RESPONSE TO ACTION REQUEST

TO: Public Service Commission

FROM: Division of Public Utilities
Chris Parker, Director,
Artie Powell, Energy Manager
Charles Peterson, Technical Consultant
Douglas Wheelwright, Utility Analyst

DATE: December 3, 2012

RE: PacifiCorp dividend declaration

I. RECOMMENDATION (No Action)

Based upon the following analysis, the Division finds no indication that the capital and operations of PacifiCorp will be impaired pursuant to UCA 54-4-27. Therefore the Division recommends that the Commission take no action.

II. ISSUE

In a letter dated November 9, 2012, PacifiCorp (Company) announced that its board of directors had declared a dividend amounting to $50 million payable December 6, 2012 to its sole common shareholder, PPW Holdings LLC, a wholly owned subsidiary of MidAmerican Energy Holdings Company (MEHC). PacifiCorp last paid a dividend on September 26, 2012. The Commission issued an action request to the Division on November 15, 2012 with a due date of December 3, 2012. This memorandum responds to the Commission action request.

III. DISCUSSION

Pursuant to Utah Code Annotated 54-4-27, the Company must notify the Commission of the dividend within five days of its declaration. The Commission has 30 days from the dividend declaration date to investigate whether the payment of such dividend would result in impairment of the capital or to the utility's service to the public, and if it finds that such impairment will or may occur, the Commission may order that the dividend not be paid.

The Division of Public Utilities (Division) has investigated the effects of the dividend on the capital and cash flows of the Company using the latest financial information available, the annual financial statements through December 31, 2011 and its interim September 30, 2012 financial filings. The Division has also reviewed the Company's bond rating through the various bond rating agencies.

In approaching this assignment, the Division understands the terms "impaired" and "impairment" in the statute to mean that (1) the payment of the dividend will result in actions being taken against the Company by creditors, rating agencies, or others due to a reduction in the value of the capital, or the violation of loan covenants, or other agreements; (2) the payment of the dividend would result in a reduced ability of the Company to provide service through a lack of working capital or other financial capacity to continue its operations in the same manner it would if the dividend were not paid.

IV. ANALYSIS

Exhibit 1 sets forth financial results for the fiscal years ended December 31, 2007 and for the through 2011; and the partial year ended September 30, 2012.

Revenues have grown at an annual rate of 1.87 percent, from about $4.26 billion in 2007 to $4.59 billion in 2011. Energy costs actually declined 1.92 percent annually over the 2007 to 2011 period and amounted to about $1.64 billion in 2011. Total operating expenses grew at an annual rate of 1.01 percent annually over 2007 to 2011. Earnings from operations grew from approximately $894 million to $1.08 billion over the 2007 to 2011 time period, for a 4.94 percent annual growth rate. Over the 2007 to 2011 time period, interest expense grew from about $285 million to $367 million, for a 6.53 percent growth rate. The Company's net income has grown from $445 million in 2007 to $555 million in 2011, for a 5.68 percent growth rate.

The nine month September 30, 2011 results suggest that the Company's 2012 annual results should approximate $4.9 billion in revenues and as much as $650 million in net income. PacifiCorp initiated dividend payments in 2011 amounting to $550 million; prior to 2011, the Company last paid a dividend in March 2007. Going forward, there is an expectation that the Company will continue to pay dividends to its parent. With the current dividend declaration, total common dividends in 2012 will amount to $200 million.

Looking at the balance sheet information on pages 3 and 4 of Exhibit 1 indicates that the cash and equivalent balances have fluctuated widely between $47 million and $228 million. The average balance has been just under $100 million; the September 30, 2012 balance was $175 million. Total current assets amounted to $1.48 billion in 2007, but have been fairly stable averaging about $1.5 billion since then. Current liabilities balances have fluctuated over the 2007 to 2011 time period, but overall have displayed an uptrend. In 2007 the current liabilities balance was $1.3 billion; in 2011 the balance was $1.8 billion, and on September 30, 2011 the balance was approximately $1.3 billion.

Net plant and equipment grew from $11.8 billion to $17.4 billion over the 2007 to 2011 period; by September 30, 2011 the balance had risen to almost $17.9 billion. Other assets have trended upward over the 2007 to 2011 time period, increasing from $1.6 billion to $2.2 billion. Total assets grew at a 9.08 percent annual rate over the 2007 to 2011 time period, ending at $21.1billion in 2011; total assets amounted to $21.57 billion on September 30, 2011.

Long-term debt (excluding the current portion) also grew steadily from $4.75 billion in 2007 to $6.40 billion in 2009, but declined to $5.81 billion in 2010 due to a lack of new debt issuances and the increase in the current portion of long-term debt from $16 million in 2009 to $588 million in 2010; it increased back to about $6.2 billion in 2011 and was approximately $6.6 billion as of September 30, 2012. Deferred income taxes, which represent the accumulation of a positive cash flow item, has increased from $1.7 billion in 2007 to nearly $3.9 billion in 2011. As of September 30, 2011, the deferred income tax balance stood at over $4.1 billion. Common equity increased from $5.0 billion in 2007 to $7.3 billion in 2011. The growth in common equity was facilitated by equity contributions from MEHC totaling around $1 billion since the 2006 acquisition, by the growth in net income, and by the lack of dividend payments between March 2006 and February 2011. Due, in part, to the relatively small dividend payment in the first half of 2012, the common equity balance increased to stand at about $7.5 billion on September 30, 2012.

