

Exhibit No. RBW-1T
Docket UE-152253
Witness: Bruce N. Williams

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of

PACIFIC POWER & LIGHT
COMPANY,

Petition For a Rate Increase Based on a Modified
Commission Basis Report, Two-Year Rate Plan,
and Decoupling Mechanism.

Docket UE-152253

**PACIFIC POWER & LIGHT COMPANY
SUPPLEMENTAL DIRECT TESTIMONY OF BRUCE N. WILLIAMS**

January 2016

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ATTACHED EXHIBITS

- Exhibit No. BNW-2—Fitch Ratings (November 24, 2015)
- Exhibit No. BNW-3—Moody’s Investor Service (May 7, 2015)
- Exhibit No. BNW-4—Standard & Poor’s Ratings Direct (March 12, 2015)
- Exhibit No. BNW-5—Cost of Long-Term Debt
- Exhibit No. BNW-6—Variable Rate PCRBs

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

2 A. My name is Bruce N. Williams. My business address is 825 NE Multnomah Street,
3 Suite 1900, Portland, Oregon 97232. My present position is Vice President and
4 Treasurer. I am testifying for Pacific Power & Light Company (Pacific Power or
5 Company), a division of PacifiCorp.

6 **QUALIFICATIONS**

7 **Q. Please 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 1980. I also received the
10 Chartered Financial Analyst designation upon passing the examination in 1986.
11 I have been employed by the Company for over 30 years. My business experience
12 has included financing of the Company's electric operations and non-utility activities,
13 responsibility for the investment management of the Company's qualified and non-
14 qualified retirement plan assets, investor relations and credit risk management.

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

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

1 **SUMMARY OF TESTIMONY**

2 **Q. Why are you providing this supplemental direct testimony?**

3 A. At the suggestion of Commission Staff, the Company agreed to file supplemental
4 direct testimony to address two discrete issues relating to the Company's cost of
5 capital. This supplemental filing was discussed at the December 22, 2015 prehearing
6 conference and is referenced in Order 03 in this docket.

7 **Q. What are the two issues?**

8 A. My testimony updates Pacific Power's long-term cost of debt and provides additional
9 information on the Company's current short-term cost of debt and capital structure.
10 Additionally, I update and briefly discuss the Company's current credit ratings.

11 **Q. Does the Company propose to change any component of cost of capital in this
12 case?**

13 A. No. The Company's petition does not propose to change any element of its cost of
14 capital. The information I provide demonstrates that the Company's long-term cost
15 of debt remains substantially similar to the level approved in the Company's last
16 general rate case, Docket UE-140762 (2014 Rate Case). While the Federal Reserve
17 Bank's decision to begin the normalization of interest rates at their December 16,
18 2015 meeting will likely increase the Company's cost of debt, in the overall context
19 of the petition, the Company believes it is reasonable to maintain the Company's
20 current debt costs and avoid litigation of cost of capital issues.

21 **UPDATED LONG-TERM COST OF DEBT**

22 **Q. How did you calculate Pacific Power's embedded costs of long-term debt?**

23 A. I calculated the embedded cost of long-term debt using the methodology relied upon

1 in the Company's previous rate cases in Washington and other jurisdictions. I
2 projected the cost of debt for June 30, 2016, just before the July 1, 2016 rate effective
3 date in the schedule the Commission adopted in Order 03.

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

5 A. The cost of long-term debt is 5.21 percent at June 30, 2016, as shown in
6 Exhibit No. BNW-5. This is slightly higher than the Company's current 5.19 percent
7 long-term cost of debt approved in the Company's 2014 Rate Case.

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

9 A. I calculated the cost of debt by issue, based on each debt series' interest rate and net
10 proceeds at the issuance date, to produce a bond yield to maturity for each series of
11 debt. It should be noted that if a bond was issued to refinance a higher cost bond, the
12 pre-tax premium and unamortized costs, if any, associated with the refinancing were
13 subtracted from the net proceeds of the bonds that were issued. Each bond yield was
14 then multiplied by the principal amount outstanding of each debt issue, resulting in an
15 annualized cost of each debt issue. Aggregating the annual cost of each debt issue
16 produces the total annualized cost of debt. Dividing the total annualized cost of debt
17 by the total principal amount of debt outstanding produces the weighted average cost
18 for all debt issues. This results in Pacific Power's 5.21 percent cost of long-term
19 debt.

