**Introduction and Summary of Rebuttal Testimony**

**Q. Are you the same Bruce N. Williams that previously provided testimony in this docket?**

A.Yes, I am.

**Q. What is the purpose of your rebuttal testimony?**

A.The purpose of my rebuttal testimony is to respond to the capital structure recommendations offered by Washington Utilities and Transportation Commission Staff (Staff) witness Mr. Kenneth L. Elgin and Industrial Customers of Northwest Utilities (ICNU) witness Mr. Michael P. Gorman. In my analysis, I demonstrate that these recommendations unreasonably propose the use of a hypothetical capital structure without a clear and compelling justification for disregarding PacifiCorp’s actual capital structure. PacifiCorp’s proposed 52.1 percent equity component remains well supported by the updated cost of capital summary presented in my testimony. Adoption of PacifiCorp’s actual capital structure will allow the Company a fair opportunity to maintain its credit rating and attract capital on reasonable terms.

My rebuttal testimony also responds to Staff’s and ICNU’s overall rate of return recommendations and shows how these recommendations, if adopted, would negatively impact PacifiCorp’s financial integrity.

**Review of Staff and ICNU Recommendations**

**Q. What are the parties' recommendations on capital structure?**

A. Messrs. Elgin and Gorman both recommend a hypothetical capital structure that

reduces the equity component from PacifiCorp’s actual equity share of 52.1 percent to 46.5 percent and 49.1 percent, respectively.

**Q. Are there items concerning the cost of capital in your direct testimony with which the parties agreed?**

A. Yes. Messrs. Elgin and Gorman both accept the Company’s proposed cost of long-term debt and preferred stock. No party in this docket has proposed changes to either of those items.

**Company’s Overall Cost of Capital**

**Q. Are you proposing a new overall cost of capital in this proceeding?**

A. No. PacifiCorp’s rebuttal filing continues to support its original overall cost of capital of 8.34 percent:

Overall Cost of Capital

Percent of % Weighted

Component Total Cost Average

Long-Term Debt 47.6% 5.89% 2.80%

Preferred Stock 0.3% 5.41% 0.02%

Common Stock Equity 52.1% 10.60% 5.52% Total 100.0% 8.34%

Although the Company had a small amount ($34 million) of short-term debt outstanding at September 30, 2010, the Company continues to expect no short-term debt at December 31, 2010. The amount of short-term debt at September 30, 2010 is immaterial to the overall calculation of cost of capital.

**Reply to Staff’s Capital Structure Adjustment**

**Imputation of Hypothetical Short-term Debt**

**Q. Please describe the adjustment that Mr. Elgin is proposing to the Company’s capital structure.**

A. Mr. Elgin proposes a hypothetical capital structure that includes less common equity, more long-term debt and a component for short-term debt. To derive his capital structure Mr. Elgin: (1) adds a hypothetical short-term debt component of 3 percent; (2) reduces the common equity to 46.5 percent; and (3) forces the long-term debt component up to 50.2 percent to get his hypothetical capital structure weights to sum to 100 percent. Mr. Elgin made no adjustment to the company’s proposed preferred stock component of the capital structure. (Elgin Direct at 2.)

**Q. What is the Commission’s policy with respect to the use of hypothetical capital structures in setting cost of capital?**

A. It is my understanding that the Commission has allowed the use of hypothetical capital structures only when there is a “clear and compelling” reason to do so. Mr. Elgin has not addressed this standard in his testimony, nor has he provided evidence that satisfies it.

**Q. What are your specific concerns with Mr. Elgin’s proposed capital structure?**

A. As noted, Mr. Elgin’s proposed capital structure does not match the Company’s actual capital structure. Mr. Elgin imputes a short-term debt component of 3 percent, even though the Company’s actual short-term debt is now approximately 0.2 percent. The absence of any material amount of short-term debt in the Company’s capital structure is not an aberration; for the previous six quarters, the Company has had no short-term debt in its capital structure.

