

Rocky Mountain Power  
Docket No. 10-035-124  
Witness: Bruce N. Williams

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF UTAH

ROCKY MOUNTAIN POWER

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Direct Testimony of Bruce N. Williams

Cost of Capital

January 2011

1 **Q. Please state your name, business address and present position with**  
2 **PacifiCorp dba Rocky Mountain Power (“Company”).**

3 A. My name is Bruce N. Williams. My business address is 825 NE Multnomah, Suite  
4 1900, Portland, Oregon 97232. My present position is Vice President and  
5 Treasurer.

6 **Qualifications**

7 **Q. Please describe your education and business experience.**

8 A. I received a Bachelor of Science degree in Business Administration with a  
9 concentration in Finance from Oregon State University in 1980. I also received  
10 the Chartered Financial Analyst designation upon passing the examination during  
11 1986. I have been employed by the Company for 25 years. My business  
12 experience has included financing of the Company’s electric operations and non-  
13 utility activities, responsibility for the investment management of the Company’s  
14 qualified and non-qualified retirement plan assets, and investor relations.

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

16 A. I am responsible for the Company’s treasury, credit risk management, pension  
17 and other investment management activities. I am also responsible for the  
18 preparation of PacifiCorp’s embedded cost of debt and preferred equity and any  
19 associated testimony related to capital structure for regulatory filings in all of  
20 PacifiCorp’s state and federal jurisdictions.

21 **Q. Please provide a summary of your testimony?**

22 A. My testimony discusses the Company’s capital structure and costs of capital. It  
23 supports the proposed common equity level of 51.9 percent and provides evidence

24 of why that level is appropriate and demonstrates the benefits to customers,  
25 including maintaining the Company's current credit ratings which will facilitate  
26 continued access to the capital markets for the Company and over the long-term a  
27 more competitive cost of debt and overall cost of capital. This capital structure  
28 will allow the Company to continue its capital program and invest in projects and  
29 infrastructure in order to provide safe and reliable service to our customers at  
30 reasonable costs.

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

32 A. Rocky Mountain Power is proposing an overall cost of capital of 8.25 percent.  
33 This cost includes the return on equity recommendation of 10.5 percent from Dr.  
34 Samuel C. Hadaway and the following capital structure and costs:

Overall Cost of Capital

<u>Component</u>	<u>Percent of Total</u>	<u>% Cost</u>	<u>Weighted Average</u>
Long Term Debt	47.8%	5.81%	2.78%
Preferred Stock	0.3%	5.43%	.02%
Common Stock Equity	<u>51.9%</u>	10.50%	<u>5.45%</u>
Total	100.0%		8.25%

35 **Financing Overview**

36 **Q. Please explain Rocky Mountain Power's need for and sources of new capital.**

37 A. As described in Mr. A. Richard Walje's testimony, Rocky Mountain Power is in  
38 the process of completing or adding significant new investments, including  
39 required pollution control equipment, transmission facilities as well as local  
40 distribution facilities. These investments help system reliability, improve power  
41 delivery and help to assure safe operations for the benefit of our customers.

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

43 A. Generally, the Company finances its regulated utility operations utilizing roughly  
44 a 50/50 percent mix of debt and common equity capital. Immediately prior to and  
45 during periods of significant capital expenditures, the Company may allow the  
46 common equity component of the capital structure to increase. This provides more  
47 flexibility regarding the type and timing of debt financing, better access to the  
48 capital markets, a more competitive cost of debt, and over the long-run, more  
49 stable credit ratings; all of which assist in financing such expenditures. In  
50 addition, all else being equal, the Company will need to have a greater common  
51 equity component to offset various adjustments that rating agencies make to the  
52 debt component of the Company's published financial statements. I will discuss  
53 these adjustments in greater detail later in this testimony.

54 **Q. What has been the Company's practice with regards to paying dividends to**  
55 **MEHC?**

56 A. PacifiCorp has not paid a dividend to MEHC since being acquired in March,  
57 2006. MEHC recognizes that the Company is in a period requiring significant  
58 capital investments which, until recently, has far exceeded the Company's ability  
59 to finance them with internally generated funds. As such, MEHC has allowed the  
60 Company to retain all earnings to date totaling over \$2 billion plus invested well  
61 over an additional \$1 billion in order to help maintain the credit ratings during this  
62 period of capital spending. As I will discuss later, the maintenance of credit  
63 ratings has allowed the Company to access the capital markets when other utilities  
64 were denied access, provided a lower cost of debt and a lower overall cost of

65 capital.

