**Q. Please state your name, business address, and present position with PacifiCorp dba Rocky Mountain Power ("the Company").**

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

**Qualifications**

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

A. I received a Bachelor of Science degree in Business Administration with a concentration in Finance from Oregon State University in 1980. I also received the Chartered Financial Analyst designation upon passing the examination during 1986. I have been employed by the Company for 28 years. My business experience has included financing of the Company's electric operations and non-utility activities, responsibility for the investment management of the Company's qualified and non-qualified retirement plan assets, and investor relations.

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

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

**Summary of Testimony**

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

A. My testimony discusses the Company's capital structure and costs of capital. It supports the proposed common equity level of 51.60 percent and provides evidence that such level is appropriate and benefits customers. Those benefits include maintaining the Company's current credit ratings, which will facilitate continued access to the capital markets for the Company, and providing a more competitive cost of debt and overall cost of capital over the long-term. I also support the Company's cost of long-term debt of 5.28 percent and cost of preferred stock of 6.75 percent.

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

A. Rocky Mountain Power is proposing an overall cost of capital of 7.72 percent. This cost includes the return on equity recommendation of 10.00 percent from Dr. Samuel C. Hadaway and the following capital structure and costs:

**Overall Cost of Capital**

| | Percent of Total | Cost | Weighted Ave |
|---|---|---|---|
| Long Term Debt | 48.38% | 5.28% | 2.56% |
| Preferred Stock | 0.02% | 6.75% | —% |
| Common Stock Equity | 51.60% | 10.00% | 5.16% |
| | 100.00% | | 7.72% |

**Q. How does the proposed overall cost of capital compare to the Company's current authorized cost of capital?**

A. The proposed overall cost of capital is a slight increase of four basis points (0.04 percent) compared to the 7.68 percent currently reflected in rates and adopted in the Commission Order issued September 19, 2012, in Docket Nos. 11-035-200, 12-035-79 and 12-035-80. As I will discuss in more detail later in this testimony, by maintaining its credit ratings, the Company has been able to continue to lower its cost of long-term debt and moderate increases to customers.

**Financing Overview**

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

A. Rocky Mountain Power is in the process of adding significant new plant investments over multiple years. These investments include required pollution control equipment, new generation, transmission facilities and other capital investments to properly maintain the existing infrastructure. These investments help system reliability, improve power delivery and help to assure safe operations for the benefit of customers.

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

A. The Company finances its regulated utility operations with a mix of debt and common equity capital. During periods of significant capital expenditures or periods following the end of bonus depreciation, both of which are currently occurring, the Company will need to maintain a common equity component in excess of 50 percent of the capital structure in order to maintain its credit rating and finance the debt component of the capital structure at the lowest reasonable cost to customers. The end of bonus depreciation is another material factor causing the Company to maintain a common equity component above the 50 percent level. This capital structure provides more flexibility regarding the type and timing of debt financing, better access to the capital markets, a more competitive cost of debt and, over the long run, more stable credit ratings, all of which assist in financing such expenditures.

In addition, all else being equal, the Company will need to have a greater common equity component to offset various adjustments that rating agencies make to the debt component of the Company's published financial statements. I will discuss these adjustments in greater detail later in this testimony.

**Credit Ratings**

**Q. What are the Company's current credit ratings?**

A. The Company's current ratings are:

| | **Fitch** | **Moody's** | **Standard & Poor's** |
|---|---|---|---|
| Senior Secured Debt | A- | A2 | A |
| Senior Unsecured Debt | BBB+ | Baa1 | A- |
| Outlook | Stable | Stable | Stable |

**Q. Why should this Commission be concerned about credit ratings and the views expressed by rating agencies?**

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

Second, credit ratings are an estimate of the probability of default by the issuer on each rated security. Lower ratings equate to higher risks and higher costs of debt. But even investment grade rated borrowers have experienced problems accessing the capital markets or been shut out entirely. The financial crisis of 2008 and 2009 provided clear and compelling evidence of the benefits of the Company's credit rating as it was able to issue new long-term debt during the midst of the financial turmoil. Other lower-rated utilities were simply shut out of the market and could not obtain new capital regardless of how much they were willing to pay.

