Introduction and Summary of Rebuttal Testimony

Q. Are you the same Bruce N. Williams that provided direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony responds to the proposed adjustment by Department of Public Utilities (Division) witness, Mr. Charles Peterson to the Company's capital structure. In addition, I respond to several other related elements of the testimony of Mr. Peterson and the testimony of Daniel J. Lawton on behalf of the Office of Consumer Services. RMP witness Dr. Samuel C. Hadaway will address Mr. Peterson's and Mr. Lawton's return on equity recommendations.

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

A. Yes. Mr. Lawton recommends that the Commission approve the Company's capital structure and the costs of debt and preferred stock[1]. Mr. Peterson has concluded that the Company's cost of preferred stock and long-term debt is reasonable and proposes no adjustments.[2]

Reply to Division Capital Structure Adjustment

Q. Please describe the adjustment that Mr. Peterson is proposing to the Company's capital structure.

A. Mr. Peterson proposes to reduce the common equity component of the Company's

[1] Lawton direct testimony, September 17, 2009, lines 791-804.

[2] Peterson direct testimony, September 17, 2009, lines 125-125.

capital structure from 51.0 percent to 50.5 percent.

Q. Do you agree with this proposed adjustment?

A. No for several reasons. First, Mr. Peterson has selected a single point in time, December 31, 2009, as the basis of his estimate for the Company's capital structure. As Mr. Peterson states in his testimony the capital structure on that date "is assumed to represent the average for the test year."[3] As I discussed in my direct testimony, the Company's proposed capital structure is based on an average of the quarter ending balances spanning the test period. I believe the five quarter average is a superior method to determine the average capital structure in this docket, particularly as it helps smooth out the impact of the Company's debt issuance in January, 2009. In addition, Mr. Peterson's adjustment is based on his analysis of the Company's June 30, 2009 capital balances which are then adjusted for his projected net income during the second half of 2009. A key assumption underlying his analysis and adjustment is that Mr. Peterson projects that the Company will earn $508 million during 2009.[4]

Q. Is that earnings estimate consistent with the Company's budget?

A. No. The Company's budget provides a projection for net income of [redacted] million[5] which helps explain why Mr. Peterson's estimated capital structure has less common equity than the Company's filing.

---

[3] Peterson direct testimony, September 17, 2009 lines 328 through 329.

[4] Peterson direct testimony, September 17, 2009, line 338.

[5] Confidential response to MDR 2.12

Q. Is the Company's projected net income for 2009 an increase over its actual 2008 net income?

A. Yes, both Mr. Peterson's estimate and the Company's budgeted net income reflect an increase from the results of the prior period. While the Company's has budgeted higher net income for 2009, the projection is a realistic target and it produces a return on equity of approximately [redacted] percent for our shareholders, a result well below the Company's authorized return on equity. At the same time, the Company continues to make substantial new investments to better serve customers, including a capital budget of over $2.2 billion total company during 2009.[6]

Q. Mr. Peterson states that there is no reason to increase the equity percentage of the capital structure at this time. Do you agree?

A. No. The projected increase in the equity percentage of the capital structure is expected to help produce financial results consistent with the rating agencies targets for our current ratings category.

Absent improved financial metrics the Company likely faces a downgrade in its credit ratings. As I discussed in my direct testimony, the Company's stand-alone results are seen by rating agencies as in-line with a "BBB" category rating (see Exhibit RMP___(BNW-1R) "Standard & Poor's Ratings Direct – PacifiCorp, April 1, 2009" page 2.) The Company has been fortunate to avoid a downgrade due to our ownership by MidAmerican Energy Holdings Company and its parent, Berkshire Hathaway, as well as the expectation that PacifiCorp will continue to receive supportive regulatory treatment.

[6] Confidential response to MDR 2.12

Q. Do you agree with Mr. Peterson's view that the "slight increase" in the Company's capital structure will not improve the Company's bond rating?

