

Exh. NLK-1T
Docket UE-19____
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-19____

PACIFICORP

DIRECT TESTIMONY OF NIKKI L. KOBLIHA

December 2019

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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

Confidential Exhibit No. NLK-5C—S&P Ratings Direct November 19, 2013

Exhibit No. NLK-6—Variable Rate PCR, Pollution Control Revenue Bond

Exhibit No. NLK-7—Cost of Preferred Stock

1 **Q. Please state your name, business address, and present position with PacifiCorp.**

2 A. My name is Nikki L. Kobliha and my business address is 825 NE Multnomah Street,
3 Suite 1900, Portland, Oregon 97232. I am currently employed as Vice President,
4 Chief Financial Officer and Treasurer for PacifiCorp. I am testifying for PacifiCorp
5 dba Pacific Power & Light Company (PacifiCorp or the Company).

6 **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
11 responsibility before being appointed Chief Financial Officer in 2015. I am
12 responsible for all aspects of PacifiCorp's finance, accounting, income tax, internal
13 audit, Securities and Exchange reporting, treasury, credit risk management, pension,
14 and other investment management activities.

15 **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 52.55 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
 3 necessary to enable the Company’s continued investment in infrastructure to provide
 4 safe and reliable service from clean energy resources at reasonable costs. In addition,
 5 I support PacifiCorp’s proposed cost of long-term debt of 4.92 percent and cost of
 6 preferred stock of 6.75 percent.

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

8 A. The rate effective date proposed in this proceeding is January 1, 2021. Consistent
 9 with the methodology PacifiCorp has relied upon for several general rate cases in
 10 Washington and other jurisdictions, I determined the capital structure, costs of long-
 11 term debt, and costs of preferred stock using an average of the five quarter-ending
 12 balances for the twelve months ending December 31, 2020, based on known and
 13 measurable changes from September 30, 2019.

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

15 A. PacifiCorp is proposing an overall cost of capital of 7.69 percent. This cost includes
 16 the return on equity recommendation of 10.2 percent as discussed in the direct
 17 testimony of Ms. Ann E. Bulkley (Exhibit No. AEB-1T) and the capital structure and
 18 costs set forth in Table 1.

Table 1: Overall Cost of Capital

Component	\$m	% of Total	Cost %	Weighted Ave Cost %
Long-Term Debt	\$ 8,038	47.44%	4.92%	2.33%
Preferred Stock	\$ 2	0.01%	6.75%	0.00%
Common Stock Equity	\$ 8,904	52.55%	10.20%	5.36%
	\$ 16,944	100.00%		7.69%

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

¹ *WUTC v. Pac. Power & Light Co., a Division of PacifiCorp*, Docket 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 UE-140762, Order No. 08 ¶¶180, 183 (Mar. 25, 2015) (same).

² Senate Bill 5116, 66th Leg., 2019 Reg. Sess. (Wa. 2019).

1 **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 Through its Energy Vision 2020 project, PacifiCorp is in the process of
7 repowering its wind generation fleet, and significantly increasing its wind generation
8 and transmission capacity. PacifiCorp expects to spend approximately \$3.6 billion
9 for investments in renewable energy projects and related transmission through
10 calendar year end 2020. This capital spending will require PacifiCorp to raise funds
11 by issuing new long-term debt in the capital markets, retaining earnings, and if
12 needed, obtaining new capital contributions from its parent company, Berkshire
13 Hathaway Energy Company (BHE). This increase in wind generation and
14 transmission capacity will allow PacifiCorp to meet requirements in CETA, which
15 requires coal-fired resources out of customer rates by December 31, 2025, retail sales
16 of electricity to be greenhouse gas neutral by January 1, 2030, and 100 percent of
17 retail sales of electricity to be from non-emitting sources by January 1, 2045.

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

19 A. Generally, PacifiCorp finances its regulated utility operations using a mix of debt and
20 common equity capital of approximately 48/52 percent, respectively. This provides
21 more flexibility on the type and timing of debt financing, better access to capital
22 markets, a more competitive cost of debt, and over the long-run, more stable credit
23 ratings. All of these factors assist in financing expenditures like PacifiCorp’s Energy

1 Vision 2020 project. In addition, PacifiCorp needs a greater common equity
2 component to offset various adjustments that rating agencies make to the debt
3 component of the Company's published financial statements and to mitigate the
4 impact the Tax Cut and Jobs Acts (TCJA) has had on the Company's credit metrics.
5 I discuss these adjustments in greater detail later in this testimony.