**Q. What is the Company’s actual capital structure?**

A.At September 30, 2010 the capital structure was:

Short-Term Debt 0.2%

Long-Term Debt 46.9%

Preferred Stock 0.3%

Common Stock Equity 52.6%

As the table above shows, the Company’s actual equity component at the end of September is in excess of the 52.1 percent in the proposed capital structure. In addition, the common equity component will increase through the end of the year as the Company continues to retain all earnings. Finally, it should be noted that since acquisition by MidAmerican Energy Holdings Company in 2006, PacifiCorp’s common equity component has averaged 50.2 percent of total capitalization (including short-term debt).

**Q. Why has the Company had little or no short-term debt?**

A.The Company has not needed short-term debt for various reasons, including issuing a significant amount of new long-term debt during January 2009 and capital contributions received from our indirect parent company. The Company’s capital structure takes advantage of short-term interest rates in its portfolio of remarketed tax-exempt bond obligations. With long-term debt rates at such favorable levels, the Company has been able to reduce short-term debt and limit the exposure of PacifiCorp’s financial structure to short-term interest rate fluctuations and turbulence in the commercial paper markets.

**Q. Please explain the benefits of PacifiCorp’s actual capital structure.**

A. The Company’s actual capital structure is intended to maintain current credit ratings. As I discussed in my direct testimony, maintenance of the Company’s credit ratings benefits customers by reducing immediate and future borrowing costs. In addition, higher rated companies are more likely to have on-going, uninterrupted access to capital and access at lower costs. Further, higher rated companies have greater access to the long-term markets for power purchases and sales which provides more alternatives to meet the current and future load requirements of customers. Also, higher rated companies can often avoid or reduce the amount of costly collateral requirements that are typically imposed on lower-rated companies when transacting in the wholesale energy markets.

**Q. Is there a clear and compelling basis for imputing hypothetical short-term debt into PacifiCorp’s capital structure?**

A. No. There is no clear and compelling rationale to impute hypothetical short-term debt into PacifiCorp’s capital structure. Indeed, in my opinion, the only basis for including actual short-term debt in a utility company’s capital structure is if: (1) the balance of short-term debt exceeded the company’s balance of construction work in progress (CWIP); and (2) there was a persistent balance of short-term debt in excess of CWIP. Under those conditions, a commission could make a finding that a utility was financing long-term assets with short-term sources of funds and reasonably include the average of any persistent excess balance of short-term debt above the balance of CWIP. Clearly, because PacifiCorp has not maintained a material amount of short-term debt, these conditions would not be met in PacifiCorp’s case.

**Q. Historically, have the Company’s CWIP balances exceeded its short-term debt?**

A. Yes. PacifiCorp has historically had CWIP balances that, on average, were in excess of short-term debt, especially during periods of large plant construction. Exhibit No.\_\_\_(BNW-8) compares PacifiCorp’s short-term debt to CWIP balances over the most recent 18-month period. During this period, the CWIP balances have exceeded short-term debt by over $1.7 billion on average.

**Q. Could the imputation of short-term debt in the capital structure result in double-counting of short-term debt?**

A.Yes.Mr. Elgin is essentially proposing that short-term debt be implied to fund assets in service. The more appropriate view is that short-term debt funds CWIP and thus it should not be a component of the capital structure that finances rate base.

The inclusion of short-term debt in the capital structure creates a mismatch inasmuch as rate base excludes CWIP, while the capital structure would include the short-term debt financing. The result of including short-term debt in the capital structure is to overstate the overall level of debt used to support rate base. Even Mr. Elgin agrees that short-term debt is used to fund CWIP and that completed construction projects financing will be “rolled-over” to more permanent sources of funding (Elgin, page 19, lines 5-6).

Inclusion of short-term debt in the capital structure implies that CWIP must be financed by long-term capital financing. This runs counter to the allowance for funds used during construction (AFUDC) mechanism for recovery of CWIP financing costs as prescribed by FERC, and followed by the Company, which calls for short-term rates and balances to be incorporated into the determination of the AFUDC rates. A key element underlying the FERC-prescribed AFUDC rate is that short-term debt is the first source of capital used to finance CWIP.

If short-term debt were to be included in the capital structure for ratemaking purposes, it would be appropriate for PacifiCorp to adjust its AFUDC to remove the impact of short-term debt in the determination of the AFUDC rate. This adjustment would be necessary to avoid the double counting that would be created by including short-term debt in the capital structure.

