Exhibit No.___(BNW-1T)
Docket No. UE-10___
Witness: Bruce N. Williams

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. PACIFICORP dba Pacific Power Respondent.	)	Docket No. UE-10______

PACIFICORP

DIRECT TESTIMONY OF BRUCE N. WILLIAMS

May 2010

1 **Q. Please state your name, business address and present position with**
2 **PacifiCorp (the Company).**
3 A. My name is Bruce N. Williams. My business address is 825 NE Multnomah,
4 Suite 1900, Portland, Oregon 97232. My present position is Vice President and
5 Treasurer.
6 **Qualifications**
7 **Q. Briefly describe your educational and professional background.**
8 A. I received a Bachelor of Science degree in Business Administration with a
9 concentration in Finance from Oregon State University in June 1980. I also
10 received the Chartered Financial Analyst designation upon passing the
11 examination in September 1986. I have been employed by the Company for 24
12 years. My business experience has included financing of the Company's electric
13 operations and non-utility activities, responsibility for the investment
14 management of the Company's qualified and non-qualified retirement plan assets,
15 and investor relations.
16 **Q. Please describe your present duties.**
17 A. I am responsible for the Company's treasury, credit risk management, pension
18 and other investment management activities. I am also responsible for the
19 preparation of PacifiCorp's embedded cost of debt and preferred equity and any
20 associated testimony related to capital structure for regulatory filings in all of
21 PacifiCorp's state and federal jurisdictions.

1 **Purpose of Testimony**

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

3 A. First, I present a financing overview of the Company. Next, I discuss the amounts
4 of common equity, debt, and preferred stock included in the Company's proposed
5 capital structure. I then analyze the embedded cost of debt and preferred stock
6 supporting PacifiCorp's electric operations in the state of Washington as of
7 December 31, 2010. This analysis includes the use of known and measurable
8 changes to the debt and preferred stock portfolios.

9 **Q. What time period does your analyses cover?**

10 A. The test period in this proceeding is the twelve-months ended December 31, 2009
11 with known and measurable adjustments. For cost of capital, the Company has
12 used a pro forma period through December 31, 2010. Therefore, the
13 determination of the embedded cost of debt and preferred stock was conducted
14 using the Company's actual costs adjusted for changes through December 31,
15 2010, as I later detail in my testimony.

16 **Q. What is the overall cost of capital that you are proposing in this proceeding?**

17 A. PacifiCorp is proposing an overall cost of capital of 8.34 percent. This cost
18 includes the Return on Equity recommendation presented in the direct testimony
19 of Company witness Samuel C. Hadaway and the following capital structure and
20 costs:

1 **Overall Cost of Capital**

Component	Percent of Total	% Cost	Weighted 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%

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

9 A. The Company does not expect to have any short-term debt during the period
10 ending December 31, 2010. As discussed later in my testimony the Company's
11 proposed capital structure is based on an average of the five-quarter ends during
12 the time period ending December 31, 2010.

13 **Q. Does the Company have concerns about the fairness of the inclusion of short-**
14 **term debt in the capital structure?**

15 A. Yes. The Company continues to believe that it is inappropriate and inequitable to
16 include short-term debt in the capital structure for PacifiCorp as short-term debt
17 would effectively be double-counted as financing both rate base and construction
18 work in progress. To remedy this inconsistency, PacifiCorp would need to
19 deviate from the Federal Energy Regulatory Commission-prescribed method for
20 determining the allowance for funds used during construction. Unfortunately, this
21 is not a practical solution for PacifiCorp as it would result in assets that are
22 allocated to more than one state having multiple, different book values and
23 depreciation rates.

1 Further, short-term balances can move dramatically and the Company
2 often has periods of time when there is no short-term debt outstanding, such as the
3 period ending December 31, 2010. The fact that there are periods of time with no
4 short-term debt demonstrates that short-term debt is not a permanent source of
5 financing rate base. The Company will continue to evaluate this treatment of
6 short-term debt and may request the Commission to reconsider it in future cases.