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

8 A. As a regulated public utility, PacifiCorp has a duty and an obligation to provide safe,
9 adequate, and reliable service to customers in its Washington service area while
10 prudently balancing cost and risk. Major capital expenditures are required in the
11 near-term for new plant investment to fulfill its service obligation, including capital
12 expenditures for repowering wind projects, new wind and new transmission. These
13 capital investments also have associated operations and maintenance costs.
14 PacifiCorp reviews all of its estimated cash inflows and outflows to determine the
15 amount, timing, and type of new financing required to support these activities and
16 provide for financial results and credit ratings that balance the cost of capital with
17 continued access to the financial markets.

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

19 A. PacifiCorp benefits from its affiliation with BHE as there is no dividend requirement.
20 Historically, PacifiCorp has paid dividends to BHE to manage the common equity
21 component of the capital structure and keep the Company's overall cost of capital at a
22 prudent level. In major capital investment periods, PacifiCorp is able to retain
23 earnings to help finance capital investments and forego paying dividends to BHE.

1 For example, following BHE's acquisition of PacifiCorp in 2006, PacifiCorp
2 managed the capital structure through the timing and amount of long-term debt
3 issuances and capital contributions, while forgoing any common dividends for nearly
4 five years. At other times, absent the payment of dividends, retention of earnings
5 could cause the percentage of common equity to grow beyond the level necessary to
6 support the current credit ratings. Accordingly, dividend payments can be necessary,
7 in combination with debt issuances, to maintain the appropriate percentage of equity
8 in PacifiCorp's capital structure. With the increased capital investment required for
9 the Energy Vision 2020 project and other capital expenditures, however, the proposed
10 capital structure in this case anticipates no additional common dividend payments by
11 PacifiCorp to BHE through calendar year 2020.

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

13 A. PacifiCorp has completed the majority of its recent long-term financing using secured
14 first mortgage bonds issued under the Mortgage Indenture dated January 9, 1989.
15 Exhibit No. NLK-2, Cost of Long-Term Debt, shows that, over the test period,
16 PacifiCorp is projected to have an average of approximately \$7.8 billion of first
17 mortgage bonds outstanding, with an average cost of 5.0 percent. Presently, all
18 outstanding first mortgage bonds bear interest at fixed rates. Proceeds from the
19 issuance of the first mortgage bonds (and other financing instruments) are used to
20 finance the utility operation.

21 Another important source of financing in the past has been the tax-exempt
22 financing associated with certain qualifying equipment at power generation plants.
23 Under arrangements with local counties and other tax-exempt entities, these entities

1 issue securities, PacifiCorp borrows the proceeds of these issuances and pledges its
2 credit quality to repay the debt to take advantage of the tax-exempt status of the
3 financing. During the 12 months ending December 31, 2020, PacifiCorp's tax-
4 exempt portfolio is projected to average approximately \$249 million, with an average
5 cost of 1.9 percent, including the cost of issuance and remarketing.

6 **Credit Ratings**

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

8 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

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

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

18 Second, credit ratings are an estimate of the probability of default by the
19 issuer on each rated security. Lower ratings equate to higher risks and higher costs of
20 debt. The Great Recession of 2008-2009 provides a clear and compelling example of

1 the benefits of the Company's credit rating because PacifiCorp was able to issue new
2 long-term debt during the midst of the financial turmoil. Other lower-rated utilities
3 were shut out of the market and could not obtain new capital.

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

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

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

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

19 Further, those issuers who could access the markets paid rates well above the
20 levels that PacifiCorp was able to obtain. For example, PacifiCorp issued new
21 10-year and 30-year long-term debt in January 2009 with 5.50 percent and 6.00
22 percent coupon rates, respectively. Subsequently, Puget Sound Energy (rated

1 Baa2/A- at that time) issued new seven-year debt at a credit spread over Treasuries of
2 480.3 basis points resulting in a 6.75 percent coupon.