Under the FERC System of Accounts, PacifiCorp’s utility customers receive the benefits of lower-cost short-term debt financing at the time the CWIP assets enter service, as their cost basis at that time will be lower. If the determination of the AFUDC rates were adjusted as suggested above, then assets would likely enter service at a higher cost.

**Q. What about Mr. Elgin’s statement that a** **utility should use its short-term borrowing capability to fund its construction budget?**

A.I find it wholly inconsistent for Mr. Elgin to promote the financing of construction (which is not in rate base) with short-term debt while at the same time proposing to use short-term debt as financing plant in service. The CWIP balance is already charged a financing rate at the Company’s AFUDC rate which includes a short-term debt component. It would make sense and the Company would be receptive to the inclusion of short-term debt in the capital structure if Staff correspondingly proposed that CWIP be placed into rate base and included in the Company’s revenue requirements.

**Q. How did Mr. Elgin determine the amount of short-term debt he imputes into PacifiCorp’s capital structure?**

A. Mr. Elginimputes short-term debt in the amount of $500 million or 3 percent of the capital structure primarily by reference to the capital structures of Puget Sound Energy and Avista. Exhibit No.\_\_\_(BNW-9), page 1.

**Q. Should the Company’s capital structure be set by reference to short-term debt levels of two unrelated utilities?**

A. No. The Commission has made clear that a company’s capital structure should be based upon its own capital structure, absent a clear and compelling reason to impute other data. Further, these two utilities have lower credit ratings than the Company’s, making them inappropriate comparators.

**Hypothetical Common Equity Component**

**Q. How did Mr. Elgin determine the 46.5 percent common equity component for his hypothetical capital structure?**

A. Mr. Elgin’s analysis included utilities that are either not rated or rated below investment grade, neither of which should be used as the basis of determining the Company’s capital structure. Exhibit No.\_\_\_(BNW-9), pages 2-3.

Further, the data from SNL that Mr. Elgin uses as the basis of his capital structure analysis is not comparable to the Company’s capital structure Exhibit No.\_\_\_(BNW-9), pages 4. SNL includes current maturities of long-term debt in the definition of “short-term debt” [[1]](#footnote-1)which results in a reduction of long-term debt and a corresponding increase in short-term debt As such, any analysis that uses SNL data to determine peer group short-term debt levels or long-term debt levels should be disregarded.

**Q. What capital structure does Mr. Elgin’s ROE peer group have on average?**

A. If one were to use the projected capital structure of Mr. Elgin’s peer group that he uses for determining return on equity Exhibit No.\_\_\_(BNW-9), pages 5-11, the average common equity level would be 50.4 percent determined as follows:



**Q. Mr. Elgin states that his proposed hypothetical capital structure balances economy and safety. Do you agree?**

A. No, in fact the opposite is true. Mr. Elgin’s own testimony is that his capital structure would lead to a downgrade for PacifiCorp.

“A 46.5 percent equity ratio is sufficient to support a solid BBB corporate credit rating and an A- secured rating for the

Company.”[[2]](#footnote-2)

However, the Company’s existing ratings are above that level and as such, adoption of his proposed capital structure would indicate this Commission’s support for at least a one notch downgrade and possibly more for PacifiCorp.

Having a BBB rating imposes a tremendous risk for a utility, like PacifiCorp, in the midst of a build cycle with a need to access the capital markets. That rating level leaves little margin for unexpected events such as unsettled financial markets, issues in the power markets, storms or other such developments. For example, during the financial turmoil of 2008 Arizona Public Service Company (rated Baa2/BBB- at that time) filed a letter with the Arizona Corporation Commission stating that the commercial paper market was completely closed to them and they could not likely issue long-term debt. See Exhibit No.\_\_\_(BNW–11). Another example is Avista Corporation which has just recently achieved investment grade status from the three major rating agencies. As stated in Avista’s 2008 annual report:

“In late 2007 and early 2008, we restored an overall corporate investment grade credit rating with the two major credit rating agencies. Our credit ratings were downgraded during the fourth quarter of 2001, which resulted in an overall corporate credit rating that was below investment grade. The downgrades were due to liquidity concerns primarily related to significant amounts of purchase power and natural gas costs that we incurred in our utility operations. These downgrades increased our debt service costs.”

