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PacifiCorp

Primary Credit Analyst:
Anne Selting, San Francisco (1) 415-371-5009; anne_selting@standardandpoors.com

Secondary Contact:
Todd A Shipman, New York (1) 212-438-7676; todd_shipman@standardandpoors.com

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PacifiCorp

Major Rating Factors

Corporate Credit Rating
A-/Stable/A-2

Strengths:

- Market and regulatory diversity is afforded by PacifiCorp's electric utility business, which serves portions of six western U.S. states;
- Retail electric rates compare favorably with those of other electric suppliers operating in the states PacifiCorp serves, suggesting that the company may be able to maintain its competitive advantage despite its ongoing need for rate relief to support a large capital program;
- The recent approval of a fuel and purchased power adjuster in Utah is a positive development because the state is the company's largest market and will limit the amount that the utility will have to absorb if purchased fuel and power costs exceed levels authorized in electric rates;
- Dependence on purchased power has decreased; and
- A settlement reached in February 2010 regarding the contentious Klamath hydro relicensing case protects the company from any financial consequences if the project is decommissioned, which will not occur before 2020.

Weaknesses:

- Despite the company's practice of filing nearly annual rate cases, regulatory lag continues to allow only modest improvement in the company's financial profile: Its return on equity remains under authorized levels and cash flow metrics remain just adequate to support the rating, although adjusted leverage has improved since MidAmerican Energy Holdings Co. acquired the utility in 2006;
- Regulators will need to consistently support retail rate increases to recover PacifiCorp's large capital investment program amid sluggish economic indicators; and
- Retail electric sales growth has stalled in the portions of the Pacific Northwest that PacifiCorp serves, which, if it becomes a medium- to long-term trend, could lower profitability and put additional pressure on retail electric rates.

Rationale

The 'A-' corporate credit rating (CCR) on PacifiCorp reflects what Standard & Poor's Ratings Services views as a significant financial profile and is supported by PacifiCorp's modest use of leverage to finance a large capital program and parent MidAmerican Energy Holdings Co.'s (MEHC; BBB+/Stable) willingness to deploy equity into PacifiCorp as needed to support the company's capital structure as it expands its rate base. Since acquiring the company in 2006, MEHC has provided $1.06 billion in equity support for the utility's capital needs.

PacifiCorp's excellent business profile benefits from the geographical, market, and regulatory diversity provided by its six-state service territory. PacifiCorp provides power to retail customers under the name Rocky Mountain Power in Utah, Wyoming, and Idaho, and as Pacific Power in Oregon, Washington, and California. Utah and Oregon are the most important markets for the company, providing around 42% and 24% of annual retail sales, respectively, as of year-end 2010.

Since being acquired in 2006 by MEHC, the electric utility has made modest strides in improving key business and regulatory aspects of the utility that serves more than 1.7 million retail electric customers. Despite sluggish economic recovery in the company's Pacific Northwest territory, its western states, especially Utah, continue to exhibit some growth. PacifiCorp has been able to eke out rate increases that are in line with our expectations, and the utility was recently granted a fuel and purchased power adjuster in Utah. Despite its weak design (the utility may collect only 70% of any difference between actual and budgeted costs) and its pilot status (it will sunset in four years), we view the Utah adjuster as a step forward for credit quality because it mitigates a key business risk for electric utilities, the vast majority of which were afforded such mechanisms beginning shortly after the western energy crisis in 2001 and 2002. About 90% of PacifiCorp's retail electric sales are now covered by some type of fuel adjusters. (None exist in Washington state.) The company is building an additional baseload natural-gas–fired plant and in 2010 relied on natural gas for 12% of energy supplies.

The company's deferred tax balances are lifting cash flows due to an extension of bonus depreciation, and credit metrics this year are likely to exceed our expectations for this reason. For the 12 months ended June 30, adjusted funds from operations (FFO) to total debt and FFO interest coverage were 24.3% and 5.4x, respectively. Beneath this benefit, operating income and EBITDA in the first half of 2011 are approximately flat relative to the prior-year period, but a $117 million (7%) electric rate increase approved in Utah and a $62 million (11%) increase in Wyoming, both effective at the end of September, should nudge earnings metrics up in the fourth quarter. Adjusted debt to total capitalization was 52.4% as of June 30, an increase from 50.1% at year-end 2010. The leverage uptick is due to a $400 million May debt issuance and a common stock distribution of $550 million to its parent, which reduced shareholder equity.