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

21 **What is the basis for the projected interest rates used for these securities?**

22 A. The Company's variable rate long-term debt in this case is in the form of tax-exempt
23 debt. Exhibit No. BNW-6 shows that, on average, these securities have been trading

1 at approximately 86 percent of the 30-day London Interbank Offered Rate (LIBOR)
2 rate for the period January 2000 through November 2015. Therefore, the Company
3 has applied a factor of 86 percent to the forward 30-day LIBOR rate at June 30, 2016,
4 and then added the respective credit enhancement and remarketing fees for each
5 variable rate tax-exempt bond. Credit enhancement and remarketing fees are
6 included in the interest component because these are costs which contribute directly
7 to the interest rate on the securities and are charged to interest expense. This method
8 is consistent with the Company's past practices when calculating the cost of debt in
9 previous Washington general rate cases and in the Company's other jurisdictions.

10 **Q. Based on your analysis, have there been any material changes in the Company's**
11 **long-term debt costs since the 2014 Rate Case?**

12 A. No. The current cost of long-term debt is substantially similar to the currently
13 approved cost of long-term debt.

14 **Q. Did the Company also project its cost of short-term debt?**

15 A. Yes, I prepared this estimate even though the Company continues to maintain
16 negligible amounts of short-term debt in its capital structure. I projected the
17 Company's cost of short-term debt for June 30, 2016, just before the July 1, 2016,
18 rate effective date. The cost of short-term debt is 2.15 percent higher than the
19 1.73 percent cost the Commission set in the 2014 Rate Case. This projection is
20 derived from forward LIBOR rates plus the contractual borrowing margin in
21 committed credit agreements at the Company's current ratings plus related fees and
22 expenses. This is the same way I determined the cost of short-term debt in the
23 Company's 2014 Rate Case, which was approved by the Commission.

1 **Q. Based on your analysis, have there been any material changes in the Company's**
2 **short-term debt costs since the 2014 Rate Case?**

3 A. Yes. The projected cost of short-term debt is higher than the currently approved cost,
4 reflecting an increase in interest rates. The small amount of short-term debt in the
5 Company's capital structure, however, means that this change does not materially
6 impact the Company's overall cost of capital.

7 **Q. Please summarize your update to the Company's cost of debt.**

8 A. Table 1 compares the cost of short-term and long-term debt approved in the
9 Company's 2014 Rate Case and PacifiCorp's projected short-term and long-term cost
10 of debt as of the July 1, 2016 rate effective date in this case.¹

Table 1

COST OF DEBT		
	Approved 2014 Rate Case	Updated for July 1, 2016
Cost of Long-Term Debt	5.19%	5.21%
Cost of Short-Term Debt	1.73%	2.15%

11 **CAPITAL STRUCTURE**

12 **Q. What is the Company's capital structure?**

13 A. Using an average of the five quarter-ends for the twelve months ending June 30, 2016
14 produces the following capital structure, which is compared to the ordered 2014 Rate
15 Case capital structure below:

¹ *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Dockets UE-140762 *et al.*, Order 08 at 77-78, ¶ 183 (Mar. 25, 2015).

Table 2

CAPITAL STRUCTURE		
	Approved 2014 Rate Case	Updated for July 1, 2016
Short-Term Debt	0.19%	0.04%
Long-Term Debt	50.69%	48.91%
Preferred Stock	0.02%	0.02%
Common Equity	49.10%	51.03%

1 **Q. Is the Company proposing that the actual capital structure be used for**
2 **determining the revenue requirement in this docket?**

3 A. No. As noted earlier, the Company is not proposing to change any component of cost
4 of capital in this case. I am presenting this updated capital structure to respond to
5 Staff's request for additional evidence on the Company's updated cost of capital. My
6 testimony shows that the Company continues to have a common equity level above
7 the hypothetical capital structure approved in the Company's 2014 Rate Case.