Prior to downgrade, Avista was rated BBB- by S&P and Baa2 by Moody’s, similar to what Mr. Elgin is now recommending for PacifiCorp. Avista became a victim of the Western energy crisis of 2000-2001 because of its weak investment grade status. Its investment grade credit was not strong enough to survive the strain on liquidity due to extreme purchased power costs. It was forced to non-investment grade status causing debt costs to rise and capital market access to shrink.

**Q. Does Mr. Elgin propose a corresponding increase in the cost of debt due to the new lower ratings of the Company resulting from his proposed capital structure?**

A. No. Mr. Elgin accepts the Company’s proposed cost of debt – which reflects the interest rates resulting from the Company’s actual credit ratings – while at the same time proposing at least a one notch downgrade and ignoring the future higher costs that would result.

It is at best inconsistent to propose a lower equity level while ignoring the impact of the resulting downgrade on the Company’s overall cost of debt. Mr. Elgin seeks to diminish the Company’s credit rating without reflecting any of the costs of doing so.

**Q. Had PacifiCorp’s credit ratings been lower, would the Company’s cost of debt be at the level is it today?**

A.Absolutely not. For comparison, the cost of long-term debt as filed by Puget Sound Energy, which is rated at levels below the Company, in their most recent rate case was 6.82 percent, nearly **100** basis points higher than PacifiCorp which is at 5.89 percent.

**Q. Have you attempted to quantify what the Company’s cost of debt would be had it been downgraded as Mr. Elgin is proposing?**

A. Yes. I have analyzed the Company’s debt issuances since acquisition by MEHC during 2006 and have correspondingly changed the issuance spread to match what a BBB rated utility achieved at approximately the same point in time that the Company issued debt. The result is that on those seven series of debt totaling $3.4 billion the cost would increase by 88 basis points to 6.91 percent. That increase in the cost of debt would result in PacifiCorp’s customers paying approximately $30 million more in annual interest expense. However, that may not capture the extent of the increased capital costs as it assumes that PacifiCorp would have been able to issue debt during the recent financial crisis, during which certain BBB rated utilities found the long-term debt markets were closed to them. It is also possible that the Company would have been forced to cut its capital programs in response to the markets being inaccessible. Finally, it also ignores the increase in investor required equity returns as described by Company witness Dr. Samuel C. Hadaway. However, the Company was able to avoid this scenario by being prudently capitalized and enjoying the benefits of its current ratings.

**Q. In addition to higher borrowing costs, would there be other adverse consequences to a ratings downgrade?**

A. Yes, including potential loss of access to the capital markets, increased fees under credit agreements, letters of credit and other banking arrangements, increased collateral requirements to support wholesale energy activities and possible loss of access to long-term wholesale energy markets.

**Q. Have you reviewed Mr. Elgin’s analysis on the safety of his proposed capital structure containing 46.5 percent common equity?**

A. Yes. Mr. Elgin appears to be confusing the issue with an attempt to analyze whether a “typical bond indenture covenant” would allow additional debt issuances. The relevant issue is whether investors and creditors would choose to invest in and lend to such a company and if so, on what terms and conditions.

**Q. Are Mr. Elgin’s attempts to justify his leveraging of the Company’s balance sheet persuasive?**

A. No. Mr. Elgin uses a pretax interest coverage ratio to determine the appropriateness of his 46.5 percent common equity structure Exhibit No.\_\_\_(BNW-9), pages 12. However, there are several issues regarding his analysis. First, pretax interest coverage is not a critical ratio followed by the rating agencies. Instead, the agencies tend to rely on cash-flow driven ratios such as funds from operations interest coverage and funds from operations debt coverage in addition to capital structure. Please see Exhibit No.\_\_\_(BNW-12) which are copies of recent Moody’s and S&P credit rating reports concerning PacifiCorp. Their discussions concerning financial ratios highlights funds from operations (also referred to as cash from operations before changes in working capital) as the key interest coverage metric. One can safely conclude the rating agencies do not consider pretax interest coverage a major credit rating determinant.