Further, the Company has a near constant need for short-term liquidity, as well as periodic long-term debt issuances. On a daily basis, the Company pays significant amounts to suppliers to provide necessary goods and services, such as fuel, spare parts, and inventory. Being unable to access funds can jeopardize the successful completion of necessary capital infrastructure projects and would increase the chance of outages and service failures over the long term.

**Q. Can regulatory actions or orders affect a company's credit rating?**

A. Yes, in a very significant way. Regulated utilities are fairly unique since they cannot set their own prices for their services. The financial integrity of a regulated utility is significantly impacted by how the utility is treated on cost recovery issues and in the rates set by regulators. Rates are established by regulators to permit the utility to recover prudently incurred operating expenses and a reasonable opportunity to earn a fair return on the capital invested. Therefore, rate decisions by utility commissions have a direct and significant impact on the financial condition of utilities.

Rating agencies and investors have a keen understanding of the importance of regulatory outcomes. For example, Standard & Poor's ("S&P") writes:

> The assessment of regulatory risk is perhaps the most important factor in Standard & Poor's Ratings Services' analysis of a U.S. regulated, investor-owned utility's business risk.[1]

Similarly, Moody's has stated:

[1] Standard & Poor's Ratings Direct-Assessing U.S. Utility Regulation Environments (March 11, 2010).

> For a regulated utility, the predictability and supportiveness of the regulatory framework in which it operates is a key credit consideration and the one that differentiates the industry from most other corporate sectors. The most direct and obvious way that regulation affects utility credit quality is through the establishment of prices or rates for the electricity, gas and related services provided (revenue requirements) and by determining a return on a utility's investment, or shareholder return.[2]

**Q. How does maintaining the Company's current credit ratings benefit customers?**

A. The Company is in the midst of a period of capital spending and investing in infrastructure to provide for the needs of customers and to meet regulatory and legislative mandates. If the Company does not have consistent access to the capital markets at reasonable costs, these borrowings and the resulting costs of building new facilities become more expensive than they otherwise would be. The inability to access financial markets can threaten the completion of these necessary projects, which will, in turn, affect system reliability and customer safety. All of the resulting higher costs are ultimately borne by the customers. Maintaining the current single-A credit rating for senior secured debt makes it more likely the Company will have access to the capital markets at reasonable costs, even during periods of financial turmoil. This rating will allow the Company continued access to the capital markets, which will enable it to fulfill its capital investments for the benefit of customers.

**Q. Can you provide an example of how the current ratings have benefited customers?**

A. Yes. One example is the Company's ability to significantly reduce its cost of

[2] Moody's Investors Service Regulated Electric and Gas Utilities (August 2009).

long-term debt primarily through obtaining new financings at very attractive interest rates. These lower debt costs benefit customers via lower overall rate of return and lower revenue requirements.

The table below shows the reduction in the Company's cost of long-term debt since June 2010.

| Docket No. | 2014 GRC Proposed June 2015 | 11-035-200 March 2013 | 10-035-124 June 2012 | 09-035-23 June 2010 |
|---|---|---|---|---|
| Cost of Long-Term Debt | **5.28%** | **5.37%** | **5.71%** | **5.98%** |

Clearly, customers have benefitted from a 70 basis points (0.70 percent) reduction in the Company's cost of long-term debt. The Company estimates that this reduction in the average cost of debt since June 2010 results in a decrease of approximately $20 million in the revenue requirements in this case.

**Q. Are there other identifiable advantages to a favorable rating?**

A. Yes. Higher-rated companies have greater access to the long-term markets for power purchases and sales. This access provides these companies with more alternatives when attempting to meet the current and future load requirements of their customers. Additionally, a company with strong ratings will often avoid costly collateral requirements that are typically imposed on lower-rated companies when securing power in these markets.

Maintaining the current single-A rating provides the best balance between costs and the continued access to the capital markets necessary to fund capital projects for the benefit of customers.

