State of Utah
Department of Commerce
Division of Public Utilities

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ACTION REQUEST RESPONSE

To: Utah Public Service Commission

From: Utah Division of Public Utilities

Chris Parker, Director

Artie Powell, Energy Section Manager

Charles Peterson, Technical Consultant

Doug Wheelwright, Technical Consultant

Date: June 11, 2013

Re: **Action Request Memorandum (Docket No. 13-999-01)**

PacifiCorp dividend declaration with expected payment on June 26, 2013.

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.

ISSUE

In a letter dated May 24, 2013, PacifiCorp (Company) announced that its board of directors had declared a dividend amounting to $350 million payable June 26, 2013 to its sole common shareholder, PPW Holdings LLC, a wholly owned subsidiary of MidAmerican Energy Holdings Company (MEHC). PacifiCorp last paid a dividend on January 31, 2013 that amounted to $150 million. The Commission issued an action request to the Division on June 4, 2013 with a due date of June 18, 2013. This memorandum responds to the Commission action request.

DISCUSSION

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, 2012 and its interim March 31, 2013 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.

Exhibit 1 sets forth financial results for the fiscal years ended December 31, 2007 through 2012; and the partial year ended March 31, 2013.

Revenues have grown at an annual rate of 2.77 percent, from about $4.26 billion in 2007 to $4.88 billion in 2012. Energy costs have been relatively flat over the period, increasing at a relatively slow 0.56 percent annually over the 2007 to 2012 period and amounted to about $1.82 billion in 2012. Total operating expenses grew at an annual rate of 2.79 percent annually over 2007 to 2012; however, this includes one-time charges for the USA Power litigation costs and judgment as well as some other apparently one-time expense that were expensed in the fourth quarter 2012.

Earnings from operations grew from approximately $894 million to $1.08 billion over the 2007 to 2011 time period, before declining in 2012 due to the one-time costs mentioned above. The average annual growth rate for that period is 2.69 percent. From 2007 to 2012, interest expense grew from about $285 million to $351 million, for a 4.25 percent growth rate. The Company's net income has grown from $445 million in 2007 to $555 million in 2011, but declined somewhat in 2012 to $537 million, for a 3.83 percent growth rate. The three month March 31, 2013 results show that revenues increased 3.44 percent and net income increased 5.96 percent over the March 2012 period. This result suggests that the Company's 2013 annual results should approximate $5.0 billion in revenues and as much as $590 million in net income.

PacifiCorp initiated dividend payments in 2011 amounting to $550 million; in 2012 the Company paid $200 million in common stock dividends. 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 2013 amount to $500 million. While additional dividend payments in the second half of 2013 are possible, the Division doesn't expect them to amount to as much as the $500 million to be paid out in the first half of the year.

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 $31 million and $228 million. The average balance has been just under $100 million; the March 31, 2013 balance was $133 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 2012 time period, but overall have been relatively flat. In 2007 the current liabilities balance was $1.3 billion; in 2011 the balance was $1.8 billion, but in 2012 and March 2013 the balances were approximately $1.3 billion again.

Net plant and equipment grew from $11.8 billion to almost $18.1 billion over the 2007 to 2012 period; on March 31, 2013 the balance had risen to over $18.1 billion. Other assets have trended upward over the 2007 to 2012 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 2012 time period, ending at $21.7 billion in 2012.

Long-term debt (excluding the current portion) has also grown steadily from $4.75 billion in 2007 to nearly $6.60 billion in 2012; long-term debt was approximately $6.57 billion as of March 31, 2013. Deferred income taxes, which represent the accumulation of a positive cash flow item, has increased from $1.7 billion in 2007 to almost $4.2 billion in 2012. As of March 31, 2013, the deferred income tax balance stood at over $4.2 billion. Common equity increased from $5.0 billion in 2007 to $7.6 billion in 2012. 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. With the apparent resumption of significant annual dividend payments (i.e. in excess of $500 million annually), the Division expects common equity balances to grow relatively slowly going forward.

Reviewing the financial ratios on page 7 of 7 of Exhibit 1, while there have been year-to-year variations, most of the short-term and long-term liquidity ratios have been basically flat, with 2012 generally showing some improvement over 2011. From a bond-rating perspective, one of the crucial measurements, times-interest-earned, made a five year low in 2011 at 3.09 times, where it remained in 2012. 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. Of interest is that in March 31, 2013 period, this FFO-like measure increased to 5.20. It remains to be seen whether or not this improvement can last for the whole year.

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 2012 they amount to 3.71, 5.72, and 7.19 percent. For the three months ended March 31, 2013, these ratios recovered to approximate their six 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 as will, over time, the various energy balancing account programs in Utah and elsewhere. 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, from 2007 to 2011, has been incurring capital expenditures at a rate of at least $1.5 billion annually. Capital expenditures declined to 1.34 billion in 2012. 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 IRP-based expectation is realized, then the Company's building program will be reduced for the next decade or so, because additional generation resources will not be needed as quickly as previously expected. Furthermore, the Company stated in its December 31, 2012 SEC Form 10-K that it expected capital expenditures for 2013, 2014, and 2015 to total only $3.4 billion, or less than an average of $1.15 billion per year.[3] This decline in capital expenditures will improve the Company's cash flow before the Company's for financing activities (e.g. debt issuances and retirements and dividend payments).

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.[4] The economic assumptions that are made in the forecast include a benign inflationary environment for the period of the forecast, continued low interest rates, modest growth in revenues and improved profitability. Based upon

[3] PacifiCorp 10-K, pages 39-40.
[4] This forecast also takes into account the Company's statement in its March 31, 2013 SEC Form 10-Q (see page 15), that it was going to re-acquire and retire in May 2013 a series of preferred stock, valued at about $4 million.

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 perhaps slowly improving the levels of profitability and keeping its capital structure stable.

On June 6, 2013 in an SEC Form 8-K filing, the Company announced that it had sold $300 million in 2.95 percent ten-year First Mortgage Bonds. The stated purpose of this bond issuance is "to fund capital expenditures and for general corporate purposes, which may include paying a portion of the $350 million dividend payable...on June 26, 2013."[5] Given the Company's relatively strong balance sheet at this time, the Division has no issue with funding "a portion" of a dividend payment with debt. In its forecast model which was constructed prior to the debt issuance announcement, the Division had previously included short-term debt at a 3 percent interest set at a level of one-half the forecast dividend payments. Thus, the announcement of this debt issuance has no effect on the Division's financial forecast results.

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.[6] 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.

[5] PacifiCorp SEC Form 8-K, June 6, 2013, page 2.
[6] 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."

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