Q. Please state your name, business address, and position with PacifiCorp (the Company).

A. My name is William E. Peressini. My business address is 825 N.E. Multnomah, Suite 1900, Portland, Oregon 97232. I am employed by PacifiCorp as Vice President and Treasurer and report directly to PacifiCorp's Executive Vice President – Finance and Administration

Q. Mr. Peressini, please briefly describe your education and business experience.

A. I received a Bachelor of Arts degree in finance from the University of Illinois in May, 1978. I also received a Masters in Business Administration with a major in finance from DePaul University in Chicago in February, 1982. I have been employed by PacifiCorp for 15 years, the first 10 years working in PacifiCorp's financial services unit. I was elected Treasurer of PacifiCorp in October 1993, and commenced, at that time, my responsibilities in PacifiCorp's regulated electric operations.

Q. Please describe your present responsibilities.

A. I am responsible for the Company's corporate finance, treasury, credit, investment management and property risk management activities. As it relates to this matter, I'm responsible for the Company's borrowed liabilities, the development and maintenance of commercial bank and investment banking relationships, rating agency and regulatory staff relations as it relates to capital structure and financing matters.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present the Company's position regarding the return PacifiCorp should earn on its rate base in Utah with specific recommendations on capital structure. In addition, I will analyze the embedded cost of long-term debt

and preferred stock supporting PacifiCorp's electric operations in the state of Utah for the period ended December 31, 1998.

Q. Will you please summarize your testimony?

A. Using the capital structure sponsored in Section I, I applied the costs of long-term debt and preferred stock in Section II, plus the cost of common equity sponsored by Samuel C. Hadaway and concluded that a 9.15% return on rate base for the the test period is a fair and reasonable cost of capital as summarized in Exhibit UP&L __.1 (WEP-1). In the testimony, I discuss the reasons why the capital structure for the Company's electric utility operations should be developed independently of the effects of PacifiCorp's non-regulated operations, continuing the long-held tenet that Utah customers should be neither disadvantaged nor subsidized by PacifiCorp's non-regulated business activities.

I. Capital Structure

Q. What factors influence the mix of debt and equity in the capital structure?

A. The capital structure mix is a tradeoff between cost and risk and, as a result, debt and equity. Debt typically has a lower cost than equity, although the incremental cost of debt will increase as the amount of debt in the capital structure increases, assuming interest rates remaining constant. Debt requires a contractual repayment of principal and interest and has priority over preferred and common dividend payments. Failure to meet those contractual obligations means default, penalties and perhaps the loss of property and other assets to creditors. Interest payments to bondholders have priority over dividends to equity holders.

Payments to equity holders are not contractually committed. If the capital structure contained only common stock and cash flows were not sufficient to pay a dividend to common shareholders, common shareholders could not force bankruptcy. Also, there is no contractual obligation to repay the principal amount of the equity investment as there is with debt investments. To accept the uncertainty of dividends, as well as an uncertain future investment value associated with common stock, shareholders expect to earn a higher return relative to bondholders. [1]

The Company attempts to balance its capital structure and the resulting mix of debt and equity with the needs of all of its constituents, including ratepayers, stockholders and bondholders. The balance between debt and equity is a delicate one. Generally speaking, the greater percentage of equity in the capital structure, the higher the Company's bond rating, and the greater the ease of access to the capital markets. The cost of this relatively higher equity component is a higher absolute cost of capital for the Company. Conversely, the more relative debt in the capital structure (assuming it stays within reasonable bounds), the lower the after-tax cost of capital for the Company. While the absolute costs may be lower, the benefits might be illusory because with the lower bond ratings, the Company's access to capital market could be restricted.

The appropriate levels of debt in a capital structure should be a function of the Company's cash flow and its ability to pay the interest costs associated with that debt. As a general rule, the more consistent and predictable the Company's cash flow, the

[1]Preferred stockholders represent somewhat of a hybrid between debt and common equity. Preferred shareholders generally have their rate of return "capped" by their dividend rate but the failure of the issuer to pay preferred dividends does not create an acceleration right, only a right to vote on the directors (i.e. the senior management) and other matters of consequence normally reserved for the common shareholder.

more debt it can support in its capital structure. Utilities possess generally stable cash flow patterns and typically have a greater amount of debt than an industrial company with comparable risk characteristics. The opposite of a utility company might be an internet service provider wherein customers can and do change service providers in a moment's notice. Those businesses, which have had a spectacular run in the stock market based upon previously unheard of valuations, also possess capital structures that are almost 100% equity, reflecting the volatile and unpredictable nature of their cash flow.