Reviewing the financial ratios on page 7 of 7 of Exhibit 1, most of these financial measures worsened somewhat between 2010 and 2011. However, for the September 30, 2012 interim period short-term liquidity measures and long-term solvency ratios were similar to the longer-term average. From a bond-rating perspective, one of the crucial measurements, times-interest-earned, made a five year low in 2011 at 3.09 times. Its 2007-2010 average was 3.27. For the nine-month interim period ended September 30, 2012, this measure was calculated at 3.44. A similar measurement adds back depreciation to the earnings in times-interest-earned and may approximate rating agencies' Funds from Operations (FFO) measure. This measurement is also set forth on page 7 of Exhibit 1 and follows a similar path as the times-interest-earned ratio. It ranges from 5.08 times in 2007 to 4.76 times in 2011; with a five year average of 4.86.

All of the profitability ratios have been trending downward since 2007. In 2007 returns on total assets, total capital, and common equity were 4.60, 7.20, and 9.79 percent respectively; by 2011 they amount to 3.98, 6.16, and 7.61 percent. For the nine months ended September 30, 2012, these ratios recovered to approximate their five year averages. The level of return on equity has consistently been one or more percentage points below the Company's authorized returns. The recent rate cases in Utah and other states will, hopefully, result in the improvement of these ratios. Failure to improve profitability might result in bond rating downgrades and increased costs of capital generally.

Asset utilization ratios have generally declined which suggests that in recent years the Company has not been doing as well as in the past in generating revenues (and profits) from its expanding asset base. Whether this is due to the Company's current build cycle, or some systemic negative in the Company or both is not clear from the data.

Bond rating agencies such as Standard & Poor's focus on a similar measure based upon "funds from operations" (FFO) instead of earnings. FFO includes after-tax operating profits plus depreciation, deferred income taxes plus "other items."[1] In other words an outside analyst cannot replicate exactly FFO as calculated by, say, Standard & Poor's. However, Standard & Poor's in its April 26, 2012 report on PacifiCorp made the following statement: "The stable rating outlook on PacifiCorp reflects our base-case assumption of adjusted FFO to total debt in the 20% area, FFO interest coverage of 4.6x, and debt to total capitalization of around 51% [including imputed debt for purchased power agreements]. Performance below this level could result in a rating downgrade if credit metrics fall below 18% or if adjusted debt to total capitalization exceeds 52% on a sustained basis." [2] This comment suggests that PacifiCorp cannot continue to experience deteriorating financial ratios and profitability without facing a credit rating downgrade.

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[1] Standard & Poor's "2008 Corporate Criteria: Ratios and Adjustments" http://www.standardandpoors.com/prot/ratings/articles/en/us/?articleType=HTML&assetID=1245319405405
[2] Standard & Poor's, RatingsDirect on the Global Credit Portal, PacifiCorp, April 26, 2012, p. 4.

The Company's bond ratings for its senior secured debt (the large majority of the debt) is a Standard & Poor's "A" rating. Moody's recently rated PacifiCorp Baa1 (similar to Standard & Poor's BBB+), Fitch Ratings also gives PacifiCorp a BBB+ rating. It should be noted that these ratings are in part based upon the benefit of the Company's relationship as a subsidiary of MEHC and, ultimately, Berkshire Hathaway.

As indicated on Exhibit 1 page 5, PacifiCorp is currently incurring capital expenditures at a rate of about $1.5 billion annually. Cash from operations (primarily net income plus depreciation plus deferred income taxes) has been running at about 75 percent of capital expenditures between 2007 and 2011; however, this ratio improved to 87 percent due primarily to a $700 million reduction in capital expenditures in 2010 over 2009. In 2011 the cash from operations ratio to capital expenditures improved further to 108 percent as a result of a further $100 million reduction in capital expenditures between 2010 and 2011 and an improvement in cash from operations of over $200 million. The Company's capital expenditure program has required that the Company obtain funding from the debt markets as well as the receipt of equity contributions from MEHC. Beginning in 2011, the Company resumed dividend payments which has likely ended further capital contributions from MEHC. The Company in its most recent Integrated Resource Plan cycle has indicated that it believes load growth will be noticeably lower than the Company was previously expecting. If the new expectation is correct, then the Company's building program will be reduced because additional generation resources will not be needed as quickly as previously expected.

Exhibit 2 sets forth a forecast of PacifiCorp's financial statements based upon assumptions made by the Division that seemed reasonable in light of historical results, the expectation of lower load growth and generation needs and current economic conditions. The economic assumptions that are made in the forecast include a benign inflationary environment for the period of the forecast and continued low interest rates, coupled with modest growth in revenues and improved profitability. Based upon these assumptions, it appears that there should be no significant affect on the Company's financial health due to the payment of the currently announced dividend. It appears that the Company can maintain a program of dividend payments while keeping at least the current levels of profitability and approximate capital structure.

V. CONCLUSION

To date MEHC appears to have kept to its promises to make significant capital expenditures and to maintain an equity capital structure at or above the Acquisition Commitments.[3] The Company has grown significantly over the past few years and has made some improvements in its balance sheet. On the negative side, profitability as measured by returns on equity and total capital has not improved, indeed, as highlighted above, profitability has been on a downward trend for the last five years. The Company does appear, at this time, to be able to make the proposed dividend payment and probably continue a regular dividend payment program without impairing its operations.

cc: Dave Taylor, PacifiCorp
Michele Beck, Office of Consumer Services

[3] Acquisition Commitment 18 indicates the expectation that PacifiCorp's equity percentage be kept above a 44 percent minimum. Standard & Poor's indicated in a Research Update on August 8, 2006 related to the $350 million debt issuance that it expects PacifiCorp/MEHC to manage PacifiCorp's debt and equity in a manner "sufficient to maintain roughly a 50-50 capital structure."