66 **Q. Does the Company now anticipate paying dividends to MEHC?**

67 A. Yes. The Company is balancing a number of interests, some of which are in  
68 conflict with each other. For example, in order to maintain credit ratings during  
69 the capital build cycle a higher common equity component is necessary at times in  
70 order to provide room and flexibility in the capital structure to accommodate the  
71 amount, type and timing of additional long-term debt issuance. In addition, the  
72 various adjustments that rating agencies make to published financial statements  
73 simply require an initial higher equity component in order to offset the impact of  
74 these adjustments. As equity has a higher cost than debt, the Company intends to  
75 have no more common equity than is necessary to support its credit ratings.

76 Since the MEHC acquisition, the Company has managed the capital  
77 structure through the timing and amount of long-term debt issuances and capital  
78 contributions while forgoing dividends and retaining earnings. However, with the  
79 passage of recent legislation enacting bonus depreciation, the Company's  
80 expected net cash flow during the next two years will increase significantly. This  
81 will reduce the need for new borrowings and, absent the payment of dividends,  
82 retention of earnings could cause the percentage of common equity to grow  
83 beyond the level necessary to support the current credit ratings. Consequently,  
84 dividend payments are now expected, possibly even in combination with debt  
85 issuances, to keep the percentage of equity in the Company's capital structure in  
86 line with the level sufficient to support the Company's credit ratings. As a result,  
87 the Company anticipates initiation of dividends to MEHC to continue to manage

88 the common equity component of the capital structure, maintain the current credit  
89 ratings, maintain access to the capital markets and keep the Company's overall  
90 cost of capital at a prudent level.

91 **Q. Shouldn't the additional cash flow generated by the tax law changes mitigate**  
92 **the need for a rate increase?**

93 A. No. The cash flow mitigates the need for some of the external financing that  
94 otherwise would be required but it does not change the need for rate relief.

### 95 **Credit Ratings**

96 **Q. Should this regulatory commission be concerned about credit ratings and the**  
97 **views expressed by rating agencies?**

98 A. Yes, regulators should be concerned about credit ratings and the views of rating  
99 agencies for several reasons. First, the credit rating of a utility has a direct impact  
100 on the price that a utility pays to attract the capital necessary to support its current  
101 and future operating needs. Many institutional investors have fiduciary  
102 responsibilities to their clients, and are typically not permitted to purchase non  
103 investment grade (i.e. rated below BBB-) securities or in some cases even  
104 securities rated below a single A.

105 Second, credit ratings are an estimate of the probability of default by the  
106 issuer on each rated security. Lower ratings equate to higher risks and higher  
107 costs of debt. However, even investment grade rated borrowers have experienced  
108 recent problems accessing the capital markets or even been shut out entirely. The  
109 financial crisis of 2008 and 2009 provided clear and compelling evidence of the  
110 benefits of the Company's credit rating as it was able to issue new long-term debt

111 during the midst of the financial turmoil. Other lower rated utilities were simply  
112 shut out of the market and could not obtain new capital regardless of how much  
113 they were willing to pay. For example, Arizona Public Service Company (rated at  
114 that time Baa2/BBB-) filed a letter with the Arizona Corporation Commission  
115 stating that the commercial paper market was completely closed to them and, they  
116 likely could not successfully issue long-term debt. See Exhibit RMP\_\_\_\_(BNW-1).

117 Further, those issuers who could access the markets paid rates well above  
118 the levels that the Company was able to achieve. For example, Nevada Power  
119 (rated Baa3/BBB) issued new debt two days following PacifiCorp's 2009  
120 issuance and was required by investors to pay a coupon of 7.375% for a five year  
121 maturity. Subsequently, Puget Sound Energy (rated Baa2/A-) issued new seven  
122 year debt at a credit spread over Treasuries of 480.3 basis points resulting in a  
123 6.75 percent coupon. By comparison, the Company completed an offering of  
124 \$350 million of first mortgage bonds with a ten year maturity at a coupon rate of  
125 5.50 percent and \$650 million of thirty year first mortgage bonds with a coupon  
126 of 6.00 percent. These favorable debt rates are included in the cost of debt  
127 calculation in this docket.