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

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

10 Rating agencies and investors have a keen understanding of the importance of
11 regulatory outcomes. For example, Standard & Poor's (S&P) has opined on the
12 correlation between regulatory outcomes and credit ratings, concluding:

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

26 Similarly, Moody's recently issued a credit opinion for PacifiCorp,
27 concluding:

28 The stable outlook incorporates our expectation that PacifiCorp will
29 continue to receive reasonable regulatory treatment....The ratings
30 could be downgraded if...adverse regulatory rulings lower its credit
31 metrics....PacifiCorp's rating recognizes the rate-regulated nature of its
32 electric utility operations which generate stable and predictable cash

1 flows. PacifiCorp operates in regulatory jurisdictions that are
2 reasonably supportive in terms of rate decisions and cost recovery.
3 The ability to use a forward test year in its rate requests helps to limit
4 regulatory lag in Utah, Oregon, Wyoming, and California. The
5 company benefits from energy cost adjustment mechanisms in all its
6 jurisdictions, but in most, some lag remains in recovering portions of
7 the energy costs. Moody's Credit Opinion of PacifiCorp (April 7,
8 2017).

9 As discussed in the testimony of Ms. Bulkley, the regulatory environment and
10 the rate decisions by utility commissions have a direct and significant impact on the
11 financial condition of utilities.

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

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

1 **Q. Can you provide an example of how the current ratings have benefitted**
2 **customers?**

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

7 To determine the savings realized from maintaining a higher credit rating, in
8 Exhibit No. NLK-4, I compared the actual effective interest rate on the Company's
9 currently outstanding long-term debt issued since its acquisition by BHE in 2006,
10 comprising 15 series of debt, to what the effective interest rate would have been with
11 a BBB credit rating. The issuance spread of each issuance was changed to match
12 what a BBB rated utility achieved at about the same point in time that PacifiCorp
13 issued the debt. The result is that on the 15 series of debt averaging \$6.2 billion over
14 the test period, the effective interest rate would have been approximately 5.30 percent
15 or 56 basis points higher than the actual effective interest rate. Combined with the
16 existing pre-acquisition debt and projected new debt issuances, the resulting overall
17 cost of long-term debt would increase to 5.35 percent if the Company had a BBB
18 rating. PacifiCorp is currently projecting an overall cost of long-term debt of 4.92
19 percent, or 43 basis points lower than it might have otherwise been under the scenario
20 I described above.

21 Table 3 below shows the reduction in the Company's cost of long-term debt
22 since 2011.

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

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

1 PacifiCorp's customers have benefited from a 97 basis points reduction in the
2 Company's cost of long-term debt. The Company estimates that this reduction in the
3 average cost of debt since 2011 results in a decrease of approximately \$6.3 million in
4 the revenue requirement in the current case. Customers have also benefited from the
5 Company's ability to negotiate lower underwriting fees on long-term debt issuances
6 through BHE's global underwriting fee position.

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

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

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

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

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

1 expectations. Moody's stated its expectations and factors that could lead to a
2 downgrade for PacifiCorp in their June 22, 2018 Credit Opinion of PacifiCorp:

3 The ratings could be downgraded if PacifiCorp's capital expenditures
4 are funded in a manner inconsistent with its current financial profile,
5 or if adverse regulatory rulings lower its credit metrics, as
6 demonstrated for example, by a ratio of CFO pre-WC/Debt sustained
7 below 20 percent.

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

10 A. Yes. Although ring-fenced, PacifiCorp's credit ratios have been weak for the ratings
11 level. PacifiCorp has been able to sustain its ratings in part through the acquisition by
12 BHE and its parent, Berkshire Hathaway Inc. (BRK) S&P was very clear on this point
13 in its June 27, 2016 assessment of PacifiCorp:

14 The stable rating outlook on PacifiCorp is based on that of parent
15 Berkshire Hathaway Energy Co. (BHE). This reflects our expectation
16 that its relationship to its parent does not change and that management
17 will continue to focus on its core utility operations and reach
18 constructive regulatory outcomes that support the existing business
19 risk. Although BHE has used significant debt leverage for acquisitions
20 and capital investments, we expect credit measures to strengthen to
21 support the current rating. Under our base-case forecast, we expect
22 adjusted funds from operations (FFO) to debt to range from 15% to
23 16% over the next few years.