7 **Financing Overview**

8 **Q. How does the Company finance its electric utility operations?**

9 A. The Company finances its regulated utility operations utilizing roughly a 50/50
10 percent mix of debt and common equity capital. Immediately prior to and during
11 periods of significant capital expenditures, the Company may need to allow the
12 common equity component of the capital structure to increase. This provides
13 more flexibility regarding the type and timing of debt financing, better access to
14 the capital markets, a more competitive cost of debt, and over the long-run, more
15 stable credit ratings; all of which assist in financing such expenditures. In fact,
16 the Company's equity component has increased from the 50/50 percent and is
17 expected to remain above that level for the next several years to facilitate the
18 financings necessary for investments in system reliability and infrastructure.
19 In addition, all else being equal, the Company will need to have a greater
20 common equity component to offset various adjustments that rating agencies
21 make to the debt component of the Company's published financial statements. I
22 will discuss these adjustments in greater detail later in this testimony.

1 **Q. More specifically, what does the Company anticipate for the period ending**
2 **December 31, 2010?**
3 A. During the period ending December 31, 2010, the Company anticipates: (1) to
4 receive additional cash equity contributions from its indirect parent company,
5 MidAmerican Energy Holdings Company (MEHC), (2) to retain all of the
6 earnings generated rather than pay a dividend and, (3) at this time, to issue no new
7 long-term debt. While the Company does not presently expect to issue new long-
8 term debt before December 31, 2010, the need exists for significant new issuances
9 in subsequent periods and it will be important to maintain the Company's credit
10 ratings in order to access the market for this new debt at reasonable interest rates.
11 **Q. Please explain the Company's requirements to generate new capital.**
12 A. As described in Company witness Richard P. Reiten's direct testimony, the
13 Company continues to have ongoing investment in infrastructure including
14 investment in transmission and distribution. These and future capital additions
15 and investments will require the Company to raise funds by issuing significant
16 amounts of new long-term debt in the capital markets and obtaining new capital
17 contributions from its parent company. Funds will also be made available by the
18 continued absence of any dividends or distributions by PacifiCorp to its parent
19 company during the period. Since the acquisition of PacifiCorp by MEHC in
20 March 2006, there have been no common stock dividends or distributions,
21 PacifiCorp has received $990 million in additional cash equity contributions from
22 MEHC and $1.6 billion of earnings have been retained in PacifiCorp. These

1 actions help ensure that PacifiCorp remains well-positioned to support the
2 additional investments that have been and will continue to be made in the system.
3 **Q. What type of debt and preferred equity securities does the Company employ**
4 **in meeting its financing requirements?**
5 A. The Company relies on a mix of first mortgage bonds, other secured debt, tax-
6 exempt debt, unsecured debt and preferred stock to meet its long-term financing
7 requirements. These securities employ various maturities in order to provide
8 flexibility and mitigate refinancing risks.
9 The Company has completed the majority of its long-term financing
10 utilizing secured first mortgage bonds issued under the Mortgage Indenture dated
11 January 9, 1989. Exhibit No.___(BNW-2) shows that, for the twelve-months
12 ending December 31, 2010, the Company is projected to have approximately
13 $5.6 billion of first mortgage bonds outstanding, with an average cost of 6.38
14 percent. Presently, all outstanding first mortgage bonds bear interest at fixed
15 rates. Proceeds from the issuance of the first mortgage bonds (and other financing
16 instruments) are used to finance the combined utility operation.
17 Another important source of financing has been the tax-exempt financing
18 associated with certain qualifying equipment at power generation plants. Under
19 arrangements with local counties and other tax-exempt entities, the Company
20 borrows the proceeds and guarantees the repayment of the long-term debt in order
21 to take advantage of the tax-exempt status of the other entities in financings.
22 During the twelve-months ending December 31, 2010, the Company's tax-exempt
23 portfolio is projected to be $738 million in principal amount with an average cost

1 of 2.21 percent (based on the actual costs at December 31, 2009, including the
2 cost of issuance and credit enhancement).

3 **Capital Structure**

4 **Q. How did the Company determine the capital structure proposed in this**
5 **proceeding?**

6 A. The Company used an average of the five-quarter ends during the time period
7 ending December 31, 2010 to calculate its proposed capital structure. This
8 approach smoothes volatility in the capital structure which will fluctuate as the
9 Company expends capital, issues or retires debt, retains earnings and receives
10 infusions of new equity. The Company calculated its capital structure in this
11 same manner in its last two Washington general rate cases. This method is also
12 consistent with the approach to capital structure advocated by Public Counsel in
13 Docket UE-050684.