Second, his ratio analysis is merely hypothetical, taking his recommended pretax weighted cost of equity (both common equity and preferred) plus the weighted cost of debt and dividing by the weighted cost of debt. This calculation assumes that hypothetical authorized cost of capital will translate into actual operating returns and debt costs, does not take into account adjustments that rating agencies make to a utility’s financial statements for off-balance sheet financing and makes no allowances for future capital expenditures. As a result, Mr. Elgin’s pretax interest coverage ratio is not representative of the metrics used by rating agencies in today’s environment.

Third, Mr. Elgin’s metric is further exposed as unrealistic because at one point he states a 100 percent debt capital structure would be “very unsafe and likely result in default”.[[3]](#footnote-3) However, his pretax interest coverage calculation of a coverage ratio of 2x is in reality a 100 percent debt structure. This can be seen by the fact that a 2x pretax coverage ratio with debt costs as the denominator effectively requires the numerator to be twice the cost of debt or the pretax weighted cost of capital. This is verified by the fact that the after tax cost of debt 3.83 percent (5.89 percent times (1-35 percent tax rates)) is almost identical to his calculated ROE of 4.0 percent.[[4]](#footnote-4) It also should be noted that he makes no adjustment for removing the weighted preferred cost which slightly overstates the result. More importantly, to say that by staying just above a 2x pretax interest coverage ratio (a ratio not used by rating agencies and is hypothetically based), the Company can maintain access to capital markets and maintain its loan covenant requirements is unrealistic.

**Q. Mr. Elgin states that he performed an analysis of the cost of “additional equity compared to the lower interest expense that would be achieved by the higher equity level.” Can you please comment on his analysis?**

A. Yes, in reviewing his work papers there appear to be several errors. Among other things, he has not used the correct amount of debt outstanding in his analysis Exhibit No.\_\_\_(BNW-9, pages 13). The impact of this error is to underestimate the amount of additional debt service cost which lowers the resulting all-in cost of debt.

The next error is more significant and results from Mr. Elgin not increasing the amount of debt to correspond to his proposed reduced equity component. Clearly, the amount of assets being financed are not changed so as equity is reduced, debt must correspondingly increase. However, Mr. Elgin failed to increase the amount of debt and thus has significantly underestimated the increased interest expense. As such, his analysis on this point should be ignored.

As I mentioned earlier, I have performed an analysis that shows the Company’s debt cost would be nearly 0.90 percent higher had Mr. Elgin’s capital structure been implemented. That increase in cost is just on the amount of existing debt and does not capture the additional interest which accompanies the additional debt Mr. Elgin proposes, the combined effect of which would be a very substantial increase in the Company’s costs.

**Q. Mr. Elgin also states that most electric utilities are rated BBB and that only about 1 in 4 pay the extra cost to achieve the added safety of an “A” rating. Can you comment on that?**

A. Certainly. While I cannot state why each of the other approximately 175 utilities select their capital structure, I do believe that the industry as a whole is moving to higher equity levels in their capital structure, just as the Company is. Following the financial crisis of 2008, when many had difficulty accessing funding, the utility industry is decreasing their debt component and correspondingly moving to higher equity levels. As stated in S&P’s recent report “*U.S. Investor-Owned Electric Utilities Trended Positively In A Quiet Third Quarter” (dated October 15, 2010):*

“Based on a significant sampling of U.S. electric utilities, adjusted total debt to total capital, including hybrid preferred securities (to which most, if not all, were accorded intermediate equity treatment) and adjusted for off-balance-sheet obligations such as leases, purchased power contracts, accounts receivable financing, and pension and retiree medical liabilities, declined to 57.78% at June 30, 2010 from the 59% recorded at the end of 2009 and the 61% at the end of 2008. Notwithstanding the slight improvement in capital structure balance, we generally consider a debt to capital level of 50% or greater to be aggressive to highly leveraged for utilities.”

**Q. Please summarize your response to Mr. Elgin’s testimony.**

A. Mr. Elgin proposes a hypothetical capital structure without providing a clear and compelling justification for it. His hypothetical capital structure contributes to his 7.48 percent ROR recommendation, which is well below industry averages. Mr. Elgin acknowledges that his capital structure recommendation will produce a ratings downgrade, and his attempts to suggest that the Company’s financial integrity will remain intact if his capital structure is adopted are unpersuasive.

