WUTC DOCKET: UE-191024
EXHIBIT: NLK-1T
ADMIT ☑ W/D ☐ REJECT ☐

Exh. NLK-1T
Docket UE-19____
Witness: Nikki L. Kobliha

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

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

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

QUALIFICATIONS

Q. Please describe your education and professional experience.

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

PURPOSE OF TESTIMONY

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

A. My testimony supports PacifiCorp's overall cost of capital recommendation in this case. I sponsor the Company's proposed capital structure with a common equity level of 52.55 percent. I provide evidence demonstrating how this meets the Washington Utilities and Transportation Commission's (Commission) standard for capital structure by balancing the financial integrity of the Company (safety) with its cost to customers (economy). I explain why the recommended equity ratio is required to maintain PacifiCorp's current credit ratings, which provides for a more competitive cost of debt and overall cost of capital, and facilitates continued access by the Company to the capital markets over the long term. This capital structure is necessary to enable the Company's continued investment in infrastructure to provide safe and reliable service from clean energy resources at reasonable costs. In addition, I support PacifiCorp's proposed cost of long-term debt of 4.92 percent and cost of preferred stock of 6.75 percent.

Q. What time period do your analyses cover?

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

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

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

Table 1: Overall Cost of Capital

Component	$m	% of Total	Cost %	Weighted Ave Cost %
Long-Term Debt	$ 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%

Q. Why haven't you included short-term debt as part of the capital structure?

A. Short-term debt is an important source of liquidity for the Company, including interim funding for long-term debt maturities and new capital spending, and provides the Company a window of time to assess market conditions before using more permanent long-term debt financing. However, short-term debt balances can move dramatically and the Company often has periods when there is little or no short-term debt outstanding. For example, in the Company's last two Washington rate cases, including short-term debt had no practical impact on the cost of capital rounded to two decimal places.[1] Similarly, in the current rate case, if the Company were to include short-term debt in the capital structure it would decrease the weighted average cost of capital by only two basis points. Because short-term debt is not a permanent or material source of financing rate base, it should not be imputed into PacifiCorp's capital structure. As such, the Company respectfully asks the Commission to reconsider whether any short-term debt should be included in the Company's capital structure. As I explain below, PacifiCorp is making major capital investments, including investments that will help the Company meet Washington's recently-passed Clean Energy Transformation Act (CETA).[2] Including short-term debt in the Company's capital structure effectively double counts short-term debt as financing both rate base and construction work in progress.

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[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).

FINANCING OVERVIEW

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

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

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

Q. How does PacifiCorp finance its electric utility operations?

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

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

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

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

Q. How does PacifiCorp manage its dividends to BHE?

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

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

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

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

Another important source of financing in the past has been the tax-exempt financing associated with certain qualifying equipment at power generation plants. Under arrangements with local counties and other tax-exempt entities, these entities issue securities, PacifiCorp borrows the proceeds of these issuances and pledges its credit quality to repay the debt to take advantage of the tax-exempt status of the financing. During the 12 months ending December 31, 2020, PacifiCorp's tax-exempt portfolio is projected to average approximately $249 million, with an average cost of 1.9 percent, including the cost of issuance and remarketing.

Credit Ratings

Q. What are PacifiCorp's current credit ratings?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Table 3 below shows the reduction in the Company's cost of long-term debt 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%

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

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

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

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

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

A. Yes. This capital structure is intended to help the Company deliver its required capital expenditures and achieve financial metrics that will meet rating agency expectations. Moody's stated its expectations and factors that could lead to a downgrade for PacifiCorp in their June 22, 2018 Credit Opinion of PacifiCorp:

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

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

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

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

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

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

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

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

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

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

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

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

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

> Tax reform mainly affects companies that already had limited cushion in their credit profile. The tax reform usually resulted in a further 150-250 bps drop in CFO pre-WC/debt.
>
> Moody's expects that most utilities will attempt to manage any negative financial implications of tax reform through regulatory channels. Corporate financial policies could also change. The actions taken by utilities will be incorporated into our credit analysis on a prospective basis. It is conceivable that some companies will sufficiently defend their credit profiles.
>
> In practice, we believe that most companies will actively manage their cash flow to debt ratios by issuing more equity or obtaining relief by working through regulatory channels.

Rating Agency Debt Imputations

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

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

Q. How does this impact PacifiCorp?

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

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

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

CAPITAL STRUCTURE DETERMINATION

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

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. 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.

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?

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

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

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

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

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

FINANCING COST CALCULATIONS

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

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

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

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

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

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

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

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

Embedded Cost of Long-Term Debt

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

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

Embedded Cost of Preferred Stock

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

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

Q. Please summarize your recommendations to the Commission.

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

Q. Does this conclude your direct testimony?

A. Yes.