14 **Q. How does the Company determine the amount of common equity, debt, and**
15 **preferred stock to be included in its capital structure?**

16 A. As a regulated utility, PacifiCorp has a duty and an obligation to provide safe,
17 adequate and reliable service to customers in its Washington service territory
18 while balancing cost and risk. Significant capital expenditures for system
19 reliability and infrastructure are required for the Company to fulfill this
20 obligation. Through its planning process, the Company determined the amounts
21 of necessary new financing needed to support these activities and calculated the
22 equity and debt ratios required to maintain continued access to the financial
23 markets.

1 **Q. Has the Company's capital structure demonstrated increased amounts of**
2 **equity?**
3 A. Yes. This is consistent with the "general trend of increasing equity capitalization
4 in the industry," noted by the Commission in its final Order in Docket UE-
5 050684, and reflects MEHC's significant capital contributions to PacifiCorp since
6 it acquired the Company.
7 **Q. Why is there the need for additional equity in the capital structure?**
8 A. The Company's capital structure reflects the cost increases described in this case,
9 including investment in infrastructure and power costs. These cost increases,
10 coupled with the credit rating agencies' expectations for credit metrics and
11 balance sheet strength, mean that the Company cannot finance itself solely with
12 new debt. Additional equity is required along with improved business results and
13 other considerations to support PacifiCorp's current senior secured 'A' credit
14 rating from Standard & Poor's (S&P), 'A2' rating from Moody's Investors
15 Service (Moody's), and 'A-'from Fitch Ratings.
16 **Q. Please describe the changes to the amount of outstanding long-term debt.**
17 A. During the period ending December 31, 2010, the balance of the outstanding
18 long-term debt will change through maturities and principal amortization. Based
19 upon the long-term debt series outstanding at December 31, 2009, I have
20 calculated the reduction to the outstanding balances for maturities, principal
21 amortization and sinking fund requirements which are scheduled to occur during
22 the period ending December 31, 2010.

1 **Q. Is the proposed capital structure consistent with the Company's current**
2 **credit rating?**
3 A. Yes. This capital structure is intended to enable the Company to deliver its
4 required capital expenditures while maintaining credit ratios that are expected to
5 support the continuance of PacifiCorp's current credit ratings.
6 **Q. Are PacifiCorp's stand-alone credit metrics consistent with the Company's**
7 **current credit ratings?**
8 **A.** No. As stated by S&P, "Although the…. utility's credit metrics are more
9 consistent on a standalone basis with a 'BBB' category rating, S&P's Ratings
10 Services expects that management will achieve cash flow metrics more consistent
11 with the 'A' rating category over the next several years. Supportive rate case
12 outcomes remain key to maintaining and improving financial performance."[1]
13 Another important element supporting the Company's current credit
14 ratings is the ownership by MEHC. Absent ownership by MEHC and
15 constructive regulatory treatment, PacifiCorp's credit ratings would likely suffer
16 at least a one rating level downgrade.
17 Maintaining the existing ratings however, is becoming more challenging
18 due to the additional adjustments that rating agencies are making to PacifiCorp's
19 published financial results. I will discuss these adjustments in more detail later in
20 this testimony.

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[1] Standard & Poor's Rating Direct, February 17, 2010, Exhibit No.__(BNW-3)

1 **Q. How does maintenance of the Company's current credit ratings benefit**
2 **customers?**
3 A. The credit rating of a utility has a direct impact on the price that a utility pays to
4 attract the capital necessary to support its current and future operating needs. A
5 solid credit rating directly benefits customers by reducing immediate and future
6 borrowing costs related to the financing needed to support regulatory operations.
7 **Q. Are there other benefits?**
8 A. Yes. During periods of capital market disruptions, higher-rated companies are
9 more likely to have on-going, uninterrupted access to capital and access at lower
10 costs. This is not always the case with lower-rated companies, which find
11 themselves either unable to secure capital or able to secure capital only on
12 unfavorable terms and conditions during such periods.
13 In addition, higher-rated companies have greater access to the long-term
14 markets for power purchases and sales. Such access provides these companies
15 with more alternatives when attempting to meet the current and future load
16 requirements of their customers.
17 Finally, a company with strong ratings will often avoid having to meet
18 costly collateral requirements that are typically imposed on lower-rated
19 companies when securing power in these markets.
20 **Q. Did S&P and Moody's change the Company's credit ratings in 2009?**
21 A. Yes. S&P upgraded PacifiCorp's senior secured debt to 'A' while it downgraded
22 PacifiCorp's short-term debt rating to 'A-2'. Similarly, Moody's upgraded
23 PacifiCorp's senior secured debt to 'A2'.