The cash credit metrics we expect the company to achieve after this year are just adequate, in our view, to support the ratings, providing little cushion for the company to deviate. For 2012 we project adjusted FFO to total debt in the range of 20%, FFO interest coverage of 4.6x, and debt to total capitalization of around 51%. These expectations reflect our view that the company's earned return on equity (ROE) will be in line with past performance and that electric sales will grow 1.5% on average.

A key ongoing challenge for PacifiCorp is whether it will be able to achieve rate relief at levels necessary to sustain the company's capital investment program. The program has been at high levels throughout the recession and will remain so in the next few years, despite the dimming prospects for economic recovery. MEHC has been consistent in its investment thesis for the company, seeking to deploy capital in the electric utility in exchange for an opportunity to earn its authorized return, which varies by state but is in the area of 10%. Since acquisition, MEHC has spent an average of $1.7 billion per year on capital investment, providing equity investments in PacifiCorp totaling more than $1 billion to maintain a balanced capital structure. We expect PacifiCorp to spend $1.6 billion this year (it had spent $712 million as of June 30), and it is budgeting $1.8 billion for 2012 and $1.7 billion in 2013, according to its 10-K filing. This level of spending will continue to require regular retail electric rate increases in all of PacifiCorp's markets over the next three years. This begs the issue of whether rate case fatigue will set in, creating regulator or ratepayer resistance to further increases. Through the first half of this year, retail electric sales were up 2%, but this is largely a result of Rocky Mountain Power, which accounts for about two-thirds of PacifiCorp's total retail sales and includes Salt Lake City, Utah. Pacific Power, which accounts for the balance of utility electric sales, has seen load growth stagnate. Further weakening of the economy, which is increasingly appearing to be likely, could increase revenue requirements as the company seeks to spread fixed costs over smaller sales volumes.

PacifiCorp's authorized ROE varies by state but is around 10%. (In its most recent rate case in Utah, its authorized ROE was lowered from 10.6% to 10.0%). Based on our calculations, PacifiCorp's actual ROE has been in the range of 8.1% to 8.5% since 2007. Achieving stronger ROE may prove difficult given the level of capital the company is deploying, because regulatory lag is inherent given its high spending.

Among the larger projects PacifiCorp is pursuing is the buildout of Lakeside 2, a 647-megawatt combined-cycle gas plant in Utah expected in service in 2014. Coal plant environmental upgrades are also planned, as is a major transmission investment, including the multi-segment transmission line, the Energy Gateway Transmission project (EGTE). The EGTE is a multiyear, $6 billion-plus transmission project that will add approximately 2,000 miles of new transmission line across the West. The project is being completed in phases, with the last phase expected to go into service in 2019. Construction of the first, 135-mile segment, running from the Populus substation in southern Idaho to the Terminal substation near Salt Lake City, was completed December 2010 at a cost of $830 million.

Some 89% of the total costs are being recovered in current rates in the various states. But in its December 2010 rate case, the Idaho Public Utilities Commission (IPUC) disallowed recovery in current rates of 27% of its 6% share of the investment (or about 1.62% or $13 million). In December 2010 the IPUC ordered the company to carry the asset as plant held for future use. The company has filed an appeal of the IPUC's order with the Idaho Supreme Court. The IPUC's ruling is an unfavorable precedent. Given that no transmission projects have received explicit pre-approval in any of the jurisdictions PacifiCorp serves, the onus is on the company to demonstrate the value of its transmission investment to regulators, largely on an ex post basis. The next segment to be completed is Mona-to-Oquirrh, a 100-mile segment within Utah expected in service summer 2013 at a cost of $440 million. Construction is underway.

