

¹⁴ FitchRatings (November 16, 2011), Exhibit No.__(BNW-4).

1 contributed to what is generally seen by rating agencies as historically
2 weak cash flow metrics that provide little cushion against negative
3 developments.

4 The adoption of the Company's proposed PCAM will help
5 stabilize the Company's earnings and cash flows while also reducing the
6 amount of imputed debt and interest expense. These will help maintain or
7 improve the Company's ability to finance its on-going capital investments
8 at low cost for safe and reliable service for Washington customers.

9 **Capital Structure**

10 **Q. How did the Company determine the capital structure proposed in this**
11 **proceeding?**

12 A. The Company used an average of the five-quarter ends spanning the 12 months
13 ending June 30, 2013, to calculate its proposed capital structure. This approach
14 smoothes volatility in the capital structure, which will fluctuate as the Company
15 expends capital, issues or retires debt, retains earnings, or declares dividends.
16 The Company calculated its capital structure in this case in the same manner as in
17 its last several Washington general rate cases. This method is also consistent
18 with the approach to capital structure advocated by Public Counsel in docket
19 UE-050684.

20 **Q. Why does your analysis of capital structure and costs of capital utilize the**
21 **period ending June 30, 2013?**

22 A. The test period in this proceeding is the 12 months ended June 30, 2012, with
23 known and measurable changes. Therefore, for the cost of capital determination,

1 the Company has used the actual capital structure at June 30, 2012, with pro
2 forma adjustments for known and measurable changes through June 30, 2013.
3 The known and measurable changes represent actual and forecasted capital
4 activity through June 30, 2013.

5 **Q. How does the Company determine the amount of common equity, debt, and**
6 **preferred stock to be included in its capital structure?**

7 A. As a regulated utility, PacifiCorp has a duty and an obligation to provide safe,
8 adequate, and reliable service to customers in its Washington service territory
9 while balancing cost and risk. Significant capital expenditures for system
10 reliability and infrastructure are required for the Company to fulfill this
11 obligation. Through its planning process, the Company determined the amounts
12 of new financing needed to support these activities and calculated the equity and
13 debt ratios required to maintain continued access to the financial markets.

14 **Q. More specifically, what financing activity does the Company anticipate**
15 **through the period ending June 30, 2013?**

16 A. During the period ending June 30, 2013, the Company anticipates: (1) issuance of
17 \$300 million of new long-term debt; (2) retirement of approximately \$62 million
18 of long-term debt at scheduled maturities; and (3) declaration and payment of
19 \$450 million of dividends to MEHC. All of these have been included in the
20 Company's proposed capital structure.

1 **Q. How does the Company’s proposed capital structure compare to recent**
 2 **actual capital structures and to the Commission’s ordered capital structure**
 3 **in the Company’s 2010 general rate case, docket UE-100749 (2010 Rate**
 4 **Case), in which capital structure was fully litigated?**

5 A. The capital structures are compared in the table below.

PacifiCorp’s Comparison of Capital Structures						
	2013 General Rate Case	Sept. 30, 2012 Actual	June 30,2012 Actual	Mar. 31, 2012 Actual	Dec. 31, 2011 Actual	UE-100749 Ordered Capital Structure (March 2011)
Long- Term Debt	47.2%	47.2%	47.5%	48.0%	45.8%	50.6%
Preferred Stock	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Common Equity	52.5%	52.5%	52.2%	51.7%	53.9%	49.1%
Totals	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

6 The proposed capital structure in the present case is in line with the Company’s
 7 recent actual capital structures. Further, the Company’s recent actual and
 8 proposed capital structures all contain a higher common equity component than
 9 the Commission ordered in the 2010 Rate Case.

10 In Order 06 in the 2010 Rate Case, the Commission noted a “remarkable
 11 level of growth” in the common equity component of the Company’s capital
 12 structure “in just three years.”¹⁵ As can be seen in the table above, the common
 13 equity component has been relatively stable and consistently in the 52 percent
 14 range. This should alleviate any Commission concern about whether the

¹⁵ *Wash. Utils. & Transp. Comm’n*, Docket No. UE-100749, Order 06 at ¶ 40 (March 25, 2011).

1 Company's proposed capital structure in the 2010 Rate Case was a reflection of a
2 temporary increase in the common equity component or whether significant
3 additional increases in the common equity component would occur in the near
4 future.

5 The proposed capital structure is quite similar to the Company's actual
6 capital structure for the past several years. The actual capital structure has
7 assisted the Company in maintaining its credit ratings and helped to reduce the
8 interest rate on new financings. This has resulted in a reduced cost of debt for the
9 benefit of customers.

