Introduction and Purpose of Testimony

Q. Are you the same Bruce N. Williams who submitted pre-filed direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony provides an update to the Company's cost of debt and the resulting impact on overall cost of capital. In addition, I respond to several elements of the testimony of Mr. Daniel J. Lawton on behalf of the Office of Consumer Services and the testimony of The Federal Executive Agencies witness Mr. Michael Gorman.

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

A. Yes. No party has proposed adjustments to the Company's capital structure, cost of debt or preferred stock.

Update to Cost of Debt

Q. Please describe the update to cost of debt that you are proposing and why it is appropriate?

A. The Company recently completed a new issuance of long-term debt and I am updating the cost of debt and the overall cost of capital in this docket to reflect the specifics of this debt issuance.

Q. Please provide the details on this recent debt issuance.

A. On May 12, 2011 the Company completed the issuance of $400 million of first mortgage bonds with a coupon rate of 3.85 percent and a maturity of 2021. The rate on these bonds compares very favorably to debt issuances at approximately the same period of time by similarly or higher rated utility issuers including Pacific Gas & Electric Company, The Detroit Edison Company and Southern California Edison Company.

Q. Does this debt issuance result in a change to the capital structure?

A. No. The Company's capital structure included a $400 million debt issuance during May, 2011. As such, no change to the proposed capital structure is necessary or appropriate.

Q. What is the updated cost of debt and overall cost of capital that you are proposing in this proceeding?

A. The updated cost of debt is 5.71 percent as shown in Exhibit RMP___(BNW-1R). The table below shows the Company updated cost of debt and overall cost of capital in this proceeding.

Component	Percent of Total	% Cost	Weighted Average
Long-Term Debt	47.8%	5.71%	2.73%
Preferred Stock	0.3%	5.43%	0.02%
Common Stock Equity	51.9%	10.50%	5.45%
Total	100.0%		8.20%

Reply to FEA's Credit Metric Analysis

Q. Please comment on Mr. Gorman's discussion concerning financial integrity and his credit metrics.

A. Mr. Gorman attempts to support his proposed return on equity and resulting overall rate of return through an analysis of key credit metrics.

Q. Do you agree with Mr. Gorman's credit metric analysis?

A. No, Mr. Gorman's analysis is seriously flawed, not supported by facts and therefore should not be relied upon by the Commission.

Mr. Gorman and I do agree that rating agencies make adjustments to the Company's published financial statements when undertaking their credit analysis; however, Mr. Gorman's measurement of these adjustments is incomplete and one sided.

While Mr. Gorman relies upon Standard & Poor's metrics, he conveniently and clearly chose to include only a portion of the adjustments that Standard & Poor's uses in their analysis of the Company. While Mr. Gorman attempts to explain his inclusion of only a portion of the adjustments it does not change the fact that his analysis fails to include over half the adjustments. Had Mr. Gorman properly included these items and been consistent with S&P's own analysis, his resulting ratios would be further weakened.

Q. Are there other issues with Mr. Gorman's credit metric analysis?

A. Yes, in addition to including less than half of the adjustments, Mr. Gorman's model does not include the qualitative aspects that rating agencies and other financial analysts' assessments take into account. Mr. Gorman is attempting to focus attention onto one (flawed) model while giving no consideration to the qualitative aspects that may be as important or perhaps more important. For example, Moody's states that two of their key rating factors are (i) regulatory framework and (ii) ability to recover costs and earn returns. These two factors alone make up 50 percent of the total rating factors. As I noted in my direct testimony, Standard & Poor's also views regulatory risk as perhaps the most important factor in their analysis of the U.S. regulated, investor owned utility business risk.[1]

It may be difficult for the rating agencies and other market participants to view the Commission agreeing to Mr. Gorman's proposed rate of return as providing "supportive rate case outcomes"[2] or "reasonable outcomes in pending and future rate proceedings"[3] or "reasonable regulatory treatment for the recovery of its higher capital expenditures."[4] All of these are key criteria of the rating agencies which help provide support for the Company maintaining its current ratings.

Finally, parties in this case have proposed a number of adjustments to the Company's case that would reduce the inputs to Mr. Gorman's model. Should the Commission decide to accept these adjustments it should be aware that resulting ratios will be further weakened.

Reply to OCS witness Mr. Lawton

Q. Are Mr. Lawton's concerns about negative impacts on consumers related to credit rating agencies actions as a result of the Company paying dividends[5] well founded?

A. No. The credit rating agencies are all aware of the Company's recent dividend payments and projected payments and no agency has stated concerns such as Mr. Lawton is speculating about. Further, Moody's and Standard & Poor's have both published reports subsequent to the dividend payments and ratings remained unchanged.

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[1] Williams direct testimony - lines 147 through 150.
[2] Standard & Poor's Ratings Direct – April 1, 2009
[3] Fitch Ratings – October 1, 2010
[4] Moody's Investor Service - May 9, 2011
[5] Lawton direct testimony - lines 866 through 879.

Absent these dividends, the common equity component of PacifiCorp's projected capital structure would materially exceed the amount currently allowed by the Commission in rates. Issuing incremental debt solely for the purpose of reducing the common equity component of capital structure is not reasonable since the proceeds from that portion of an incremental debt issuance cannot be usefully deployed at this time. Similarly, it is not reasonable for PacifiCorp to maintain common equity in its regulated capital structure upon which it earns no equity return. Therefore, the only viable option for reducing the common equity component of capital structure was to issue dividends. When considered in combination with its cash flow metrics, the level of common equity in the capital structure is expected to support the Company's current credit rating.

In fact, absent these dividends, the Company's capital structure would contain a higher common equity component and the resulting revenue requirement in this proceeding would also be higher. This higher cost outcome directly conflicts with the Company's goal of maintaining a balanced capital structure that provides cost efficient financings for the benefit of customers while maintaining financial integrity, credit ratings and access to capital markets.

Mr. Lawton's concerns about the dividend payments having a negative impact on customers are simply not valid.

Q. Does Mr. Lawton also attempt to support his proposed return on equity through financial ratios?

A. Yes, Mr. Lawton provides financial ratios in his Exhibit (OCS 1.9) in which he concludes that his recommendations would support the Company's current bond rating.

Q. Have you reviewed Mr. Lawton's analysis and if so, do you agree with it?

A. I have reviewed Mr. Lawton's analysis and believe it to have a number of serious flaws and as such should not be relied upon by the Commission.

First, Mr. Lawton fails to include any of the adjustments that rating agencies and others make when calculating financial ratios. This means that he has failed to include nearly $1 billion of additional debt and $78 million of interest that Standard & Poor's included in their analysis.[6] The impact of ignoring these adjustments is to understate the debt component of the capital structure, overstate the cash flow coverage ratios and financial flexibility.

Further, like Mr. Gorman, Mr. Lawton attempts to look at the ratios in isolation and not consider the qualitative aspects of the ratings analysis. In particular whether his recommended rate of return would provide "supportive rate case outcomes"[7] or "reasonable outcomes in pending and future rate proceedings"[8] or "reasonable regulatory treatment for the recovery of its higher capital expenditures"[9] is at best uncertain. As noted with Mr. Gorman's model, these incorrect and overstated ratios will be further weakened should the Commission accept adjustments proposed by parties in this case.

For these reasons, Mr. Lawton's attempted use of financial ratios to support his return on equity recommendation should be ignored by the Commission.

[6] Standard & Poor's Ratings Direct October 7, 2010
[7] Op cit
[8] Op cit
[9] Op cit

Q. Does this conclude your rebuttal testimony?

A. Yes.