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Summary:
PacifiCorp

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Credit Rating: A-/Stable/A-2

Rationale

The 'A-' corporate credit rating (CCR) on PacifiCorp reflects its "excellent" business risk profile, evidenced by a diverse and growing service territory, and an "aggressive" financial risk profile that reflects a large capital program and the need to shore up cash flow metrics. Although the ring-fenced utility's credit metrics are more consistent on a stand-alone basis with a 'BBB' category rating, Standard & Poor's Ratings Services expects that management will achieve cash flow metrics more consistent with an 'A' category rating over the next several years. PacifiCorp is owned by MidAmerican Energy Holdings Co. (MEHC; BBB+/Stable/--). In turn, MEHC is privately held and majority owned by Berkshire Hathaway Inc. (AAA/Negative/A-1+), which at year-end 2008 had an 87.4% interest in MEHC on an undiluted basis. MEHC has demonstrated a willingness to deploy equity to support the utility's large capital program.

MEHC's credit profile is supported by Berkshire, which has in place through February 2011 a $3.5 billion equity commitment agreement between itself and MEHC in which MEHC can unilaterally call upon Berkshire to support either its debt repayment or the capital needs of its regulated subsidiaries, including PacifiCorp. We view this agreement between PacifiCorp's parent and a 'AAA'-rated entity as reducing the likelihood of a PacifiCorp default.

Nevertheless, we expect PacifiCorp to have a standalone credit profile consistent with the 'A-' rating. We take this view because the utility has no right to cause MEHC to make an equity contribution, either from MEHC or via Berkshire through an MEHC board request. Although MEHC would typically have strong incentives to support the utility by tapping the Berkshire contingent equity, we note that in a catastrophic utility event, we would expect MEHC to do so only if it were in the parent's best economic interests. Such a scenario is remote and would require an unprecedented event such as what occurred during the Western energy crisis, when regulators refused to allow utilities to recover power procurement costs.

PacifiCorp serves 1.7 million customers in portions of six Western states: Utah, Oregon, Wyoming, Washington, Idaho, and California. The company operates as Pacific Power in Oregon, Washington, and California, and as Rocky Mountain Power in Utah, Wyoming, and Idaho. The company's two largest markets, Utah and Oregon, comprised about 68% of the company's retail electric sales in 2008, with Wyoming and Washington at 24%, and the balance being sold to customers in Idaho and California. As of June 30, 2009, the utility's long-term debt was $6.6 billion. Consolidated long-term debt at MEHC (which includes PacifiCorp's debt) was nearly $20 billion as of the same date.

Supportive rate case outcomes remain key to maintaining and improving upon the company's financial performance. When MEHC purchased PacifiCorp in 2006 from ScottishPower, the utility had consistently been unable to earn its authorized return on equity (ROE), which varies by jurisdiction but ranges from 10% to 10.6%. Management has focused on improving its returns, with some success. In 2008, our calculations suggest that the consolidated ROE for PacifiCorp was 8.3%. Regulatory lag remains an issue for the company, although the company is permitted under state regulation to use forward test years for rate cases in Utah, Oregon, Wyoming, and California. (Idaho and Washington require historical test years.)

PacifiCorp has power and fuel cost adjusters in Wyoming and California that allow for the deferral of these costs for later collection. In Oregon, fuel and purchased power costs are updated in rates every January based on forecast power prices, but there is no true-up to reconcile these projected costs with actuals. The company has pending before the Idaho Public Utilities Commission a request to establish an energy cost adjustment mechanism to recover the difference between base power costs set in a general rate case and actual power costs incurred.

Recent rate case activities include:

- In Utah, in April 2009, the Utah Public Service Commission approved the settlement reached in the company's 2008 general rate case that provided for a $45 million rate increase, relative to the $57.4 million originally sought. Also, in June 2009 the company filed its 2009 general rate case with the UPSC requesting a $67 million, or 5%, increase in the base rates, to be effective Feb. 18, 2010.
- In Wyoming, the commission approved the company's $18 million settlement over its 2008 general rate case, relative to the $28.8 million sought, with rates going into effect May 24, 2009.
- In Idaho, the company received authorization to implement its $4.4 million rate case settlement, relative to the $5.9 million it sought.
- In Oregon, the company filed its 2009 general rate case with the Oregon Public Utility Commission, requesting a $92 million, or 9%, increase in the base rates, to be effective by February 2010.
- In Washington, the company filed its 2009 general rate case with the Washington Utilities and Transportation Commission, requesting a $39 million, or 15%, increase in the base rates, effective Jan. 11, 2010.

In September 2008 the company purchased for $308 million the Chehalis plant, a 520-megawatt (MW) combined-cycle plant that will now have to be authorized for recovery in current or future rate cases in all the states PacifiCorp serves except California. The investment will be part of the Washington and Oregon 2009 general rate cases and is part of pending cases in Wyoming and in Utah, which has preapproved the purchase. The company also brought online 382 MW of new wind generation in 2008. Nevertheless, the company's supply portfolio remains predominantly coal, meeting about 65% of all requirements in 2008.