24 Moody's states in their April 7, 2017 credit opinion of PacifiCorp:

25 PacifiCorp benefits from its affiliation with BRK, which requires no
26 regular dividends from PacifiCorp or BHE. From a credit perspective,
27 the company's ability to retain its earnings as an entity that is privately
28 held, particularly by a deep-pocketed sponsor like BRK, is an
29 advantage over most other investor owned utilities that are typically
30 held to a regular dividend to their shareholders. As an example,
31 PacifiCorp did not pay dividends for the first five years after being
32 acquired by BHE in 2006, and during that time received equity
33 contributions totaling \$1.1 billion from BHE to help PacifiCorp
34 finance its capital expenditures. Its balance sheet has strengthened
35 from this financial policy, and PacifiCorp now pays dividends that are
36 sized to manage PacifiCorp's equity ratio (as measured by unadjusted

1 equity to equity plus debt) around its allowed levels of about 50%
2 (regulations restrict dividends if this ratio falls below 44%).
3 Furthermore, BHE has placed PacifiCorp in a ring-fencing structure
4 that restricts dividends if PacifiCorp's ratings fall to non-investment
5 grade.

6 These examples are evidence of the credit rating benefit resulting from BHE's
7 ownership of PacifiCorp.

8 **Q. How does the TCJA impact PacifiCorp's credit rating?**

9 A. The three main rating agencies have issued reports on the impact of tax reform on
10 U.S. utilities and their holding companies and believe that tax reform will be
11 unfavorable to utilities in the near term but with regulatory support for a stronger
12 capital structure, highly rated utilities may retain positive credit ratings. For example,
13 S&P determined:

14 The impact could be sharpened or softened by regulators depending on
15 how much they want to lower utility rates immediately instead of
16 using some of the lower revenue requirement from tax reform to allow
17 the utility to retain the cash for infrastructure investment or other
18 expenses. Regulators must also recognize that tax reform is a strain on
19 utility credit quality, and we expect companies to request stronger
20 capital structures and other means to offset some of the negative
21 impact. S&P Ratings Direct - U.S. Tax Reform: For Utilities' Credit
22 Quality, Challenges Abound (January 24, 2018).

23 The Company has passed through partial benefits related to tax reform and is
24 planning to pass through all of the remaining benefits in its jurisdictions, thus the
25 negative impact to the Company's key credit metric (Moody's CFO pre-WC/Debt)
26 has not yet been fully realized. Absent regulatory support for a stronger capital
27 structure, however, the Company's cash from operations will likely fall below levels
28 where it can maintain the minimum 20 percent expectation for this credit metric,
29 which could increase the likelihood of a downgrade.

30 Moody's states in their January 24, 2018 Sector Comment on Tax Reform:

1 Tax reform mainly affects companies that already had limited cushion
2 in their credit profile. The tax reform usually resulted in a further 150-
3 250 bps drop in CFO pre-WC/debt.

4 Moody's expects that most utilities will attempt to manage any
5 negative financial implications of tax reform through regulatory
6 channels. Corporate financial policies could also change. The actions
7 taken by utilities will be incorporated into our credit analysis on a
8 prospective basis. It is conceivable that some companies will
9 sufficiently defend their credit profiles.

10 In practice, we believe that most companies will actively manage their
11 cash flow to debt ratios by issuing more equity or obtaining relief by
12 working through regulatory channels.

13 **Rating Agency Debt Imputations**

14 **Q. Is PacifiCorp subject to rating agency debt imputation associated with Purchase**
15 **Power Agreements?**

16 A. Yes. Rating agencies and financial analysts consider Purchase Power Agreements
17 (PPAs) to be debt-like and will impute debt and related interest when calculating
18 financial ratios. For example, S&P will adjust PacifiCorp's published financial
19 results and impute debt balances and interest expense resulting from PPAs when
20 assessing creditworthiness. They do so to obtain a more accurate assessment of a
21 Company's financial commitments and fixed payments. S&P Ratings Direct
22 November 19, 2013, details its view of the debt aspects of PPAs and other debt
23 imputations, and is included as Confidential Exhibit No. NLK-5C.