128 Further, the Company has a near constant need for short-term liquidity as  
129 well as periodic long-term debt issuances. We daily pay significant amounts to  
130 suppliers whom we count on providing necessary goods and services such as fuel  
131 and spare parts and inventory. Being unable to access funds can risk the  
132 successful completion of necessary capital infrastructure projects and increase the  
133 chance of outages and service failures.

134           The Company’s creditworthiness, as reflected in its credit ratings, will  
135           strongly influence its ability to attract capital in the competitive markets and the  
136           resulting cost of that capital.

137 **Q.    Can regulatory actions or orders affect a Company’s credit ratings?**

138 A.    Yes, in a very significant way. Regulated utilities such as the Company are fairly  
139           unique since they unilaterally cannot set their own prices for their services. The  
140           financial integrity of a regulated utility is largely a result of how the utility is  
141           treated on cost recovery issues and the prices set by regulators. Rates are  
142           established by regulators to permit the utility to recover prudently incurred  
143           operating expenses and a reasonable opportunity to earn a fair return on the  
144           capital invested. Therefore, rate decisions by utility commissions have a direct  
145           and significant impact on the financial condition of utilities.

146           Rating agencies and investors have a keen understanding of the  
147           importance of regulatory outcomes. For example, Standard & Poor’s writes  
148           “(t)he assessment of regulatory risk is perhaps the most important factor in  
149           Standard & Poor’s Ratings Services’ analysis of U.S. regulated, investor-owned  
150           utility’s business risk.”<sup>1</sup> Similarly, Moody’s has stated “(f)or a regulated utility,  
151           the predictability and supportiveness of the regulatory framework in which it  
152           operates is a key credit consideration and the one that differentiates the industry  
153           from most other corporate sectors. The most direct and obvious way that  
154           regulation affects utility credit quality is through the establishment of prices or  
155           rates for the electricity, gas and related services provided (revenue requirements)

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<sup>1</sup> Standard & Poor’s Ratings Direct – Assessing U.S. Utility Regulatory Environments; March 11, 2010.

156 and by determining a return on a utility's investment, or shareholder return."<sup>2</sup>

157 **Q. How does maintenance of the Company's current credit rating benefit**  
158 **customers?**

159 A. The Company is in the midst of a period of heavy capital spending and investing  
160 in infrastructure in order to provide for the needs of customers. If the Company  
161 does not have consistent access to the capital markets at reasonable costs these  
162 borrowings and the resulting costs of building new facilities become more  
163 expensive than it otherwise would be. The inability to access financial markets  
164 can threaten the completion of these necessary projects which, in turn will impact  
165 system reliability and customer safety. All of these resulting higher costs are  
166 ultimately borne by the customers. Maintaining the current single-A credit rating  
167 makes it more likely the Company will have access to the capital markets at  
168 reasonable costs even during periods of financial turmoil. Such a rating will  
169 allow the Company continued access to the capital markets that will enable it to  
170 fulfill its capital investments for the benefit of customers.

171 In addition, higher-rated companies have greater access to the long-term  
172 markets for power purchases and sales. Such access provides these companies  
173 with more alternatives when attempting to meet the current and future load  
174 requirements of their customers.

175 Finally, a company with strong ratings will often avoid having to meet  
176 costly collateral requirements that are typically imposed on lower-rated  
177 companies when securing power in these markets. In my opinion, maintaining the  
178 current single A rating provides the best balance between costs and continued

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<sup>2</sup> Moody's Investors Service Regulated Electric and Gas Utilities; August 2009.

179 access to the capital markets which is necessary to fund capital projects for the  
180 benefit of customers.

181 **Q. Is the proposed capital structure consistent with the Company's current**  
182 **credit rating?**

183 A. Yes. This capital structure is intended to enable the Company to deliver its  
184 required capital expenditures and result in financial metrics which will meet  
185 rating agency expectations.