Mr. Elgin’s proposed capital structure and overall cost of capital would clearly miss the mark with rating agencies, investors and others who expect the Company to receive “reasonable outcomes in pending and future rate proceedings….”[[5]](#footnote-5)

**Reply to ICNU Witness Mr. Gorman**

**Q. What is your general response to Mr. Gorman’s capital structure recommendations?**

A.Mr. Gorman proposes a series of adjustments to PacifiCorp’s actual capital structure to produce a hypothetical capital structure with a common equity component of 49.1 percent. Like Mr. Elgin, Mr. Gorman has failed to provide a clear and compelling justification for his hypothetical capital structure. Mr. Gorman’s adjustments for cash and acquisition adjustments are arbitrary and without a financial basis. Further, he uses a time period for his common equity analysis which is inconsistent with the rate case test period and his attempts to prove the recommended equity structure is supportive of the Company’s credit rating are in error.

**Q. Does Mr. Gorman propose to impute short-term debt into his hypothetical capital structure?**

A. No, unlike Mr. Elgin, Mr. Gorman does not attempt to include short-term debt in the capital structure.

**Q. Please explain Mr. Gorman’s adjustments to the Company’s actual common equity component.**

A.Mr. Gorman proposes to remove acquisition adjustments, special deposits, short-term investments, and the difference in affiliate notes receivable and payable. The most significant of these are the approximate $360 million adjustment for short-term investments of $196 million and acquisition adjustments of $158 million for a total of $354 million. Mr. Gorman believes his capital structure “is more reasonable in setting rates because it reflects the actual common equity capital PacifiCorp relied on to invest in utility plant.”[[6]](#footnote-6)

**Q. Please identify the fundamental problems in Mr. Gorman’s analysis regarding the removal of acquisition adjustments.**

A. The acquisition adjustments Mr. Gorman proposes to remove from the common equity component of the capital structure relate to the Craig and Wyodak generating plants, both of which are recoverable investments in all other state jurisdictions. Due to the Washington allocation methodology, Mr. Gorman excluded the adjustments since they relate to plants outside the western control area. However, this makes no sense for several reasons. First, the Company finances its operations for all states with one capital structure. The Company does not finance a specific unique capital structure for each state jurisdiction or finance assets differently depending on state allocations. For example, the majority of pollution control bonds are related to plants out of the west control area and have

a rate of 2.69 percent. Mr. Gorman does not exclude these favorable financings from the capital structure.

Second, Mr. Gorman mistakenly excludes the gross amount of acquisition adjustments and ignores the accumulated amortization related to the two plants totaling nearly $100 million. Had he correctly determined his proposed exclusion for the acquisition adjustments, it would be $58 million. Even at this reduced level, however, the adjustment remains inappropriate and violates the matching principle.

**Q. Please respond to Mr. Gorman’s adjustment related to short-term investments.**

A. First, as of September 30. 2010, the Company had exhausted its temporary cash investments, effectively eliminating this aspect of Mr. Gorman’s adjustment. Additionally, in general financial treatment, short-term investments are often netted against long-term debt to determine what is known as “net debt”. Net debt is used as a financial metric to reflect the company’s net obligation to its bondholders. Nowhere in general finance is there support for Mr. Gorman’s novel proposal to net common equity with cash to derive net common equity.

**Q. Did Mr. Gorman use the same period of time as the Company to determine his hypothetical capital structure?**

A. No, based on his workpapers (Exhibit No.\_\_(MPG-3)) Mr. Gorman is using a period of time from June 30, 2009 through June 30, 2010. However, the Company’s capital structure was determined as the average during the twelve months ending December 31, 2010. Therefore, as the Company expects to retain all earnings during 2010 to finance necessary capital expenditures to serve its customers, Mr. Gorman would naturally have a lower common equity percentage than what the Company calculated.