10 **Q. How does the common equity component ordered by the Commission in the**
11 **2010 Rate Case compare to the common equity component authorized by**
12 **your other jurisdictions?**

13 A. It is significantly lower than any of the six state jurisdictions that PacifiCorp
14 serves, as shown in the table below.

	Washington UE-100749	California A.09-11-015	Idaho PAC-E-10-7	Oregon UE 246	Utah 11-035-200	Wyoming 20000-405- ER-11
Common Equity Component	49.1%	52.2%	52.1%	52.1%	52.1%	52.1%

15 **Q. If the Company actually maintained only 49.1 percent common equity in its**
16 **capital structure (as in the hypothetical structure adopted by the Washington**
17 **Commission), what would be the impact on the the cost of debt in the capital**
18 **structure?**

19 A. In my opinion, the cost of debt would be higher. It is unrealistic to assume that
20 one element of capital structure can materially change without impacting other

1 elements. With only 49 percent common equity in the capital structure, I believe
2 PacifiCorp's current investment grade credit rating would be lowered. As a
3 consequence, the cost of debt would be higher. A comparison of PacifiCorp to
4 other Washington utilities regulated by this Commission supports my belief.

5 **Q. Has short-term debt been included as part of the capital structure?**

6 A. No. The Company does not expect to have short-term debt at any of the quarter-
7 ends during the period ending June 30, 2013, nor in any significant amount at any
8 of the month-ends during this period.

9 **Q. Is the Company concerned about the fairness of including short-term debt in
10 the capital structure?**

11 A. Yes. The Company continues to believe that it is inappropriate and inequitable to
12 include short-term debt in the capital structure for PacifiCorp because short-term
13 debt would effectively be double-counted as financing both rate base and
14 construction work-in-progress. To remedy this inconsistency, PacifiCorp would
15 need to deviate from the method prescribed by the Federal Energy Regulatory
16 Commission that includes short-term debt in the measurement of the allowance
17 for funds used during construction (AFUDC). Unfortunately, this is not a
18 practical solution because none of PacifiCorp's other states include short-term
19 debt in the capital structure. PacifiCorp would need to maintain two set of
20 property records, tax records, and AFUDC computations to comply with these
21 divergent approaches.

22 Further, short-term balances can vary dramatically. The Company often
23 has periods of time when there is no short-term debt outstanding. For example,

1 PacifiCorp has had no short-term debt outstanding at month end since February,
2 2012. The fact that there are periods of time with no short-term debt
3 demonstrates that short-term debt is not a permanent source of financing rate
4 base. The Company will continue to evaluate this treatment of short-term debt
5 and may request the Commission to reconsider it in future cases.

6 **Historical Adjustments to Capital Structure**

7 **Q. Did other parties propose adjustments to the Company's actual capital**
8 **structure in the 2010 Rate Case?**

9 A. Yes. Staff and the Industrial Customers of Northwest Utilities (ICNU) each
10 proposed a series of separate adjustments that would have reduced the Company's
11 common equity component.

12 **Q. Did the Commission address Staff's adjustments in its order in the 2010 Rate**
13 **Case?**

14 A. Yes, the order states, "[w]e are not persuaded, in this case, by Staff's arguments to
15 impute short-term debt in the Company's hypothetical capital structure." The
16 Commission further stated that they were not persuaded that the Company's
17 "actual capital structure contains such short-term debt." In this case, the
18 Company's actual capital structure also does not contain short-term debt.

19 **Q. What is the Company's assessment of ICNU's proposed adjustments in the**
20 **2010 Rate Case?**

21 A. ICNU's adjustments were inappropriate, were not founded on facts, and do not
22 reflect other offsetting adjustments that would need to be made. For example, one
23 of ICNU's most significant adjustments was to exclude the acquisition

1 adjustments related to the Craig and Wyodak generating plants due to the West
2 Control Area inter-jurisdictional allocation methodology. However, ICNU did
3 not remove from the cost of debt the low cost pollution control revenue bond
4 financings that are associated with these plants. Removal of these financings
5 would have produced a higher cost of debt since these bonds are among the
6 Company's lowest cost financings.

7 **Q. Have you estimated the resulting impact on the Company's current cost of**
8 **debt if this corresponding adjustment were made?**

9 A. Yes. Removal of the financings directly associated with the Craig, Wyodak, and
10 other non-west-control-area plants would increase the Company's cost of debt by
11 17 basis points (0.17 percent) to 5.54 percent. The pro forma impact could be
12 more significant depending on what alternative financing arrangements are
13 assumed.