186 Historically, the Company's credit ratios have been weak for the ratings  
187 level and we have been able to sustain our ratings, in part through the acquisition  
188 by MEHC and its parent, Berkshire Hathaway. S&P was very clear on this point  
189 in their recent assessment of PacifiCorp in stating "...cash flows metrics remain  
190 just adequate to support the ratings." S&P further stated ".....the Company's  
191 funds for operations (FFO) to total debt has been consistently in the high teens,  
192 slightly below our expected credit metrics for the rating, since it was acquired by  
193 [MEHC]. Leverage has also been somewhat high for the rating at 53 percent at  
194 year-end 2009. However, we expect that credit metrics will improve in the  
195 coming years, producing FFO total debt in the area of 20 percent, FFO interest  
196 coverage ...in the range of 4.0x – 4.5x, and leverage of about 50 percent."<sup>3</sup>  
197 Clearly, PacifiCorp and its customers have benefited from the higher ratings the  
198 Company would otherwise not likely have been awarded on a stand-alone basis.  
199 Another important element supporting the Company's current ratings is the rating  
200 agencies' expectations that PacifiCorp will receive supportive regulatory  
201 treatment including reasonable outcomes in rate proceedings. Absent ownership

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<sup>3</sup> Standard & Poor's Rating Direct October 7, 2010.

202 by MEHC and constructive regulatory treatment that permits a fair opportunity  
203 for the Company to recover its reasonable and prudent expenses, including a  
204 return on its investment comparable to other similarly situated utilities,  
205 PacifiCorp's senior secured and corporate credit ratings would have likely  
206 suffered at least a one rating level downgrade.

207 Maintaining the existing ratings is becoming more challenging due to the  
208 additional adjustments that rating agencies are making to our published financial  
209 results. I will discuss these adjustments in more detail later in this testimony.

210 **Q. Has there been any changes in the Company's credit ratings that needs**  
211 **clarification?**

212 A. Yes. In March 2009, S&P upgraded PacifiCorp's senior secured debt to 'A' while  
213 it downgraded PacifiCorp's short-term debt ratings to 'A-2'. Similarly, Moody's  
214 revised PacifiCorp's senior secured debt to 'A2' from 'A3' in August 2009.

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

216 A. The action on the PacifiCorp's senior secured debt merely reflects a change in  
217 S&P's methodology rather than a change in PacifiCorp's credit quality or  
218 financial metrics. S&P changed its approach to estimating the amount of collateral  
219 that would be available to senior secured debt holders in the event of a default by  
220 PacifiCorp on its first mortgage bonds.

221 S&P continues to be cautious about PacifiCorp credit metrics and, as  
222 noted previously, views the Company's credit metrics on a stand-alone basis as  
223 just adequate to support the ratings. Indeed, in downgrading the Company's  
224 short-term debt ratings, S&P cited a need to take a firmer view on linking

225 PacifiCorp short-term ratings to stand-alone credit quality. S&P sustained their  
226 current 'A-' corporate credit rating based on their expectation "that management  
227 will achieve cash flow metrics more consistent with an 'A' rating over the next  
228 several years."<sup>4</sup>

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

234 **Q. Do S&P's recent credit reports on PacifiCorp underline S&P's expectation**  
235 **that PacifiCorp improve its financial metrics in order to maintain its current**  
236 **credit rating?**

237 A. Yes. S&P made several references to the need for PacifiCorp to improve its  
238 stand-alone financial metrics, noting that PacifiCorp's financial risk profile  
239 reflects a large capital program and the need to shore up cash flow metrics. S&P  
240 also stated that "Given the recent turmoil in both the liquidity and capital markets,  
241 we have taken a firmer view on the need to link the PacifiCorp short-term ratings  
242 to its stand-alone quality, which supports an 'A-2' short-term rating." S&P also  
243 reiterated its credit view that "supportive rate case outcomes remain key to  
244 maintaining and improving upon the company's financial performance." Exhibits  
245 RMP\_\_\_(BNW-2) and RMP\_\_\_(BNW-3) are the October 7, 2010 and April 30,  
246 2010 S&P Ratings Direct publications.

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<sup>4</sup> Standard & Poor's Rating Direct April 30, 2010.