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

A. Yes. This capital structure is intended to enable the Company to deliver its required capital expenditures and achieve financial metrics that will meet rating agency expectations. S&P has stated very clearly its expectations for PacifiCorp:

> The stable outlook on PacifiCorp reflects our expectation that management will continue to focus on its core utility operations and reach [constructive] regulatory outcomes to avoid any meaningful business risk rise. The outlook also includes our projection that cash flow measures will decrease as construction project[s] move forward and bonus depreciation benefits decrease. Our base forecast includes adjusted FFO to total debt of about 18%, adjusted debt to EBITDA of roughly 4x, and adjusted debt to total capital hovering at 50%. These measures are consistent with our expectations for the rating. We could lower ratings if financial measures consistently underperform our base forecast and remain at less credit-supportive levels…. We do not contemplate positive rating actions because of near-term capital needs, but we could raise ratings if financial measures strengthen and consistently exceed our base forecast[.][3]

**Q. Do the Company's credit ratings benefit because of MidAmerican Energy Holdings Corporation ("MEHC") and its parent Berkshire Hathaway?**

A. Yes. Although ring-fenced, historically the Company's credit ratios have been weak for the ratings levels, and the Company has been able to sustain its ratings, in part, through MEHC and its parent, Berkshire Hathaway. S&P, Fitch and Moody's have been very clear on this point in recent assessments of PacifiCorp:

> The company's significant financial profile is supported by modest use of leverage to finance a large capital program and parent MidAmerican Energy Holdings Co.'s willingness to deploy equity into PacifiCorp as needed to support the company's capital structure as it expands its rate base . . . . 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

[3] Standard & Poor's Ratings Direct (October 23, 2012), attached as Exhibit RMP___(BNW-1).

> company to deviate.[4]

> PPW's ratings and outlook also reflect the benefits of affiliation with ultimate corporate parent, Berkshire Hathaway (BRK) . . . . Loss of the benefits of BRK ownership would have negative rating implications.[5]

> The rating also considers PacifiCorp's position as a subsidiary of MEHC, a holding company whose subsidiaries are primarily engaged in regulated activities, and the benefits from its affiliation with BRK.[6]

Clearly, PacifiCorp and its customers have benefited from higher ratings than the Company would otherwise likely have been awarded on a stand-alone basis. Another important element supporting the Company's current ratings is the rating agencies' expectations that PacifiCorp will receive supportive regulatory treatment, including reasonable outcomes in rate proceedings and applications to recover the full cost of large scale capital projects. Absent ownership by MEHC and supportive regulatory treatment that permits a fair opportunity for the Company to recover its reasonable and prudent costs, including a return on its investment comparable to other similarly situated utilities, PacifiCorp's senior secured and corporate credit ratings would have likely suffered a downgrade of at least one rating level.

**Q. Do rating agencies share a view concerning the need for supportive rate case outcomes?**

A. Yes, quite clearly. Fitch stated: "Ratings stability is predicated on reasonable outcomes in pending and future rate proceedings to recover anticipated, significant capital investments. A key rating concern is the execution of a large

[4] Standard & Poor's Ratings Direct (April 26, 2012), attached as Exhibit RMP___(BNW-2).
[5] Fitch Ratings (November 16, 2011), attached as Exhibit RMP___(BNW-3).
[6] Moody's Investors Service (May 8, 2013), attached as Exhibit RMP___(BNW-4).

capital plan and timely recovery of related costs."[7] Fitch has further stated:

> Given the size of its planned capital investment, timely recovery of capital and related operating and maintenance costs is crucial for PPW's creditworthiness. Therefore, currently unanticipated adverse developments in PPW's six regulatory jurisdictions, leading to greater regulatory lag or lower recoveries, and resulting weaker coverage ratios compared with Fitch's projections could lead to future deterioration in PPW's creditworthiness and lower credit ratings.[8]

Likewise, Moody's lists "Reasonably supportive regulatory environment" as one of the ratings drivers, stating: "The stable outlook incorporates Moody's expectation that PacifiCorp will continue to receive reasonable regulatory treatment for the recovery of its capital expenditures[.]"[9] Moody's further stated that one of the factors that could cause the rating to be lowered is "adverse regulatory rulings on current and future rate cases such that we would anticipate a sustained deterioration in financial metrics[.]"[10] Moody's notes "Regulatory lag is a challenge for PacifiCorp, which has long maintained large capital programs to meet load growth as well as regulatory requirements for emissions control, renewable standards, and reliability."[11]