PacifiCorp is wholly owned by MEHC and has put in ring-fencing provisions that allow us to rate PacifiCorp above the 'BBB+' CCR on MEHC, if its stand-alone credit metrics and business profile risks warrant. In turn, MEHC is privately held and majority owned by Berkshire Hathaway (AA+/Negative/A-1+). PacifiCorp benefits from regulatory insulation from its parent. Our criteria provide that the PacifiCorp CCR can be no more than three notches above the MEHC consolidated credit rating. The parent and subsidiary are currently rated within one notch of one another.

Liquidity

On a stand-alone basis (i.e., unenhanced by the existing $2 billion contingent equity agreement available to MEHC to support any of its regulated subsidiaries, including PacifiCorp) we view PacifiCorp's liquidity as adequate under our corporate liquidity methodology. This methodology categorizes liquidity in five standard descriptors (exceptional, strong, adequate, less than adequate, and weak). Projected sources of liquidity, which consist of operating cash flow and available bank lines, exceed projected uses, including capital expenditures, debt maturities, and common dividends, by more than 1.2x. Under our criteria, we exclude as sources of liquidity any facilities expiring within one year of the liquidity assessment date.

The utility maintains unsecured credit facilities that totaled $1.395 billion as of June 30. Of this total, $304 million of liquidity is reserved for letters of credit to support tax exempt bond obligations, reducing available borrowings to $1.091 billion. (In July 2011, as scheduled, $40 million in bank commitments under one of its facilities expires; current credit lines total $1.355 billion.) There are no rating triggers on the credit lines. One facility, for $635 million, expires in October 2012. (We have included this facility as source of liquidity based on this assessment completed in late September.) The other credit facility is sized at $720 million and will decline to $630 million in July 2012 and expire in 2013. Regulatory restrictions limit PacifiCorp's short-term debt to $1.5 billion.

PacifiCorp's liquidity is indirectly supported by Berkshire Hathaway, which has in place through February 2014 a $2 billion equity commitment agreement between itself and MEHC under which MEHC can unilaterally call upon Berkshire Hathaway to support either its parent debt repayment or the capital needs of its regulated subsidiaries, including MidAmerican Energy Co. Nevertheless, we assess PacifiCorp's liquidity on a stand-alone basis because the utility has no authority to cause MEHC to make an equity contribution from Berkshire Hathaway through an MEHC board request. Although MEHC would typically have strong incentives to support the utility by tapping the Berkshire Hathaway contingent equity, MEHC would be expected to do so only if doing so were in the parent's best economic interests. Because Berkshire has up to 180 days to fund an equity request, we also do not count on the agreement to provide PacifiCorp with immediate cash. For these reasons, we consider the equity agreement a qualitative enhancement to liquidity but continue to calculate the utility's liquidity metrics on a stand-alone basis.

Recovery analysis

We rate PacifiCorp's first mortgage bonds (FMB) 'A', a notch higher than the 'A-' issuer credit rating, and have assigned them a recovery rating of '1+'. We assign recovery ratings to FMBs issued by investment-grade U.S. utilities, and this can result in issue ratings that are higher than the utility CCR depending on the CCR category and the extent of the collateral coverage. We base our investment-grade FMB recovery methodology on the ample historical record of nearly 100% recovery for secured-bond holders in utility bankruptcies and on our view that the factors that supported those recoveries (the limited size of the creditor class and the durable value of utility rate-based assets during and after a reorganization, given the essential service provided and the high replacement cost) will persist. Under our notching criteria, we consider the limitations of FMB issuance under the utility's indenture relative to the value of the collateral pledged to bondholders, management's stated intentions on future FMB issuance, and the regulatory limitations on bond issuance. FMB ratings can exceed a utility CCR by as many as one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade categories. (See "Changes To Collateral Requirements For '1+' Recovery Ratings On U.S. Utility First Mortgage Bonds," published Sept. 6, 2007, on RatingsDirect on the Global Credit Portal.)

PacifiCorp's FMBs benefit from a first-priority lien on substantially all of the utility's real property owned or subsequently acquired. Collateral, in combination with regulatory covenants that restrict borrowing that were entered into as a condition of MEHC's acquisition of PacifiCorp in 2006, provides coverage of more than 1.5x, supporting a recovery rating of '1+' and an issue rating one notch above the CCR.