247 **Q. Do other rating agencies share S&P's view concerning the need for**  
248 **supportive rate case outcomes?**

249 A. Yes. Fitch stated "The current ratings and stable outlook assume [PacifiCorp]  
250 continues to benefit from parent company support and reasonable outcomes in  
251 pending and future rate proceedings to recover anticipated, significant capital  
252 investment".<sup>5</sup> Likewise Moody's lists "Supportive regulatory environment" as  
253 one of the ratings drivers. Moody's also states "The stable outlook incorporates  
254 Moody's expectation that PacifiCorp will continue to receive reasonable  
255 regulatory treatment for the recovery of its higher capital expenditures...."  
256 Further as to what could change the rating-down; Moody's writes ".....if there  
257 were to be adverse regulatory rulings on current and future rate cases such that we  
258 would anticipate a sustained deterioration in financial metrics...."<sup>6</sup>

259 **Capital Structure**

260 **Q. How did the Company determine the capital structure proposed in this case?**

261 A. The test period in this proceeding is the 12 months ending June 30, 2012. To  
262 appropriately match the Company's costs with customer prices during the period,  
263 the capital structure is based on the actual capital structure at September 30, 2010  
264 and forecasted capital activity, including known and measurable changes, through  
265 June 30, 2012. The Company has averaged the five quarter end capital structures  
266 measured beginning at June 30, 2011 and concluding with June 30, 2012. The  
267 budgeted capital activity includes known maturities of certain debt issues that  
268 were outstanding at September 30, 2010, planned issuances of long-term debt and

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<sup>5</sup> Fitch Ratings – October 1, 2010.

<sup>6</sup> Moody's Investor Service August 6, 2010.

269 the expected payment of dividends. The known and measurable changes represent  
270 actual and forecasted capital activity since September 30, 2010.

271 **Q. Why is Rocky Mountain Power using an average of five quarter ends to**  
272 **determine the proposed capital structure rather than simply an average of**  
273 **the beginning and ending points as in previous cases?**

274 A. As the Company has grown, its capital expenditure program has increased  
275 significantly from historical levels which, in turn, has required new financings to  
276 also be much larger. These larger financings are usually more efficient due to  
277 lower transactional costs, and better received by investors who value the greater  
278 liquidity that larger financings typically offer. However, the trade-off is greater  
279 volatility in the Company's capital structure ratios, particularly at quarter-end  
280 following sizable financings. As such, the Company is proposing in this case to  
281 use a capital structure that employs an average of the five quarter ending balances  
282 spanning the test period to help smooth out this volatility. This is also the same  
283 methodology the Company used in its most recent rate case. (Docket No. 09-035-  
284 23)

285 **Q. How does this capital structure compare to the Company's current capital**  
286 **structure and what was filed in the Company's most recent rate cases.**

287 A. The capital structures are compared in the table below.

<b>Rocky Mountain Power Comparison of Utah? Capital Structures</b>				
	<b>Docket No. 08-035- 38</b>	<b>Docket No. 09- 035-23</b>	<b>December 31, 2010<sup>7</sup></b>	<b>2011 General Rate Case</b>
<b>Long-Term Debt</b>	<b>47.7%</b>	<b>48.7%</b>	<b>46.5%</b>	<b>47.8%</b>
<b>Preferred Stock</b>	<b>0.4%</b>	<b>0.3%</b>	<b>0.3%</b>	<b>0.3%</b>
<b>Common Equity</b>	<b>51.9%</b>	<b>51.0%</b>	<b>53.2%</b>	<b>51.9%</b>
<b>Totals</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

<sup>7</sup> Preliminary as the Company has not yet published its year end financial statements.

288 The proposed capital structure in this Docket has a lower common equity  
289 component than the Company's actual December 31, 2010 capital structure and is  
290 in line with the capital structure in recent dockets. As discussed earlier, absent the  
291 expected dividends, the Company's common equity component would continue to  
292 increase.

293 **Q. How does the proposed cost of capital compare to the cost of capital that was**  
294 **determined in the Company's most recent rate case?**

295 A. The Commission determined an overall rate of return in the Company's most  
296 recent rate case of 8.34 percent. The Company's proposed cost of capital in this  
297 case is lower at 8.25 percent.

