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 9, 2014

Re: **Action Request Memorandum (Docket No. 14-999-01)**

PacifiCorp dividend declaration with expected payment on June 19, 2014.

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 22, 2014, PacifiCorp (Company) announced that its board of directors had declared a dividend amounting to $125 million payable June 19, 2014 to its sole common shareholder, PPW Holdings LLC, a wholly owned subsidiary of Berkshire Hathaway Energy (BHE) (formerly MidAmerican Energy Holdings Company). PacifiCorp last paid a dividend on March 7, 2014 that amounted to $500 million.

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, 2013 and its interim March 31, 2014 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, 2008 through 2013; and the partial year ended March 31, 2014.

Revenues have grown at an annual rate of 2.73 percent, from about $4.50 billion in 2008 to $5.15 billion in 2013. Energy costs have been relatively flat over the period, actually decreasing slightly between 2008 and 2013. Total operating expenses grew at an annual rate of 1.84 percent annually over 2008 to 2013.

Earnings from operations grew from approximately $954 million to $1.26 billion over the 2008 to 2013 time period; the average annual growth rate for that period is 5.79 percent. From 2008 to 2013, interest expense grew from about $309 million to $350 million, for a 2.52 percent growth rate. The Company's net income has grown from $465 million in 2008 to $682 million in 2013, for a 7.96 percent growth rate. The nine month March 31, 2014 results show that net income declined by $5 million to $155 million from the March 2013 period amount of $160 million.

However, revenues for the March 2014 period increased 4.55 percent over the March 2013 period. This result suggests that the Company's 2014 annual revenues may approximate $5.38 billion in revenues versus $5.15 billion in 2013, but that net income may be at or below net income for 2013. One quarter's results for net income may not project out for the entire year, however.

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 2006. Going forward, there is an expectation that the Company will continue to pay dividends to its parent. The Company paid $500 million in dividends in 2013. Additional dividend payments in 2014 are possible; however, the Division expects that dividends in 2014 will sum to less than the $800 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 $31 million as of December 31, 2010 and $172 million as of March 31, 2014. The average December 31 balance has been just under $65 million. Total current assets amounted to $1.38 billion in 2008, but have been fairly stable averaging about $1.5 billion since then. Current liabilities balances have fluctuated over the 2008 to 2013 time period, but overall have been relatively flat. In 2008 the current liabilities balance was $1.47 billion; in 2011 the balance was $1.81 billion, but in 2013 and March 2014 the balances were in the $1.2 to $1.3 billion range.

Net plant and equipment grew from $13.82 billion to $18.51 billion over the 2008 to 2013 period; on March 31, 2014 the balance had risen slightly to about $18.57 billion. Other assets have trended upward over the 2008 to 2012 time period, increasing from $2.0 billion to $2.2 billion, but have dropped noticeably in 2013 and March 31, 2104 to about $1.7 billion. Total assets grew at a 4.76 percent annual rate over the 2008 to 2013 time period, ending at almost $21.7 billion in 2013. As of March 31, 2014, total assets stood at $21.71 billion.

Long-term debt (excluding the current portion) has also grown steadily from $5.42 billion in 2008 to nearly $6.64 billion in 2013; long-term debt was approximately $7.05 billion as of March 31, 2014. Deferred income taxes, which represent the accumulation of a positive cash flow item, has increased from $2.03 billion in 2008 to almost $4.36 billion in 2013. As of March 31, 2014, the deferred income tax balance stood at $4.37 billion. Common equity increased from $6.03 billion in 2008 to $7.79 billion in 2013. 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 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.

The financial ratios on page 7 of 7 of Exhibit 1, show that while there have been year-to-year variations, most of the short-term and long-term liquidity ratios have been basically flat, with 2013 generally showing some improvement over 2012. From a bond-rating perspective, one of the crucial measurements, times-interest-earned, made a five year low in 2011 and 2012 at 3.09 times, but rebounded in 2013 to 3.80. Its 2008-2013 average is 3.29. For the nine-month interim period ended March 31, 2014, this measure was calculated at 3.58. 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 4.86 times in 2008 to 4.76 times in 2011; with a five year average of 4.98. Of interest is that in 2013 this FFO-like measure increased to 5.73; the March 31, 2014 value declined slightly to 5.66 times.

All of the profitability ratios had been trending downward between 2008 to 2012 before rebounding in 2013. For the nine months ended March 31, 2014, these ratios declined from the year-end 2013 values to approximate their 5-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. The apparent improvement in the 2013 profitability ratios may indicate that some of this expected improvement is starting to occur. Failure to improve profitability might eventually result in bond rating downgrades and increased costs of capital generally.

Asset utilization ratios have generally declined suggesting 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. These ratios improved, but only slightly, in 2013.

Standard & Poor's, in its April 29, 2013 report on PacifiCorp, rated PacifiCorp's business risk "Excellent" and its outlook "Stable." However, Standard & Poor's made the following cautionary statement: "We consider PacifiCorp's financial risk profile "significant" based on its consolidated financial measures, which include adjusted financial measures (FFO to total debt of 19.5%, debt to EBTDA of 4.5x, and debt to total capital of 50%, all for the 12 months ended Dec. 31, 2013) that are in line with the rating. Also, we consider the company's financial policies to be aggressive. Capital spending and dividend payments translate to rising negative discretionary cash flow over the forecast period, indicating external funding needs and vigilant cost recovery by management to maintain cash flow measures. Our base-case forecast suggests FFO to total debt weakening to about 18%, due in part to the waning benefits of bonus depreciation. We also expect other debt leverage measures to vary, with debt to EBITDA decreasing to about 4x and total debt to total capital remaining at about 51%."[1] This "aggressive" financial policy appears likely to translate into frequent rate case filings in the future.

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

[1] Standard & Poor's Corporation, Ratings Direct, PacifiCorp, April 29, 2013.

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 2008 to 2011, has been incurring capital expenditures at a rate of at least $1.5 billion annually. Capital expenditures declined to 1.35 billion in 2012; then declined to under $1.1 billion in 2013. Furthermore, the Company stated in its December 31, 2013 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.[2] This decline in capital expenditures will improve the Company's cash flow before accounting for the Company's financing activities (e.g. debt issuances and retirements and dividend payments). 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 BHE. However, beginning in 2011 the Company resumed dividend payments which have likely ended further capital contributions from BHE. 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.

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.[3] The economic assumptions that are made in the forecast include a benign inflationary environment for the period of the forecast, continued relatively low interest rates, moderate 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 perhaps slowly improving

[2] PacifiCorp 10-K, pages 39-40.
[3] This forecast also takes into account the fact that Company has reacquired and retired almost all of its outstanding preferred stock.

the levels of profitability. The equity portion of the capital structure is expected to decline a little over the next few years.

Conclusion

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. There are some signs that this decline in profitability may have begun reversing in 2013. 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