8 **CREDIT RATINGS**

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

10 A. PacifiCorp's current ratings are:

Table 3

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

11 **Q. Has any credit agency changed PacifiCorp's credit rating since the 2014 Rate**
12 **Case?**

13 A. Yes. In November 2015, Fitch Ratings upgraded PacifiCorp's Issuer Default Rating
14 and securities ratings one notch.

1 **Q. Please explain why Fitch Ratings made this change.**

2 A. Fitch stated that the ratings reflect the Company's "strong credit metrics, balanced
3 jurisdictional regulatory environment and meaningfully lower estimated 2015-2019
4 capex compared to historic levels. [PacifiCorp's] business risk is relatively low and
5 retail rates below the industry average."²

6 **Q. Did Fitch Ratings address recent Washington rate decisions in its credit rating
7 report?**

8 A. Yes. The portions of the report addressing Washington are quoted below:

9 Regulatory outcomes across [PacifiCorp's] service territory
10 have been and are expected to continue to be balanced with
11 the notable exception of Washington....Washington Utilities
12 and Transportation Commission (WUTC) rulings in
13 [PacifiCorp's] GRCs issued in March 2015 and December
14 2013 were notably unfavorable for investors. The WUTC
15 orders disallowed costs related to purchased power from
16 qualifying facilities located outside the state of Washington
17 and authorized a below-industry-average 9.5% ROE. In its
18 March 2015 order, the WUTC authorized a rate increase of
19 \$9.6 million, 32% of the \$30.4 million requested by
20 [PacifiCorp] in the proceeding. In its December 2013 order,
21 the WUTC approved a \$17 million rate increase,
22 approximately 46% of [PacifiCorp's] requested \$37 million
23 rate hike. [PacifiCorp] has appealed both WUTC orders.
24 Fitch notes that the WUTC earlier this year approved an all-
25 party stipulation in which the parties agreed to the
26 implementation of a power cost adjustment mechanism, which
27 includes dead bands and sharing of deferred balances between
28 the utility and ratepayers."

29 **Q. Does the Company's petition address some of the concerns expressed by Fitch
30 Ratings and provide additional support for its current credit ratings?**

31 A. Yes. If the Commission approves the Company's petition, this would improve Pacific
32 Power's financial integrity and send a positive signal to rating agencies that the

² Fitch Ratings, November 24, 2015. Attached as Exhibit No. BNW-2.

1 regulatory framework in Washington is constructively addressing cost recovery. This
2 would benefit customers and the Company.

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

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

11 Second, credit ratings are an estimate of the probability of default by the
12 issuer on each rated security. Lower ratings equate to higher risks and higher costs of
13 debt.

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

20 **Q. Do PacifiCorp's current credit ratings benefit customers?**

21 A. Yes. The Company is in the process of completing significant new plant investments
22 that span multiple years. These investments include required pollution control
23 equipment, transmission facilities, and other capital investments to properly maintain

1 the existing infrastructure. These investments support system reliability, improve
2 power delivery, and help to ensure safe operation for the benefit of customers and
3 meet regulatory and legislative mandates. If the Company does not have consistent
4 access to the capital markets at reasonable costs, these borrowings and the resulting
5 costs to build new and maintain existing facilities become more expensive than they
6 otherwise would be. All of the resulting higher costs are ultimately borne by
7 customers. Maintaining the current credit rating for senior secured debt makes it
8 more likely that the Company will have access to the capital markets at reasonable
9 costs even during periods of financial turmoil. This rating will allow the Company
10 continued access to the capital markets, which will enable it to fulfill its capital
11 investments for the benefit of customers.

12 **Q. Are the Company's current credit ratings similar to those in effect when you**
13 **filed testimony in the Company's 2014 Rate Case?**

14 A. Yes. While Fitch has upgraded the Company by one notch, Moody's and Standard &
15 Poor's have not changed their credit ratings. These credit rating are substantially
16 similar to the 2014 Rate Case credit ratings. I have attached the most recent credit
17 rating reports as exhibits to my supplemental direct testimony.

18 **Q. Does this conclude your supplemental direct testimony?**

19 A. Yes.