1 **Q. How does this impact PacifiCorp?**

2 A. In its most recent evaluation of PacifiCorp, S&P added approximately \$479 million of
3 additional debt and \$21 million of related interest expense to the Company's debt and
4 coverage tests for PPAs and other liabilities of the Company that are considered to be
5 debt-like by S&P.

6 **Q. How does inclusion of the PPA-related debt and these other adjustments affect
7 PacifiCorp's capital structure as S&P reviews your credit metrics?**

8 A. Negatively. By including the imputed debt resulting from PPAs and these other
9 adjustments, PacifiCorp's capital structure has a lower equity component as a
10 corollary to the higher debt component, lower coverage ratios, and reduced financial
11 flexibility than what might otherwise appear to be the case from a review of the book
12 value capital structure. For example, as shown in Table 4, if one were to apply the
13 total \$479 million amount of debt adjustments that S&P most recently made to
14 PacifiCorp's proposed capital structure in this case, the resulting common equity
15 percentage would decline from 52.55 percent to 51.1 percent. The corresponding
16 higher average adjusted debt to total capitalization percentage of 48.9 percent over
17 the test period reflects an adjusted capital structure that approaches the 48/52 percent
18 mix of debt and common equity capital that PacifiCorp targets than otherwise would
19 be the case.

Table 4: Rating Agency Adjusted Capital

	Proposed Cap Structure		Rating Agency Adjmts	Adjusted Cap Structure	
	Book Values	% of Total		Book Values	% of Total
Long-Term Debt	\$ 8,038	47.44%	\$ 479	\$ 8,517	48.89%
Preferred Stock	2	0.01%	(1)	1	0.00%
Common Equity	8,904	52.55%	-	8,904	51.11%
	\$ 16,944	100.00%	\$ 478	\$ 17,422	100.00%

1

CAPITAL STRUCTURE DETERMINATION

2

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

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A. The rate effective date proposed in this case is January 1, 2021. The capital structure is based on the actual capital structure at September 30, 2019, and forecasted capital activity, including known and measurable changes, through December 31, 2020.

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PacifiCorp has averaged the five quarter-end capital structures measured beginning at December 31, 2019, and concluding with December 31, 2020. The capital activity includes known maturities of certain debt issues that were outstanding at September 30, 2019, subsequent issuances of long-term debt and any capital contributions received or dividends paid. The known and measurable changes represent actual and forecasted capital activity since September 30, 2019.

12

Q. Why does your analysis of capital structure and costs of capital use average period capital balances for the 12-month period ending December 31, 2020?

13

14

A. This approach smooths volatility in the capital structure, which will fluctuate as the Company expends capital, issues or retires debt, retains earnings, or declares dividends. This is consistent with the way the Company calculated its capital structure in its last several Washington general rate cases. This method is also

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1 consistent with the approach to capital structure advocated by the Public Counsel Unit
 2 of the Washington Attorney General’s Office in docket UE-050684.

3 **Q. How does the Company’s proposed capital structure compare to recent actual**
 4 **capital structures and to the capital structure authorized in the 2015 limited-**
 5 **issue rate case, docket UE-152253 (2015 Rate Case)?**

6 A. The capital structures are compared in Table 5 below.

Table 5: Forecast and Actual Capital Structures

PacifiCorp's Comparison of % Capital Structures						
	Dec 31, 2020 Forecast w/o ST debt*	Dec 31, 2020 Forecast w/ ST debt*	Dec 31, 2019 Actual/ Forecast*	Dec 31, 2018 Actual*	Dec 31, 2017 Actual*	UE-15223 Authorized Capital Structure
Short-Term Debt		0.49%	0.04%	0.46%	0.49%	0.19%
Long-Term Debt	47.44%	47.21%	48.32%	47.67%	48.25%	50.69%
Preferred Stock	0.01%	0.01%	0.02%	0.02%	0.02%	0.02%
Common Equity	52.55%	52.29%	51.62%	51.85%	51.24%	49.10%
Totals	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

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

7 The proposed capital structure in the present case is in line with the
 8 Company’s recent actual capital structures. The increase in capital structure from the
 9 forecast December 31, 2019 five quarter average to the 2020 forecast five quarter
 10 average is due to earnings offset by debt issuances and the forgoing of any dividends
 11 in 2020. Further, the Company’s recent actual and proposed capital structures all
 12 contain a higher common equity component than the Commission ordered in the 2015
 13 Rate Case.