Although there is no single optimal capital structure for a company, the Standard & Poor's (S&P) credit rating agency has published benchmark capital ratios required for utilities to maintain a certain credit rating, which is a measure of its credit quality. A company's overall credit rating is a combination of many factors. The average electric utility today has an "A3" credit rating according to Moody's Investors Services *Industry Outlook* dated, October, 1998. S&P, which has a similar credit outlook currently for electric utility industry credit rating, has historically been more prolific in publishing financial benchmarks for different rating categories. Depending upon S&P's qualitative assessment of a company's competitive position, the debt to capitalization percentage of an "average" rated utility could range from a low of 41% for a poorly-positioned company to 52% for a well positioned company. The remaining equity capital could be a mix of preferred stock and common equity with the preferred stock component (as defined) typically not exceeding 8% of total capitalization.

Q. What credit rating does PacifiCorp target?

A. In 1994, PacifiCorp established capital structure policies for PacifiCorp and its non-regulated subsidiaries. At the time these policies were established, the Company anticipated a changing marketplace and based upon the experience of other industries that deregulated, namely telephone, airline and gas companies, assumed that the general credit profile of the industry would decline, an assessment with which many other industry observers agreed. Based upon a desire to both enter and emerge from this period of change in a position of strength, PacifiCorp established an "A" bond rating target.

Q. What capital structure do you recommend for setting electric prices in these proceedings?

A. I recommend a capital structure comprised of 47.4% long term debt, 3.8% preferred stock, and 48.8% common equity, the average capitalization of comparable electric utilities utilized to develop the return on equity recommendation. For these purposes, the comparable group of companies includes utilities that have a similar business and financial profile to that of PacifiCorp. The list includes electric utilities that have at least a "single A" credit rating from both Moody's and Standard & Poor's and generate at least 75% of their total revenues from their U.S. regulated electric business. In addition, these are companies for which complete and reliable data is available. The parameters used to determine this comparable list of currently 20 companies is consistent with what was used when the Utah Public Service Commission (Commission) last examined the Company's capital structure in Docket No. 97-035-01. (See Exhibit UP&L __.2 (WEP-2)).

Q. How does your recommendation compare with the electric industry average capitalization?

A. According to Value Line, at year-end 1998, the electric utility industry capitalization had 47.5% debt, 5.0% preferred stock, and 47.5% common equity. In other words, my recommended capitalization for the Company reflects the capitalization of the industry.

Q. Why do you recommend using the average capitalization of comparable companies for PacifiCorp's electric utility?

A. There are a number of reasons. In the past, the use of average capitalization of comparable companies was appropriate because of PacifiCorp's historical involvement with non-regulated businesses and the resulting influence those businesses had on the balance sheet of PacifiCorp. Although the Company has narrowed its strategic focus for the future, PacifiCorp's non-regulated businesses still influence the Company's reported capital structure. These other businesses have different capital structure requirements, which is much more a reflection of their industries (and the associated cash flow patterns) than any management directive. As a result, when a corporation is involved in a number of different ventures with different risk profiles, its capital structure would tend to represent an amalgamation of the different capital structures appropriate to the different lines of business. Only by coincidence would the consolidated capital structure of the corporation represent the appropriate capital structure for one of its component parts.

In the context of setting utility rates, the use of the Company's consolidated capital structure creates a risk that utility customers will pay too high a return if the

non-utility operations are unnecessarily increasing the required equity ratio or, conversely, shareholders are being denied a reasonable return on utility rate base if non-utility operations are permitting a more highly leveraged capital structure. Using a comparable company average capital structure assures that over time neither customers nor shareholders are unfairly impacted by the changing risk profiles of PacifiCorp's various regulated and non-regulated operations.

Q. What conclusions have been reached by the Commission regarding the capital structure utilized for rate-making purposes?

A. In Docket No. 97-035-01, the Commission adopted the use of the comparable company approach recommended in this testimony.

II. Cost of Debt and Preferred Stock

Q. How does PacifiCorp finance its electric utility operations?

A. PacifiCorp historically has financed the cash flow requirements of its regulated U.S. utility operations utilizing a reasonable mix of debt and equity securities designed to provide a competitive cost of capital and predictable capital markets access. Historically, PacifiCorp has relied on a mix of first mortgage bonds, secured debt, tax-exempt debt, unsecured debt and preferred stock to meet its long-term debt and preferred stock financing requirements.

The Company has concluded the majority of its long-term financing utilizing secured, first mortgage bonds issued under PacifiCorp Mortgage Indenture dated January 9, 1989. As of December 31, 1998, PacifiCorp had $2,737.58 million of first mortgage bonds outstanding, with an average cost of 7.904% and average maturity of 6.50 years. Please see Exhibit UP&L __.3 (WEP-3). All of PacifiCorp's 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 operations and are not allocated on a divisional basis.