Outlook

The stable outlook incorporates our anticipation that PacifiCorp will be able to perform to forecast, achieving adjusted FFO to debt in the area of 20%, FFO interest coverage of at least 4.5x and adjusted debt to total capitalization of around 50%. We view these cash flow levels as merely adequate to maintain the ratings, and could lower the ratings if FFO to total debt drops to less than 18% on a sustained basis, with FFO interest coverage or adjusted leverage creeping above 52% over our outlook horizon. We do not expect upward ratings momentum for the utility, given its heavy investment program.

Table 1.

PacifiCorp -- Peer Comparison*			
	PacifiCorp	**Portland General Electric Co.**	**Pacific Gas & Electric Co.**
Rating as of Sept. 22, 2010	A-/Stable/A-2	BBB/Stable/A-2	BBB+/Watch Neg/A-2
	--Average of past three fiscal years--		
(Mil. $)			
Revenues	4,404.3	1,764.0	13,218.9
Net income from cont. oper.	479.7	109.0	1,157.7
Funds from operations (FFO)	1,342.3	326.5	3,030.0
Capital expenditures	1,850.2	511.4	3,437.7
Cash and short-term investments	134.7	38.0	175.7
Debt	6,641.7	1,875.2	12,662.8
Preferred stock	34.2	0.0	258.0
Equity	5,926.2	1,404.3	10,032.3
Debt and equity	12,567.9	3,279.5	22,695.2
Adjusted ratios			
EBIT interest coverage (x)	2.8	2.2	2.9
FFO int. cov. (x)	4.3	3.5	4.1
FFO/debt (%)	20.2	17.4	23.9
Discretionary cash flow/debt (%)	(10.5)	(14.4)	(14.1)
Net cash flow/capital expenditure (%)	72.5	51.5	71.2
Total debt/debt plus equity (%)	52.8	57.2	55.8
Return on common equity (%)	7.2	6.3	11.1
Common dividend payout ratio (unadj.; %)	2.7	59.6	49.6

*Fully adjusted (including postretirement obligations).

Table 2.

PacifiCorp -- Financial Summary*					
	--Fiscal year ended Dec. 31--				
	2009	**2008**	**2007**	**2006**	**2006**
Rating history	A-/Stable/A-2	A-/Watch Neg/A-1	A-/Stable/A-1	A-/Stable/A-1	A-/Stable/A-1
(Mil. $)					
Revenues	4,457.0	4,498.0	4,258.0	4,154.1	3,896.7
Net income from continuing operations	542.0	458.0	439.0	307.9	360.7
Funds from operations (FFO)	1,760.1	1,272.1	994.8	927.6	864.5
Capital expenditures	2,297.1	1,757.0	1,496.4	1,375.0	1,030.5
Cash and short-term investments	117.0	59.0	228.0	59.0	119.6
Debt	7,415.8	6,635.9	5,873.5	5,473.6	5,185.3
Preferred stock	20.5	41.0	41.0	41.3	41.3
Equity	6,711.5	5,987.0	5,080.0	4,426.8	3,750.7
Debt and equity	14,127.3	12,622.9	10,953.5	9,900.4	8,936.0
Adjusted ratios					
EBIT interest coverage (x)	2.7	2.8	2.8	2.5	3.0
FFO int. cov. (x)	4.9	4.2	3.5	3.8	3.8

Table 2.

PacifiCorp -- Financial Summary* (cont.)					
FFO/debt (%)	23.7	19.2	16.9	16.9	16.7
Discretionary cash flow/debt (%)	(10.2)	(10.7)	(10.5)	(10.7)	(5.6)
Net cash flow/capital expenditure (%)	76.6	72.3	66.3	66.1	66.7
Debt/debt and equity (%)	52.5	52.6	53.6	55.3	58.0
Return on common equity (%)	7.0	6.8	7.8	6.2	8.9
Common dividend payout ratio (unadj.; %)	7.0	0.0	0.0	5.2	49.1

*Fully adjusted (including postretirement obligations).

Table 3.