**Q. Do you agree with Mr. Gorman’s statement that PacifiCorp’s capital structure at June 30, 2010 is 52.2 percent and is very close to that projected by PacifiCorp for year-end 2010 of 52.1 percent?[[7]](#footnote-7)**

A. Yes. Mr. Gorman has correctly stated the Company’s actual common equity level of 52.2 percent at June 30, 2010. However, the 52.1 percent he cites is the expected average during the test period in this case and the common equity component will be higher at year end 2010. This higher ratio will permit maintenance of the Company’s credit rating and allow the Company to attract additional capital to meet construction needs.

**Q. Mr. Gorman states that it is reasonable to believe that these short-term cash investments simply represent a placeholder for all the retained earnings PacifiCorp is retaining to build up its common equity ratio.[[8]](#footnote-8) Do you agree with him?**

A. No, all of the Company’s net cash from operations since acquisition by MEHC has been re-invested in the business. The fact is that PacifiCorp is investing more into its business than the amount of cash flow generated by operations. For example, during the first six months of 2010, the Company has invested $876 million into capital expenditures while generating only $779 million of net cash flow from operations. These facts show that Mr. Gorman’s position is unfounded.

**Credit Metric Analysis**

**Q. Please comment on Mr. Gorman’s discussion concerning financial integrity and his credit metric analysis.**

A. I disagree with Mr. Gorman’s analysis and conclusions for four reasons. First, Mr. Gorman’s calculations did not properly reflect the adjustments that rating agencies make when calculating their credit metrics. For instance, my direct testimony stated that S&P adds nearly $1 billion of additional debt and $73 million of interest to PacifiCorp’s reported results.[[9]](#footnote-9) While Mr. Gorman did attempt to include the adjustments, he unfortunately only included a portion of the total adjustments and not the entire amounts. He includes less than half of the total debt adjustments ($432 million vs. $998.2 million) and only $28.1 million of the $73 million of additional interest.[[10]](#footnote-10)

Second, even the portion of the adjustments he included is incorrectly stated as Mr. Gorman further reduces the amount by mis-matching a Washington allocation percentage to a total company capital structure. This further reduces the impact of the already too low adjustments.

Third, Mr. Gorman’s model also excludes a significant amount of interest expense that the Company reports on its financial statements such as interest expense on customer deposits, interest on capital leases, regulatory liabilities and others.

Fourth, Mr. Gorman ignores the rating agencies’ published expectations for PacifiCorp and instead measures the flawed results of his model against the general utility industry. Had Mr. Gorman used the Company specific targets from the rating agencies, his already over-stated results still would not have supported the Company’s current ratings.

**Q. Was Mr. Gorman aware of these rating agency published expectations for PacifiCorp?**

A. Yes, Mr. Gorman cites them in his testimony on page 9 for Standard & Poor’s and page 11 for Moody’s. It is not clear why he ignored them for purposes of his credit metrics. For all these reasons the Commission should disregard Mr. Gorman’s statements that his recommended return on equity and proposed capital structure are supportive of the Company’s current bond rating.

**Q. Does that conclude your rebuttal testimony?**

A.Yes.

1. SNL Table 10 – Definition of Short-Term Debt Exhibit 10, page 2. [↑](#footnote-ref-1)
2. Elgin Testimony October 5, 2010 page 16 lines 17 through 19. [↑](#footnote-ref-2)
3. Elgin Responsive Testimony page 13 lines 6 through 1. [↑](#footnote-ref-3)
4. Elgin Responsive Testimony page 18 line 2. [↑](#footnote-ref-4)
5. Fitch Ratings, October 1, 2010 [↑](#footnote-ref-5)
6. Gorman Responsive Testimony page 13 lines 22 and 23. [↑](#footnote-ref-6)
7. Gorman Responsive Testimony page 13 lines 14 through 15. [↑](#footnote-ref-7)
8. Gorman Responsive Testimony page 14 lines 24 through 26. [↑](#footnote-ref-8)
9. Beginning with their April 30, 2010 report, S&P now imputes $78.2 million of interest while the debt amount is approximately the same. This increase, while not material to the discussion above, would further weaken Mr. Gorman’s credit metrics had he included the updated adjustments. [↑](#footnote-ref-9)
10. Gorman Exhibit No.\_\_(MPG-19), lines 5 and 9. [↑](#footnote-ref-10)