14 **Q. Is the Company proposing this as the cost of debt?**

15 A. No, not at this time. However, the Company will reconsider its position if parties
16 propose adjustments to capital structure that do not include necessary
17 corresponding adjustments.

18 **Financing Overview**

19 **Q. Please explain the Company's capital needs.**

20 A. The Company continues to have ongoing investment in generation, transmission
21 and distribution infrastructure. These and future capital additions and investments
22 will require the Company to raise funds by issuing significant amounts of new
23 long-term debt in the capital markets. To help obtain this new debt financing at

1 attractive rates, the Company is maintaining a balanced capital structure intended
2 to support current credit ratings. These actions help to ensure that PacifiCorp
3 remains well positioned to finance the additional investments that have been and
4 will continue to be made in the system at reasonable costs to customers.

5 **Q. What type of debt and preferred equity securities does the Company employ**
6 **in meeting its financing requirements?**

7 A. The Company relies on a mix of first mortgage bonds, other secured debt, tax-
8 exempt debt, unsecured debt, and preferred stock to meet its long-term financing
9 requirements. These securities employ various maturities to provide flexibility
10 and mitigate refinancing risks.

11 The Company has completed the majority of its long-term financing
12 utilizing secured first mortgage bonds issued under the Mortgage Indenture dated
13 January 9, 1989. Exhibit No.__(BNW-9) shows that, at June 30, 2013, the
14 Company is projected to have approximately \$6.5 billion of first mortgage bonds
15 outstanding, with an average cost of 5.69 percent. Presently, all outstanding first
16 mortgage bonds bear interest at fixed rates. Proceeds from the issuance of the
17 first mortgage bonds (and other financing instruments) are used to finance the
18 combined utility operation.

19 Another important source of financing has been the tax-exempt financing
20 associated with certain qualifying equipment at power generation plants. Under
21 arrangements with local counties and other tax-exempt entities, the Company
22 borrows the proceeds and guarantees the repayment of the long-term debt to
23 take advantage of the tax-exempt status of the other entities in financings. As of

1 June 30, 2013, the Company's tax-exempt portfolio is projected to be
2 \$614 million in principal amount, with an average cost of 2.05 percent (including
3 the cost of issuance and credit enhancement).

4 **Q. In the past, the Company retained all of its earnings to help finance capital
5 investments. Has the Company recently paid dividends to MEHC?**

6 A. Yes. Since the acquisition in 2006 by MEHC, the Company managed the capital
7 structure through the timing and amount of long-term debt issuances and capital
8 contributions, while forgoing any common dividends for nearly five years.

9 More recently, the Company has initiated the payment of dividends to
10 MEHC to maintain the common equity percentage in its capital structure below
11 53 percent and expects periodic dividend payments for the foreseeable future.
12 The proposed capital structure in this case includes the impact of dividends
13 expected to be declared through the end of June 30, 2013. In fact, absent these
14 dividends, the Company's capital structure would contain a higher level of
15 common equity than the Company is proposing.

16 **Power Purchase Agreements**

17 **Q. Is the Company subject to rating agency debt imputation associated with
18 power purchase agreements?**

19 A. Yes. Rating agencies and financial analysts consider power purchase agreements
20 (PPAs) to be debt-like and will impute debt and related interest when calculating
21 financial ratios. For example, S&P will adjust the Company's published financial
22 results and impute debt balances and interest expense resulting from PPAs when
23 assessing creditworthiness. It does so in order to obtain a more accurate

1 assessment of a company's financial commitments and fixed payments. Exhibit
2 No.__(BNW-10) is the May 7, 2007 publication by S&P detailing its view of the
3 debt aspects of PPAs.

4 **Q. How does this affect the Company?**

5 A. In their Ratings Direct analysis of June 30, 2012 financial results, S&P included
6 approximately \$229 million of additional debt and related interest expense in the
7 Company's debt and coverage tests solely as a result of PPAs. There were also
8 other adjustments made by S&P that resulted in an imputation into PacifiCorp's
9 credit ratios of approximately \$850 million of debt and \$19 million of interest in
10 total. These adjustments are detailed in Exhibit No.__(BNW-11).

11 **Q. How would the inclusion of this PPA-related debt and these other**
12 **adjustments affect the Company's capital structure as S&P reviews credit**
13 **metrics?**

14 A. Negatively. By including the imputed debt resulting from PPAs and these other
15 adjustments, the Company's capital structure has a lower equity component as a
16 corollary to the higher debt component, lower coverage ratios, and reduced
17 financial flexibility than what might otherwise appear to be the case from a
18 review of the book value capital structure. For example, if one were to add the
19 \$850 million of debt adjustments that S&P makes to the Company's capital
20 structure in this case, the resulting common equity percentage would decline from
21 52.5 percent to 49.6 percent. The table below shows the proposed capital
22 structure and how the S&P adjustments affect the components.