Reconciliation Of PacifiCorp Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. $)*

	--Fiscal year ended Dec. 31, 2009--									
PacifiCorp reported amounts										
	Debt	**Shareholders' equity**	**Operating income (before D&A)**	**Operating income (before D&A)**	**Operating income (after D&A)**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	6,416.0	6,732.0	1,609.0	1,609.0	1,060.0	359.0	1,500.0	1,500.0	2.0	2,328.0
Standard & Poor's adjustments										
Operating leases	36.5	--	5.0	2.3	2.3	2.3	2.7	2.7	--	4.1
Intermediate hybrids reported as equity	20.5	(20.5)	--	--	--	1.0	(1.0)	(1.0)	(1.0)	--
Postretirement benefit obligations	369.9	--	20.0	20.0	20.0	5.0	33.8	33.8	--	--
Accrued interest not included in reported debt	111.0	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	35.0	(35.0)	(35.0)	--	(35.0)
Power purchase agreements	395.7	--	63.3	63.3	25.8	25.8	37.5	37.5	--	--
Asset retirement obligations	66.3	--	9.0	9.0	9.0	9.0	5.2	5.2	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	83.0	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	217.0	--	--
Total adjustments	999.8	(20.5)	97.3	94.6	140.2	78.2	43.1	260.1	(1.0)	(30.9)

Table 3.

Reconciliation Of PacifiCorp Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. $)* (cont.)

Standard & Poor's adjusted amounts

	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	7,415.8	6,711.5	1,706.3	1,703.6	1,200.2	437.2	1,543.1	1,760.1	1.0	2,297.1

*PacifiCorp reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Ratings Detail (As Of October 3, 2011)*	
PacifiCorp	
Corporate Credit Rating	A-/Stable/A-2
Commercial Paper	
Local Currency	A-2
Preferred Stock (2 Issues)	BBB
Senior Secured (54 Issues)	A
Senior Unsecured (2 Issues)	A-
Corporate Credit Ratings History	
27-Mar-2009	A-/Stable/A-2
18-Sep-2008	A-/Watch Neg/A-1
22-Mar-2006	A-/Stable/A-1
Business Risk Profile	Excellent
Financial Risk Profile	Significant
Related Entities	
CE Electric U.K. Funding Co.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured (1 Issue)	BBB+
CE Generation LLC	
Senior Secured (1 Issue)	BB+/Stable
Cordova Energy Co. LLC	
Senior Secured (1 Issue)	BB/Stable
Iowa-Illinois Gas & Electric Co.	
Senior Unsecured (5 Issues)	A-/A-2
Kern River Gas Transmission Co.	
Senior Secured (2 Issues)	A-/Stable
MidAmerican Energy Co.	
Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	
Local Currency	A-2
Preferred Stock (1 Issue)	BBB+
Senior Unsecured (8 Issues)	A-
Senior Unsecured (2 Issues)	A-/A-2

Ratings Detail (As Of October 3, 2011)***(cont.)**	
MidAmerican Energy Holdings Co.	
Issuer Credit Rating	BBB+/Stable/--
Preferred Stock (2 Issues)	BBB-
Senior Unsecured (8 Issues)	BBB+
MidAmerican Funding LLC	
Senior Secured (1 Issue)	BBB+
Midwest Power Systems Inc.	
Senior Unsecured (1 Issue)	A-/A-2
Northern Electric Distribution Ltd.	
Issuer Credit Rating	A-/Stable/--
Senior Unsecured (1 Issue)	A-
Northern Electric Finance PLC	
Senior Unsecured (1 Issue)	A-
Northern Electric PLC	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured (1 Issue)	A-
Northern Natural Gas Co.	
Issuer Credit Rating	A/Stable/--
Senior Unsecured (5 Issues)	A
Salton Sea Funding Corp.	
Senior Secured (1 Issue)	BBB-/Stable
Yorkshire Electricity Distribution PLC	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured (2 Issues)	A-
Yorkshire Electricity Group PLC	
Issuer Credit Rating	BBB+/Stable/--
Yorkshire Power Group Ltd.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured (1 Issue)	BBB+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.