1 **Q. Please explain these rating changes.**

2 A. The upgrade to PacifiCorp's senior secured debt merely reflects a change in
3 S&P's methodology rather than a change in PacifiCorp's credit quality or
4 financial metrics. S&P changed its approach to estimating the amount of
5 collateral available to senior secured debt holders in the event of a default by
6 PacifiCorp on its first mortgage bonds.

7 S&P continues to be cautious about PacifiCorp's credit metrics and, as
8 noted previously, views the Company's credit metrics on a stand-alone basis as
9 more consistent with a 'BBB' rating. Indeed, in downgrading the Company's
10 short-term debt rating, S&P cited a need to take a firmer view on linking
11 PacifiCorp's short-term ratings to stand-alone credit quality. S&P sustained their
12 current 'A-' corporate credit rating based on their expectation "that management
13 will achieve cash flow metrics more consistent with an 'A' rating over the next
14 several years."[2]

15 Moody's upgrade of PacifiCorp's senior debt was part of an industry-wide
16 action in which the majority of senior secured debt ratings of investment-grade
17 regulated utilities were upgraded by one level. The action was a result of an
18 analysis of the history of regulated utility defaults and was not specific or unique
19 to the Company.

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[2]Standard & Poor's Ratings Direct April 1, 2009, Exhibit No.__(BNW-5), and reiterated in the Ratings Direct of February 17, 2010.

1 **Q. Do these rating agency actions change the Company's need to add equity to**
2 **its capital structure and improve its financial metrics?**
3 A. No. Without continued improvement in financial metrics along with supportive
4 state regulatory outcomes in rate cases, the ratings direction is likely to be lower
5 rather than higher for PacifiCorp.
6 **Q. Do S&P's recent credit reports on PacifiCorp underline S&P's expectation**
7 **that PacifiCorp improve its financial metrics in order to maintain its current**
8 **credit rating?**
9 A. Yes. S&P made several references to the need for PacifiCorp to improve its
10 stand-alone financial metrics, noting that PacifiCorp had a "significant financial
11 risk profile that reflects a large capital program and the need to shore up cash flow
12 metrics." S&P also stated that "Given the recent turmoil in both liquidity and the
13 capital markets, we have taken a firmer view on the need to link the short-term
14 ratings on PacifiCorp to its stand-alone credit quality, which supports an 'A-2'
15 short-term rating." Exhibit No.___(BNW-3) is the February 17, 2010 S&P
16 Ratings Direct publication. S&P also reiterated its credit views including that
17 "supportive rate case outcomes remain key to maintaining and improving
18 financial performance."
19 **Purchase Power Agreements**
20 **Q. Is the Company subject to rating agency debt imputation associated with**
21 **Purchase Power Agreements?**
22 A. Yes. Rating agencies and financial analysts consider purchase power agreements
23 (PPAs) to be debt-like and will impute debt and related interest when calculating

1 financial ratios. For example, S&P will adjust the Company's published financial
2 results and impute debt balances and interest expense resulting from PPAs when
3 assessing creditworthiness. It does so in order to obtain a more accurate
4 assessment of a company's financial commitments and fixed payments. Exhibit
5 No.___(BNW-4) is the May 7, 2007 publication by S&P detailing its view of the
6 debt aspects of PPAs.

7 **Q. How does this impact the Company?**

8 A. In their February 17, 2010 Ratings Direct report cited above, S&P stated that
9 approximately $425 million of additional debt and related interest expense were
10 added to the Company's debt and coverage tests solely as a result of PPAs. There
11 were also other adjustments made by S&P that resulted in an imputation into
12 PacifiCorp's credit ratios of approximately $1 billion of debt and $73 million of
13 interest in total. These adjustments are detailed by S&P in their April 1, 2009
14 Ratings Direct report attached as Exhibit No.___(BNW-5).