Illustration of Rating Agency Adjustments to PacifiCorp's Capital Structure (\$ in millions)			
	Book Values/Ratios	Rating Agency Adjustments	Adjusted Book Values/Ratios
Long-Term Debt	\$6,872/47.2%	\$849	\$7,721/50.2%
Preferred Stock	\$41/0.3%	(20)	\$21/0.1%
Common Equity	\$7,644/52.5%	0	\$7,644/49.7%
Totals	\$14,557/100.0%	\$829	\$15,386/100.0%

1 **Financing Cost Calculations**

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

4 A. I calculated the embedded costs of debt and preferred stock using the
5 methodology relied upon in the Company's previous rate cases in Washington
6 and other jurisdictions. These calculations are described in greater detail below.

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

8 A. The cost of long-term debt is 5.37 percent at June 30, 2013, as shown in Exhibit
9 No.__(BNW-9).

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

11 A. I calculated the cost of debt by issue, based on each debt series' interest rate and
12 net proceeds at the issuance date, to produce a bond yield to maturity for each
13 series of debt. If a bond was issued to refinance a higher cost bond, the pre-tax
14 premium and unamortized costs, if any, associated with the refinancing were
15 subtracted from the net proceeds of the bonds that were issued. The bond yield
16 was then multiplied by the principal amount outstanding of each debt issue,
17 resulting in an annualized cost of each debt issue. Aggregating the annual cost of
18 each debt issue produces the total annualized cost of debt. Dividing the total

1 annualized cost of debt by the total principal amount of debt outstanding produces
2 the weighted average cost for all debt issues. The result is the Company's cost of
3 long-term of 5.37 percent.

4 **Q. Regarding the \$300 million of new long-term issuances mentioned above,**
5 **how did you determine the interest rate for the new long long-term debt?**

6 A. I projected that this new long-term debt would be issued at the Company's
7 estimated recent credit spread over the projected long-term Treasury rates as of
8 June 2013. Further, I added expected issuance costs to calculate the all-in rate for
9 this new long-term debt.

10 **Q. What is the resulting cost for this new long-term debt?**

11 A. The Company's current estimated credit spread for 30-year debt is 0.90 percent.
12 The recent forward long-term Treasury rate for June 2013 is approximately
13 3.08 percent. Issuance costs for this maturity and type of debt add approximately
14 six basis points (0.06 percent) to the all-in cost. Therefore, the projected cost of
15 the long-term debt is:

	June 2013 Issuance
Forward Treasury Rate	3.08%
Credit Spread	0.90%
Issuance Costs	0.06%
All-in Cost	4.04%

16 **Q. A portion of the securities in the Company's debt portfolio bears variable**
17 **rates. What is the basis for the projected interest rates used by the**
18 **Company?**

19 A. The Company's variable rate long-term debt in this case is in the form of tax-
20 exempt debt. Exhibit No.__(BNW-12) shows that, on average, these securities

1 had been trading at approximately 92 percent of the 30-day London Inter Bank
2 Offer Rate (“LIBOR”) for the period January 2000 through September 2012.
3 Therefore, the Company has applied a factor of 92 percent to the forward 30-day
4 LIBOR rates at June 30, 2013, and then added the respective credit enhancement
5 and remarketing fees for each floating rate tax-exempt bond. Credit enhancement
6 and remarketing fees are included in the interest component because these are
7 costs that contribute directly to the interest rate on the securities and are charged
8 to interest expense. This method is consistent with the Company’s past practice
9 when determining the cost of debt in previous Washington general rate cases and
10 in the Company’s other jurisdictions.

11 **Q. What is the Company’s embedded cost of preferred stock?**

12 A. Exhibit No.____(BNW-13) shows the embedded cost of preferred stock at June 30,
13 2013, to be 5.43 percent.

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

15 A. The embedded cost of preferred stock was calculated by first determining the cost
16 of money for each issue. This is the result of dividing the annual dividend rate by
17 the per share net proceeds for each series of preferred stock. The cost associated
18 with each series was then multiplied by the total par or stated value outstanding
19 for each issue to yield the annualized cost for each issue. The sum of annualized
20 costs for each issue produces the total annual cost for the entire preferred stock
21 portfolio. The total annual cost is then divided by the total amount of preferred
22 stock outstanding to produce the weighted average cost for all issues. The result
23 is the Company’s embedded cost of preferred stock of 5.43 percent.

1 Q. Does this conclude your direct testimony?

2 A. Yes.