S&P concurs, writing "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."[12] S&P also noted that "supportive rate case outcomes remain key to maintaining and improving upon the company's financial

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[7] Fitch Ratings (September 16, 2013), attached as Exhibit RMP___(BNW-5).
[8] Fitch Ratings (January 6, 2011), attached as Exhibit RMP___(BNW-6).
[9] Moody's Investors Service (May 8, 2013), attached as Exhibit RMP___(BNW-7).
[10] Moody's Investors Service (May 8, 2013).
[11] Moody's Investors Service (May 8, 2013).
[12] Standard & Poor's Ratings Direct (April 29, 2013), attached as Exhibit RMP___(BNW-8).

performance."[13]

**Capital Structure Determination**

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

A. The test period in this proceeding is the 12 months ending June 30, 2015. To appropriately match the Company's costs with customer prices during the period, the capital structure is based on the actual capital structure at September 30, 2013, and forecasted capital activity, including known and measurable changes, through June 30, 2015. The Company has averaged the five quarter-end capital structures measured beginning at June 30, 2014, and concluding with June 30, 2015. The capital activity includes known maturities of certain debt issues that were outstanding at September 30, 2013, subsequent issuances of long-term debt and any dividends paid. The known and measurable changes represent actual and forecasted capital activity since September 30, 2013.

**Q. Why is Rocky Mountain Power using an average of five quarter ends to determine the proposed capital structure?**

A. As the Company has grown, its capital expenditure program has increased significantly from historical levels which, in turn, has required new financings to also be much larger. These larger financings are usually more efficient due to lower transactional costs, and better received by investors who value the greater liquidity that larger financings typically offer. However, the trade-off is greater volatility in the Company's capital structure ratios, particularly at quarter-end following sizable financings. As such, the Company is proposing in this case to use a capital structure that employs an average of the five quarter-end balances to

[13] Standard & Poor's Ratings Direct (April 28, 2011), attached as Exhibit RMP___(BNW-9).

help smooth out this volatility. The Commission has historically accepted the five quarter average methodology beginning with its order in Docket No. 09-035-23. Accordingly, the Company is calculating its capital structure in this case in the same manner as in its last several Utah general rate cases.

**Q. How does the Company's proposed capital structure compare to the stipulated capital structure in the Company's 2012 general rate case?**

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

| | 2014 General Rate Case | 2012 General Rate Case |
|---|---|---|
| Long-Term Debt | 48.38% | 47.6% |
| Preferred Stock | 0.02% | 0.3% |
| Common Equity | 51.60% | 52.1% |
| Totals | 100.00% | 100.0% |

The proposed capital structure in the present case has a slightly lower common equity component than the stipulated capital structure in the 2012 general rate case which the Commission approved as part of the settlement of that case. This decrease in equity, albeit slight, is possible as the Company's credit metrics have strengthened, which should permit the current credit ratings to be maintained at the lower equity component.

**Financing Overview**

**Q. Please explain the Company's capital needs.**

A. The Company continues to have ongoing investment in generation, transmission and distribution infrastructure. These and future capital additions and investments will require the Company to raise funds by issuing significant amounts of new long-term debt in the capital markets. To help obtain this new debt financing at attractive rates, the Company is maintaining a balanced capital structure intended to support current credit ratings. These actions help to ensure that PacifiCorp remains well positioned to finance the additional investments that have been and will continue to be made in the system at reasonable costs to customers.

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

A. The Company relies on a mix of first mortgage bonds, other secured debt, tax-exempt debt, and preferred stock to meet its long-term financing requirements. These securities employ various maturities to provide flexibility and mitigate refinancing risks.

The Company has completed the majority of its long-term financing utilizing secured first mortgage bonds issued under the Mortgage Indenture dated January 9, 1989. Exhibit RMP___(BNW-11) shows that over the 12 months ended June 30, 2015, the Company is projected to have an average of approximately $6.6 billion of first mortgage bonds outstanding, with an average cost of 5.59 percent. Presently, all outstanding first mortgage bonds bear interest at fixed rates. Proceeds from the issuance of the first mortgage bonds (and other financing instruments) are used to finance the combined utility operation.