PacifiCorp completed $1.8 billion in capital expenditures in 2008, up from $1.5 billion in 2007. The company is projected to spend $6.1 billion in 2009-2011, excluding non-cash allowance for funds used during construction. The largest component of PacifiCorp's capital program is the construction of the Gateway transmission project, an estimated $6.1 billion, 2,000-mile transmission line connecting portions of Wyoming, Utah, Idaho, Oregon, and the southwestern U.S. The project is being completed in phases, with initial portions of new lines being placed into service as early as 2010 and a completion date scheduled for 2018. About 38% of the company's total capital budget over the next three years is devoted to transmission investment, of which Gateway is a component. In 2008, the Federal Energy Regulatory Commission awarded the company incentive rate treatment of 200 basis points for seven of the eight project segments.

High fuel prices affected PacifiCorp's 2008 results, as did hydro conditions that were about 90% of normal. However, declining fuel prices during the latter half of 2008 and during 2009, together with regulatory rate relief, have resulted in an improvement in the gross margin per MW hour sold for the 12 months ended June 30, 2009. Operating income increased about 4% due in large part to lower fuel costs. For the 12 months ended June 30, 2009, cash flow from operations was boosted by increased net income and the changes in regulatory assets and liabilities, as compared with year-end 2008 cash flows. Approximately 30%-32% of PacifiCorp's total electric sales are to industrial customers. Retail and wholesale sales were roughly flat in 2008 relative to 2007. However, due to the economic downturn the company experienced an approximate 5% decline in retail sales for the first six months of 2009, and we expect the sales contraction to continue through the year, possibly becoming a drag on 2009 performance.

Leverage as of June 30, 2009, for the company was 54.6%, up from 52.6% as of year-end 2008, which reflects approximately $990 million of new long-term borrowing in the first half of 2009, net of maturities. During 2008, MEHC infused $850 million in equity. Such equity investments will remain a key to maintaining a balanced structure throughout the company's capital program. Debt to total capitalization reflects several adjustments we make, the largest of which include adding $424 million for power purchase obligations and $379 million for post-retirement obligations. We expect that PacifiCorp will not be in a position to make distributions to its parent while it executes its capital program, and that MEHC will lower PacifiCorp's debt leverage to the 50% area in the next several years.

Cash flow metrics remain weak for the rating but are improving modestly. For the 12 months ended June 30, 2009, funds from operations (FFO) to total debt was nearly 18% and FFO interest coverage was 4.1x, which are consistent with 2008 ratios. We would expect PacifiCorp to produce FFO interest coverage in the range of 4.0x-4.5x and to achieve FFO to total debt in the 20% area.

Short-term credit factors

The company's liquidity position is strong. The 'A-2' short-term rating reflects our view that although a $3.5 billion contingent equity agreement between MEHC and Berkshire supports MEHC and its subsidiaries, the agreement is not a source of instantaneous liquidity. The agreement allows Berkshire up to 180 days to fund MEHC's request. Given the recent turmoil in both liquidity and capital markets, we have taken a firmer view on the need to link the short-term ratings on PacifiCorp to its stand-alone credit quality, which supports an 'A-2' short-term rating. However, we note that although Berkshire contractually has up to six months to respond to an MEHC call for liquidity, it has strong economic incentives to do so.

PacifiCorp's cash and cash equivalents totaled $552 million as of June 30, 2009. In addition, the company has $1.4 billion in unsecured revolving credit structured in two separate agreements: an $800 million line expiring July 2013 and a $700 million line extending through October 2012. As of June 30, 2009, the company had no outstanding balances under the credit facilities and had letters of credit in place for $258 million, leaving $1.14 billion available under its revolving credit facilities. PacifiCorp's single largest exposure to any banks under its revolving facility as a percentage of total commitments is 15%, which is manageable. Regulators limit PacifiCorp to no more than $1.5 billion in debt outstanding.

Outlook

The stable outlook for PacifiCorp incorporates our expectation that MEHC will continue to support the utility by contributing equity sufficient to ensure that fully adjusted debt to total capitalization is managed over the next few years to an adjusted level closer to 50%, and that FFO to total debt and FFO interest coverage will be 20% or better and in the range of 4.0x-4.5x, respectively. Given that PacifiCorp's financial risk profile is weak for the current ratings, we do not expect near-term upward ratings momentum, which would require the company to sustain metrics above these levels. PacifiCorp's ring-fenced structure insulates it from some MEHC credit deterioration. Specifically, our criteria provides that the PacifiCorp CCR can be no more than three notches above the MEHC CCR. The company is comfortably within this range, so we see no significant prospects for the utility rating to fall as a result of adverse rating changes at MEHC, which also enjoys a stable outlook.