Prior to the Utah Power & Light and Pacific Power & Light merger in 1989, each company had its own first mortgage indentures. Those indentures were assumed by PacifiCorp and, in addition, a new PacifiCorp indenture was established at the time of the merger. In 1996, PacifiCorp's Corporate Finance Department restructured the mortgage arrangements, which led to the extinguishment of the Pacific Power and Utah Power mortgages. This action reduced administrative requirements and associated expense and greatly simplified the Company's mortgage financing arrangements.

Although the Company's power plant construction program has slowed from the previous two decades, another important source of financing has been the tax-exempt financing associated with certain qualifying equipment at PacifiCorp's power generation plants. Under arrangements with the local counties and other tax-exempt entities, PacifiCorp borrows the proceeds and guarantees the repayment of their long-term debt in order to take advantage of their tax-exempt status in financings. As of December 31, 1998, PacifiCorp had $731.01 million of such borrowings outstanding with an average maturity of 20.26 years. Because short-term, tax-exempt interest rates have been the lowest cost capital available in the U.S. capital markets, the Company manages the significant majority of this debt (76.4%) in a variable rate mode. As of December 31, 1998, PacifiCorp's tax-exempt portfolio has an average cost 4.708% (which includes the cost of issuance, credit enhancement and the effect

of interest rate swaps). Aggregating the before mentioned debit instruments, PacifiCorp's total long-term debt portfolio had an outstanding balance of $3,468.58 million as of December 31, 1998. The cost of this portfolio was 7.231%. Please see Exhibit UP&L __.3 (WEP-3).

PacifiCorp allocates up to 10% of its regulated utility capitalization to preferred stock or subordinated debt to take advantage of their "lower than equity" cost and the equity credit typically afforded these securities by the credit rating agencies. To the extent the credit rating agencies provide less equity credit for preferred stock and subordinated debt in the future (as is being currently suggested by Standard & Poor's), PacifiCorp would expect to refinance these obligations over time maintaining a relatively balanced portfolio of investment-grade debt and equity. As of December 31, 1998, PacifiCorp had $769.19 million of preferred stock and subordinated debt outstanding with an aggregate cost of 6.017%. Excluding the perpetual preferred stock that PacifiCorp has issued in the past, the average remaining maturity is 28.6 years. All of these obligations were in a fixed rate mode at December 31, 1998. Please see Exhibit UP&L __.4 (WEP-4).

III. Calculation Methodologies

Q. How did you determine the amount of debt and preferred stock to be included in your calculation of the Company's embedded costs of debt and preferred stock?

A. For both debt and preferred stock, I used the rates and amounts outstanding at December 31, 1998 that I have previously referred to in this testimony.

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

A. The embedded costs of debt and preferred stock were calculated using the methodology prescribed by the Federal Energy Regulatory Commission.

Q. Please explain the cost of 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. The 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 which, when divided by the total principal amount of debt outstanding produces the weighted average cost for all debt issues and is the Company's embedded cost of long-term debt.

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. This is the result of dividing the annual dividend rate by the per share net proceeds for each series of preferred stock. The cost associated with each series was then multiplied by the stated value or principal amount 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 of all issues. This is the Company's embedded cost of preferred stock.

Q. Exhibit UP&L__.4 (WEP-4) includes references to QUIDS and QUIPS. Please briefly describe QUIDS and QUIPS.

A. QUIDS and QUIPS are acronyms for direct or indirect subordinated debt securities sold typically to individual investors. Because of their subordination and interest deferral provisions, the credit rating agencies assign some equity credit for purposes of assessing balance sheet strength. For issuers, the after-tax cost is attractive because, as a debt security, the interest is tax deductible.

Q. The footnotes in Exhibit UP&L__.4 (WEP-4) describe that the QUIDS and QUIPS amounts represented in the calculation are after-tax numbers. These securities appear to be debt equivalents, why do these securities get reflected in the Company's embedded cost of preferred stock?

A. Fundamentally these securities are debt. Therefore, I calculated their embedded costs in the same manner used for each series of debt described above. However, because the Company believes that these QUIDS and QUIPS are equivalent to preferred stock for regulatory accounting purposes, given the equity credit they receive from the major credit rating agencies, I chose to reflect their cost as part of the Company's embedded cost of preferred stock. For your reference, the Company has previously received approval to utilize QUIPS securities from the Commission.

Q. Does this conclude your direct testimony?

A. Yes.