Another important source of financing has been the tax-exempt financing associated with certain qualifying equipment at power generation plants. Under arrangements with local counties and other tax-exempt entities, the Company borrows the proceeds and guarantees the repayment of the long-term debt to take advantage of the tax-exempt status of the other entities in financings. During the 12 months ended June 30, 2015, the Company's tax-exempt portfolio is projected to be on average $574 million in principal amount, with an average cost of 1.71 percent (including the cost of issuance and credit enhancement).

Recently, the Company completed the redemption of all outstanding shares of redeemable preferred stock. The redemption and refinancing of these securities provide a substantial benefit to customers that I discuss later in this testimony.

**Q. In the past, the Company retained all of its earnings to help finance capital investments. Has the Company recently paid dividends to MEHC?**

A. Yes. Since the acquisition in 2006 by MEHC, the Company managed the capital structure through the timing and amount of long-term debt issuances and capital contributions, while forgoing any common dividends for nearly five years.

More recently, the Company has initiated the payment of dividends to MEHC to help manage the common equity percentage in its capital structure and expects periodic dividend payments for the foreseeable future. The proposed capital structure in this case includes the impact of dividends expected to be declared through the end of June 30, 2015. In fact, absent these dividends, the Company's capital structure would contain a higher level of common equity than the Company is proposing.

**Q. More specifically, what future financing activity does the Company anticipate through the period ending June 30, 2015?**

A. For the period from January, 2014 through June 30, 2015, the Company anticipates: (1) issuance of $675 million of new long-term debt; (2) retirement of approximately $245 million of long-term debt at scheduled maturities; and (3) declaration and payment of $1,175 million of dividends to MEHC. All of these have been included in the Company's proposed capital structure.

**Preferred Stock Refinancing**

**Q. Please discuss the refinancing of preferred stock you mentioned earlier.**

A. During 2013 the Company redeemed all remaining outstanding shares of six series of redeemable preferred stock at stated redemption prices. These six series totaled approximately $38 million in stated value and were the entirety of all preferred stock that had a redemption feature. The Company funded the redemption with cash and will complete the permanent refinancing with proceeds of the next long term debt financing, currently forecasted for March 2014.

Following these redemptions, the Company now has two series of non-redeemable preferred stock outstanding with an aggregate stated value of $2.4 million. These two remaining series do not have a redemption feature that would allow the Company to retire them.

**Q. Are these actions included in the Company's proposed capital structure?**

A. Yes. I have removed the preferred stock that was redeemed from the proposed capital structure and the projected March 2014 long-term debt issuance has been sized to include this refinancing.

**Q. How does the Company propose to recover the redemption premiums and stock issuance expenses?**

A. PacifiCorp is requesting the Commission authorize the Company to defer to Balance Sheet Account 182.3, *Other Regulatory Assets*, the amount of the premium to redeem the preferred stock as well as the related unamortized stock expense balance from Account 214 by crediting Account 407.4 *Regulatory Credits*. These amounts were debited to Account 439, *Adjustments to retained earnings* to the extent they exceeded the balance in Account 210, *Gain on resale or cancellation of reacquired stock.* PacifiCorp requests an amortization life for this regulatory asset consistent with the new long-term debt refunding issuance projected for March 2014. See Exhibit RMP___(BNW-10) for a detailed description of the accounting treatment the Company is requesting.

This requested accounting is similar to the regulatory accounting treatment provided for a debt refunding prior to stated maturity under General Instruction 17 of the FERC Uniform System of Accounts ("USOA") with amounts deferred to balance sheet account 189, *Unamortized loss on reacquired debt*.

The Company proposes recovery of these charges through the weighted average cost of debt as currently reflected in the cost of long-term debt Exhibit RMP___(BNW-11), page 2, line 24 as redemption expenses associated with the pro-forma March 2014 long-term debt issuance.