14 The proposed capital structure is similar to PacifiCorp’s actual capital
 15 structure for the past several years. The actual capital structure has assisted the
 16 Company in maintaining its credit ratings and helped to reduce the interest rate on

1 new financings. This has resulted in a reduced cost of debt for the benefit of
2 customers.

3 FINANCING COST CALCULATIONS

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

6 A. I calculated the embedded costs of debt and preferred stock using the methodology
7 relied upon in the 2015 Rate Case and the Company's general rate cases in other
8 jurisdictions.

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

10 A. I calculated the cost of debt by issue, based on each debt series' interest rate and net
11 proceeds at the issuance date, to produce a bond yield to maturity for each series of
12 debt. It should be noted that in the event a bond was issued to refinance a higher cost
13 bond, the pre-tax premium and unamortized costs, if any, associated with the
14 refinancing were subtracted from the net proceeds of the bonds that were issued.
15 Each bond yield was then multiplied by the principal amount outstanding of each debt
16 issue, resulting in an annualized cost of each debt issue. Aggregating the annual cost
17 of each debt issue produces the total annualized cost of debt. Dividing the total
18 annualized cost of debt by the total principal amount of debt outstanding produces the
19 weighted average cost for all debt issues. This is PacifiCorp's embedded cost of
20 long-term debt.

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

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

3 A. The Company's variable rate long-term debt in this case is in the form of tax-exempt
4 debt. Exhibit No. NLK-6, Variable Rate PCRB, Pollution Control Revenue Bond
5 shows that, on average, these securities have been trading at approximately 84 percent
6 of the 30-day London Inter Bank Offer Rate (LIBOR) for the period January 2000
7 through September 2019. Therefore, the Company has applied a factor of 84 percent
8 to the forward 30-day LIBOR rates at each future quarter-end spanning the test period
9 and then added the respective credit facility and remarketing fees for each floating
10 rate tax-exempt bond. Credit facility and remarketing fees are included in the interest
11 component because these are costs that contribute directly to the interest rate on the
12 securities and are charged to interest expense. This method is consistent with the
13 Company's past practices when determining the cost of debt in previous Washington
14 general rate cases as well as the other states that regulate PacifiCorp.

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

16 A. The embedded cost of preferred stock was calculated by first determining the cost of
17 money for each issue. I begin by dividing the annual dividend per share by the per
18 share net proceeds for each series of preferred stock. The resulting cost rate
19 associated with each series was then multiplied by the total par or stated value
20 outstanding for each issue to yield the annualized cost for each issue. The sum of
21 annualized costs for each issue produces the total annual cost for the entire preferred
22 stock portfolio. I then divided the total annual cost by the total amount of preferred

1 stock outstanding to produce the weighted average cost for all issues. The result is
2 PacifiCorp's embedded cost of preferred stock.

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

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

5 A. The cost of long-term debt is 4.92 percent for the period ending December 31, 2020,
6 as shown in Exhibit No. NLK-2, Cost of Long-Term Debt.

7 **Embedded Cost of Preferred Stock**

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

9 A. Exhibit No. NLK-7, Cost of Preferred Stock, shows the embedded costs of preferred
10 stock for the period ending December 31, 2020, to be 6.75 percent.

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

12 A. I respectfully request the Commission adopt PacifiCorp's proposed capital structure
13 with a common equity level of 52.55 percent. This capital structure balances the
14 financial integrity of the Company and costs to customers by reflecting the minimum
15 equity ratio necessary for PacifiCorp to maintain its ratings under current market
16 conditions, especially given the passage of the TCJA. When combined with
17 PacifiCorp's updated cost of long-term debt of 4.92 percent and the cost of equity of
18 10.20 percent recommended by Ms. Bulkley, this produces a reasonable overall cost
19 of capital of 7.69 percent.

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

21 A. Yes.