298 **Q. What type of debt and preferred equity securities does the Company employ**  
299 **in meeting its financing requirements?**

300 A. The Company relies on a mix of first mortgage bonds, other secured debt, tax-  
301 exempt debt, and preferred stock to help meet its long-term financing  
302 requirements. These securities employ various maturities in order to provide  
303 flexibility and mitigate refinancing risks. The Company has completed the  
304 majority of its long-term financing utilizing secured first mortgage bonds issued  
305 under the Mortgage Indenture dated January 9, 1989. Exhibit RMP\_\_\_(BNW-4)  
306 shows that, over the 12 months ended June 30, 2012, the Company is projected to  
307 have an average of approximately \$5.9 billion of first mortgage bonds  
308 outstanding, with an average cost of 6.23 percent. Presently, all outstanding first  
309 mortgage bonds bear interest at fixed rates. Proceeds from the issuance of the first  
310 mortgage bonds (and other financing instruments) are used to finance the

311 combined utility operation.

312 Another important source of financing has been the tax-exempt financing  
313 associated with certain qualifying equipment at power generation plants. Under  
314 arrangements with local counties and other tax-exempt entities, these entities  
315 issue securities, the Company borrows the proceeds of these issuances from the  
316 respective entities and pledges its credit quality to repay the debt in order to take  
317 advantage of the tax-exempt status of the financings. These bonds are primarily in  
318 a variable rate mode and are re-marketed, some as often as weekly. In addition to  
319 tax-exempt status, these securities take advantage of current very low short-term  
320 interest rates. On the other hand, the variable rate structure of this type of  
321 financing exposes the Company to re-marketing and interest rate risks as well as  
322 dislocations in the short-term credit markets. Hence, the Company is careful as to  
323 the total amount of this variable rate financing that it maintains in its capital  
324 structure.

325 During the 12 months ended June 30, 2012, PacifiCorp's tax-exempt  
326 portfolio is projected to be \$738 million in principal amount with an average cost  
327 of 2.46 percent (which includes the cost of issuance and credit enhancement).

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

330 A. As a regulated public utility, the Company has a duty and an obligation to provide  
331 safe, adequate and reliable service to customers in its Utah service territory while  
332 prudently balancing cost and risk. In order for Rocky Mountain Power to fulfill its  
333 service obligation, the Company is making significant capital expenditures for

334 new plant investment, including transmission and environmental control  
335 investments on existing fossil-fired generation units. Each of these capital  
336 investments also has associated operating and maintenance costs. Through its  
337 planning process, the Company determined the amount of necessary new  
338 financing needed to support these activities and to provide financial results and  
339 credit ratings that balance the cost of capital with continued access to the financial  
340 markets.

341 **Q. Please describe the changes to the amount of outstanding long-term debt.**

342 A. During the 12 months ending June 30, 2012, the balance of the outstanding long-  
343 term debt will change through maturities and principal amortization totaling  
344 \$592.7 million.

345 In addition, the Company presently expects to issue new long-term debt in  
346 the amount of \$400 million with all-in cost of 5.65 percent and \$600 million with  
347 an all in cost of 5.82 percent before the end of the test period. These expected  
348 issuances are included in the proposed capital structure and their expected costs  
349 are included in the cost of debt calculation.

#### 350 **Purchase Power Agreements**

351 **Q. Is the Company subject to rating agency debt imputation associated with**  
352 **Purchase Power Agreements?**

353 A. Yes. Rating agencies and financial analysts consider Purchase Power Agreements  
354 (“PPAs”) to be debt-like and will impute debt and related interest when  
355 calculating financial ratios. For example, S&P will adjust the Company’s  
356 published financial results and impute debt balances and interest expense resulting

357 from PPAs when assessing creditworthiness. They do so in order to obtain a more  
358 accurate assessment of a company's financial commitments and fixed payments.  
359 Exhibit RMP\_\_\_(BNW-5) is the May 7, 2007, publication by S&P detailing its  
360 view of the debt aspects of PPAs.