**Q. Have you estimated the impacts on customers?**

A. Yes. Absent the preferred stock refinancing, Utah customer rates would be $0.5 million higher annually.

The table below shows the Company's proposed capital structure and costs of each component and then a pro forma capital structure that removes the impact of the preferred stock refinancing.

| Proposed Capital Structure and Costs | | | |
|---|---|---|---|
| | Percent of Total | Cost | Weighted Ave |
| Long Term Debt | 48.382 % | 5.2805 % | 2.5548 % |
| Preferred Stock | 0.016 % | 6.7527 % | 0.0011 % |
| Common Stock Equity | 51.602 % | 10.0000 % | 5.1602 % |
| | 100.000 % | | 7.7161 % |
| *WACC Benefit of Preferred Refinancing* | | | 0.0004 % |

| Pro-forma w/o Preferred Refinancing | | | |
|---|---|---|---|
| | Percent of Total | Cost | Weighted Ave |
| Long Term Debt | 48.122 % | 5.2809 % | 2.5413 % |
| Preferred Stock | 0.276 % | 5.4274 % | 0.0150 % |
| Common Stock Equity | 51.602 % | 10.0000 % | 5.1602 % |
| | 100.000 % | | 7.7165 % |

The preferred stock redemption and refinancing provides a lower overall cost of capital which translates into a revenue requirement savings. This savings arises by redeeming preferred stock with a weighted average after-tax dividend rate of 4.925 percent with new long-term debt that has a projected 3.065 percent after-tax rate, including amortization of preferred stock redemption costs. The cost of preferred stock increases because the surviving preferred stock, which is not redeemable, carries higher dividend rates than the callable preferred stock that was redeemed. The cost of long-term debt decreases as the cost of long-term debt to refinance the preferred stock is lower than the pro forma average cost of long-term debt without the preferred stock redemption and refinancing. The cost of debt now includes the unrecovered costs related to certain hybrid debt securities, Exhibit RMP___(BNW-11), page 3, lines 90 and 91, which were previously recovered through the cost of preferred stock. This shift has no impact on customer rates and is appropriate given the small amount of remaining preferred stock and is consistent with accounting treatment for these costs.

To better show the beneficial impacts of this refinancing I have also calculated total cost of capital using the after-tax cost of debt. As interest expense is deductible, this better captures the full benefit of redeeming the preferred stock and refinancing with lower after-tax cost of debt.

| Proposed Capital Structure and Costs | % of Total | Cost | Weighted Ave |
|---|---|---|---|
| Long Term Debt | 48.382 % | 3.2766 % | 1.5853 % |
| Preferred Stock | 0.016 % | 6.7527 % | 0.0011 % |
| Common Stock Equity | 51.602 % | 10.0000 % | 5.1602 % |
| | 100.000 % | | 6.7466 % |
| *WACC Benefit of Preferred Refinancing* | | | 0.0055 % |

| Pro-forma w/o Preferred Refinancing | % of Total | Cost | Weighted Ave |
|---|---|---|---|
| Long Term Debt | 48.122 % | 3.2768 % | 1.5769 % |
| Preferred Stock | 0.276 % | 5.4274 % | 0.0150 % |
| Common Stock Equity | 51.602 % | 10.0000 % | 5.1602 % |
| | 100.000 % | | 6.7521 % |

Overall, these actions result in a reduction in the overall weighted average cost of capital and provide an approximate $0.5 million reduction in revenue requirement in this case. The deferral treatment for the redemption premium and stock expense as a refunding cost of the new long-term debt refunding issuance results in a lower overall pre-tax and post-tax weighted average cost of capital, compared to a scenario without the redemptions of preferred stock. Reducing the cost of capital through refunding of the preferred stock is a benefit to RMP ratepayers.

**Purchase Power Agreements**

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

A. Yes. Rating agencies and financial analysts consider Purchase Power Agreements ("PPAs") to be debt-like and will impute debt and related interest when calculating financial ratios. For example, S&P will adjust the Company's published financial results and impute debt balances and interest expense resulting from PPAs when assessing creditworthiness. It does so in order to obtain a more accurate assessment of a company's financial commitments and fixed payments. Exhibit RMP___(BNW-12) is a publication by S&P detailing its view of the debt aspects of PPAs.

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

A. During a recent ratings review, S&P evaluated the Company's PPAs and other related long-term commitments. Approximately $229 million of additional debt and related interest expense were added to the Company's debt and coverage tests solely as a result of PPAs. There were also other adjustments made by S&P that resulted in a total of approximately $843 million of debt and $21 million of interest being imputed into PacifiCorp's credit ratios.