15 **Q. How would the inclusion of this PPA-related debt and these other**
16 **adjustments affect the Company's capital structure as S&P reviews credit**
17 **metrics?**

18 A. Negatively. By including the imputed debt resulting from PPAs and these other
19 adjustments, the Company's capital structure has a lower equity component as a
20 corollary to the higher debt component, lower coverage ratios and reduced
21 financial flexibility than what might otherwise appear to be the case from a
22 review of the book value capital structure. For example, if one were to add the $1
23 billion of debt adjustments that S&P makes to the Company's capital structure in

1 this case, the resulting common equity percentage would decline from 52.1
2 percent to 48.4 percent. The table below shows the proposed capital structure and
3 how the S&P adjustments impact the components.

Illustration of Rating Agency Adjustments to PacifiCorp's Capital Structure ($ in millions)			
	Book Values / Ratios	Rating Agency Adjustments	Adjusted Book Values / Ratios
Long-Term Debt	$6,369/47.6%	$1,034	$7,403/51.3%
Preferred Stock	$41/0.3%	0	$41/0.3%
Common Equity	$6,984/52.1%	0	$6,984/48.4%
Totals	$13,394/100.0%	$1,034	$14,428/100.0%

4 **Financing Cost Calculations**

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

7 A. I calculated the embedded costs of debt and preferred stock using the
8 methodology relied upon in the Company's previous rate cases in Washington
9 and other jurisdictions.

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

11 A. I calculated the cost of debt by issue, based on each debt series' interest rate and
12 net proceeds at the issuance date, to produce a bond yield to maturity for each
13 series of debt. For variable rate securities, I used the costs at December 31, 2009.
14 It should be noted that in the event a bond was issued to refinance a higher cost
15 bond, the pre-tax premium and unamortized costs, if any, associated with the
16 refinancing were subtracted from the net proceeds of the bonds that were issued.

1 The bond yield was then multiplied by the principal amount outstanding of each
2 debt issue, resulting in an annualized cost of each debt issue. Aggregating the
3 annual cost of each debt issue produces the total annualized cost of debt.
4 Dividing the total annualized cost of debt by the total principal amount of debt
5 outstanding produces the weighted average cost for all debt issues. This is the
6 Company's embedded cost of long-term debt.

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

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

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

18 **Q. What is the Company's embedded cost of long-term debt?**

19 A. The cost of long-term debt is 5.89 percent, at December 31, 2010 as shown in
20 Exhibit No.___(BNW-2).

1 **Embedded Cost of Preferred Stock**

2 **Q. What is the Company's embedded cost of preferred stock?**

3 A. The embedded cost of preferred stock is 5.41 percent, at December 31, 2010, as
4 shown in Exhibit No.___(BNW-6).

5 **Fulfillment of MEHC Commitment**

6 **Q. Did PacifiCorp and MEHC make certain commitments concerning cost of**
7 **incremental long-term debt?**

8 A. Yes. During the regulatory approval process related to the acquisition of the
9 Company, MEHC stated that the incremental cost of long-term debt would be
10 reduced as a result of the acquisition by MEHC, due to the association with
11 Berkshire Hathaway. In Docket UE-051090, MEHC and PacifiCorp made a
12 formal commitment (General Commitment 37) that over the five years following
13 the closing of the transaction, they would demonstrate that incremental long-term
14 debt issuances would be at a spread ten basis points below PacifiCorp's similarly
15 rated peers.

16 **Q. Has the Company issued any long-term debt that has not been previously**
17 **assessed as to whether it satisfied General Commitment 37?**

18 A. No. All long-term debt issuances subject to this commitment have been included
19 in prior cases with evidence that each of the respective issuances of long-term
20 debt fulfilled the requirements of General Commitment 37.

21 **Q. Is there an action that would be appropriate for the Commission to now**
22 **take?**

23 A. Yes. This five-year commitment will expire before the end of the suspension

1 period in this case. If no additional long-term debt is issued prior to March 21,
2 2011, five years following the close of the transaction, the Company respectfully
3 requests the Commission include in its order a finding that the Company has
4 fulfilled the requirements of General Commitment 37 and the commitment has
5 been completed.
6 **Does this conclude your direct testimony?**
7 A. Yes.