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

362 A. During a recent ratings review, S&P evaluated the Company's PPAs and other  
363 related long-term commitments. Approximately \$396 million of additional debt  
364 and \$26 million of related interest expense were added to the Company's debt and  
365 coverage tests solely as a result of PPAs. There were also other adjustments made  
366 by S&P that resulted in a total of approximately \$1 billion of debt and \$78 million  
367 of interest being imputed into PacifiCorp's credit ratios.<sup>8</sup>

368 **Q. How would the inclusion of this PPA related debt and these other**  
369 **adjustments affect the Company's capital structure as S&P reviews your**  
370 **credit metrics?**

371 A. Negatively. By including the imputed debt resulting from PPAs and these other  
372 adjustments, the Company's capital structure has a lower equity component as a  
373 corollary to the higher debt component, lower coverage ratios and reduced  
374 financial flexibility than what might otherwise appear to be the case from a  
375 review of the book value capital structure. For example, if one were to add the  
376 total \$1 billion amount of debt adjustments that Standard & Poor's makes to the  
377 Company's capital structure in this case, the resulting common equity percentage  
378 would decline from 51.9 percent to 48.4 percent. The 48.4 percent equity ratio  
379 falls below S&P's published expectations for PacifiCorp.

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<sup>8</sup> Standard & Poor's Rating Direct October 7, 2010.

	Book Values/Ratios	Rating Agency Adjustments	Adjusted Book Values/Ratios
Long-Term Debt	\$6,629/47.8%	\$1,000	\$ 7,629/51.3%
Preferred Stock	\$41 / 0.3 %	0	\$41 /0.3 %
Common Equity	\$7,210 / 51.9%	0	\$ 7846/ 48.4%
Totals	\$13,879/ 100.0%	\$1,000	\$ 14,879/ 100.0%

380 **Financing Cost Calculations**

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

383 A. I calculated the embedded costs of debt and preferred stock using the  
384 methodology relied upon in the Company's previous rate cases in Utah and other  
385 jurisdictions.

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

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

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

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

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

411 A. The Company's variable rate long-term debt in this case is in the form of tax-  
412 exempt debt. Exhibit RMP\_\_\_(BNW-6) shows that, on average, these securities  
413 had been trading at approximately 93 percent of the 30-day London Inter Bank  
414 Offer Rate ("LIBOR") for the period January 2000 through September, 2010.  
415 Therefore, the Company has applied a factor of 93 percent to the forward 30-day  
416 LIBOR rates at each quarter-end spanning the test period and then added the  
417 respective credit enhancement and remarketing fees for each floating rate tax-  
418 exempt bond. Credit enhancement and remarketing fees are included in the  
419 interest component because these are costs which contribute directly to the  
420 interest rate on the securities and are charged to interest expense. This method is

421 consistent with the Company's past practices when determining the cost of debt in  
422 previous Utah general rate cases as well as the other states that regulate  
423 PacifiCorp.

424 **Q. Regarding the new long-term debt issuances mentioned above, how did you**  
425 **determine the interest rate for this new long-term debt?**

426 A. I projected that this new long-term debt would be issued at the Company's  
427 estimated recent credit spread over the projected long-term Treasury rates as of  
428 May, 2011 and January, 2012. Further, I added in the effect of issuance costs to  
429 the debt offering. This reflects our best estimate of the costs of new debt,  
430 assuming the Company's senior secured long-term debt ratings remain  
431 unchanged.

432 **Q. What is the resulting estimated interest rate for this new long-term debt?**

433 A. The Company's current estimated credit spread for 30-year debt is 1.025 percent.  
434 The recent forward long-term Treasury rate for May 2011 and January 2012 is  
435 approximately 4.56 percent and 4.73 percent respectively. Issuance costs for this  
436 type of debt add approximately six basis points (i.e. 0.06 percent) to the all-in  
437 cost. Therefore the projected cost of the new long-term debt is as follows:

	May 2011 Issuance	January 2012 Issuance
Forward Treasury Rate	4.56 percent	4.73 percent
Credit Spread	1.025 percent	1.025 percent
Issuance Costs	0.06 percent	0.06 percent
All-in Cost	5.65 percent	5.82 percent

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

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

440 A. The cost of long-term debt is 5.81 percent for the period ending June 30, 2012, as  
441 shown in Exhibit RMP\_\_\_\_(BNW-4).

442 **Embedded Cost of Preferred Stock**

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

444 A. Exhibit RMP\_\_\_\_(BNW-7) shows the embedded cost of preferred stock for the  
445 period ending June 30, 2012, to be 5.43 percent.

446 **Q. Does this conclude your direct testimony?**

447 A. Yes.