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

A. Negatively. By including the imputed debt resulting from PPAs and these other adjustments, the Company's capital structure has a lower equity component as a corollary to the higher debt component, lower coverage ratios and reduced financial flexibility than what might otherwise appear to be the case from a review of the book value capital structure. For example, if one were to add the $843 million of debt adjustments that Standard & Poor's makes to the Company's capital structure in this case, the resulting common equity percentage would decline from 51.60 percent to 48.82 percent. The resulting 48.82 percent equity ratio falls below S&P's published expectations for PacifiCorp.

| | Book Values ($m) | % of Total | Rating Agency Adjustments ($m) | Adjusted Book Values ($m) | % of Total |
|---|---|---|---|---|---|
| Long Term Debt | $ 7,149 | 48.38% | $ 843 | $ 7,992 | 51.17% |
| Preferred Stock | 2 | 0.02% | (1) | 1 | 0.01% |
| Common Equity | 7,625 | 51.60% | — | 7,625 | 48.82% |
| | $ 14,776 | 100.00% | $ 842 | $ 15,618 | 100.00% |

**Financing Cost Calculations**

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

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

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

A. The cost of long-term debt is 5.28 percent for the period ending June 30, 2015, as shown in Exhibit RMP___(BNW-11).

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

A. I calculated the cost of debt by issue, based on each debt series' interest rate and net proceeds at the issuance date, to produce a bond yield to maturity for each series of debt. It should be noted that in the event a bond was issued to refinance a higher cost bond, the pre-tax premium and unamortized costs, if any, associated with the refinancing were subtracted from the net proceeds of the bonds that were issued. Each bond yield was then multiplied by the principal amount outstanding of each debt issue, resulting in an annualized cost of each debt issue. Aggregating the annual cost of each debt issue produces the total annualized cost of debt. Dividing the total annualized cost of debt by the total principal amount of debt outstanding produces the weighted average cost for all debt issues. The result is the Company's cost of long-term debt of 5.28 percent.

**Q. Regarding the $675 million of new long-term debt issuances mentioned earlier, how did you determine the interest rate for the new long-term debt?**

A. The Company currently plans to issue new long-term debt during March 2014 and March 2015. I projected that these issuances would be completed at the Company's estimated recent credit spreads for 30-year debt issuances over the projected 30-year Treasury rates at March 2014 and March 2015. Further, I have added expected issuance costs to calculate the all-in rate for each series of new long-term debt.

**Q. What is the resulting cost for this new long-term debt?**

A. The Company's current estimated credit spread for 30-year debt is 0.95 percent. The recent forward long-term Treasury rates for March 2014 and March 2015 are 3.89 percent and 4.10 percent, respectively. Issuance costs for this maturity and type of debt add approximately seven basis points (0.07 percent) to the all-in cost. Therefore, the projected costs of the new long-term debt are:

| | March 2014 Issuance | March 2015 Issuance |
|---|---|---|
| Forward Treasury Rate | 3.891 % | 4.101 % |
| Credit Spread | 0.950 % | 0.950 % |
| Redemption Expense | 0.033 % | n/a |
| Issuance Costs | 0.065 % | 0.068 % |
| All-in Cost | 4.939 % | 5.119 % |

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

A. The Company's variable rate long-term debt in this case is in the form of tax-exempt debt. Exhibit RMP___(BNW-13) shows that, on average, these securities had been trading at approximately 90 percent of the 30-day London Inter Bank Offer Rate ("LIBOR") for the period January 2000 through October 2013. Therefore, the Company has applied a factor of 90 percent to the forward 30-day LIBOR rates at each future quarter-end spanning the test period and then added the respective credit enhancement and remarketing fees for each floating rate tax-exempt bond. Credit enhancement and remarketing fees are included in the interest component because these are costs which contribute directly to the interest rate on the securities and are charged to interest expense. This method is consistent with the Company's past practices when determining the cost of debt in previous Utah general rate cases and in the Company's other jurisdictions

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

A. Exhibit RMP___(BNW-14) shows the embedded cost of preferred stock for the period ending June 30, 2015, to be 6.75 percent.

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

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

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

A. Yes.