A. Yes, however Mr. Peterson misses the point of my testimony. The increase in the common equity percentage was not expected to result in an upgrade, rather it is solely intended to help the Company retain its current rating. The benefits of maintaining the current rating are discussed in detail in my direct testimony and include lower borrowing costs and more consistent access to the capital markets particularly during times when the markets may not be available to lower rated borrowers.

Q. Do you have any further comments regarding Mr. Peterson's testimony?

A. Yes, while Mr. Peterson and I are generally in agreement with most matters in my testimony, he seems skeptical as to the effect that the adjustments rating agencies make for purchased power agreements and other items have on ratings. While there are varying opinions about the appropriateness of the adjustments the rating agencies make, the fact is that rating agencies do make these adjustments and it does affect ratings. For PacifiCorp, these adjustments can be very significant. In fact Standard & Poor's made adjustments when assessing the Company's 2008 financial results that increased the Company's debt by over $1 billion (nearly a 20% increase in the amount of debt) when assessing creditworthiness (see Exhibit RMP___(BNW-1R) "Standard & Poor's Ratings Direct – PacifiCorp, April 1, 2009" page 7.)

Q. Have you quantified the impact of these imputed debt adjustments on the Company's financial ratios?

A. Yes. The table below shows the key financial ratios before and after the impact of these adjustments by Standard & Poor's and whether the adjusted ratios meet the targets called for by the agency.

	Unadjusted		Adjusted *	
Ratio	Result	Target Met? **	Result	Target Met **
FFO/Interest	4.1x	Yes	4.0x	Yes
FFO/Debt	19.2%	No	17.8%	No
Debt/Capitalization	49.0%	Yes	52.8%	No

*Adjustments made by Standard & Poor's Rating Direct, April 1, 2009.
**Target as stated by Standard & Poor's Ratings Direct, April 1, 2009.

It is clear that when the adjustments are included, two of the Company's key financial ratios do not achieve the targets and the third is borderline.

Q. Do you agree with Mr. Peterson assessment that a capital structure of 50 percent equity should be adequate to maintain an A3 rating from Moody's?

A. Perhaps, but it is far from a certainty. Debt to capitalization is only one of the four key financial metrics that Moody's uses to assess utility credit ratings. The other three are cash flow metrics which are similar to S&P's funds from operations (FFO) measures. Each of these four measures are equally weighted by Moody's so even if one measure such as capital structure supports a certain ratings level the other measures (as well as the other ratings considerations) could very well result in the credit ratings being different.

Reply to OCS Witness Mr. Lawton

Q. Please comment on Mr. Lawton's Exhibit 1.10, which purports to show that the OCS recommended overall cost of capital provides financial metrics consistent with a solid single 'A' bond rating.

A. I do not agree that the OCS recommended cost of capital would result in financial metrics that secure the Company's current bond rating. This is clear from the most recent rating agency reports that the Company has received, including the report from Standard & Poor's cited above, indicating that the Company's metrics are more consistent with a 'BBB' rating, than its current rating. If accepted by the Commission, the OCS's proposed reduction to the Company's cost of capital would negatively impact the Company's financial metrics and put further downward pressure on the Company's current rating.

Exhibit OCS 1.10 takes a much more superficial approach to the calculation of financial metrics than that employed by the rating agencies. For example, the Exhibit severely underestimates the amount of debt and interest that rating agencies and financial analysts will utilize in their financial models. As I discussed earlier in this rebuttal testimony, the adjustments by Standard and Poor's results in over $1 billion of additional debt and nearly $75 million of corresponding interest expense being added to the financial metrics. Certainly, this amount of additional debt and interest will weaken the ratios.

Also, the Exhibit 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. Further, Mr. Lawton ignores any interest expense associated with financings necessary to support the significant construction work in progress balance that the Company will have during the test period. These financings will add real debt and interest to the Company's financial statements which isn't accounted for in Mr. Lawton's Exhibit. While there should be an earnings benefit from the allowance for funds used during construction (AFUDC) during the construction period there is no corresponding cash flow increase to offset the financing costs. This will further erode the financial metrics in Mr. Lawton's Exhibit OCS 1.10.

Q. Does this conclude your rebuttal testimony?

A. Yes.