MEMORANDUM

To: Utah Public Service Commission

From: Utah Division of Public Utilities
Chris Parker, Director
Artie Powell, Energy Section Manager
Doug Wheelwright, Utility Analyst
Charles Peterson, Technical Consultant

Date: September 8, 2015

Re: Docket No. 15-999-01. PacifiCorp Dividend Declaration with Intended Payment on September 23, 2015

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 Utah Public Service Commission (Commission) take no action.

ISSUE

In a letter dated August 24, 2015, PacifiCorp (Company) informed the Commission that its board of directors had declared a dividend amounting to $250 million payable September 23, 2015 to its sole common shareholder, PPW Holdings LLC, a wholly owned subsidiary of Berkshire Hathaway Energy (BHE). PacifiCorp has previously paid dividends in 2015 totaling to $700 million. This latest announcement would bring total cash dividends paid on the Company's common stock to $950 million in 2015.

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, 2014 financial filings, and interim financial statements as of June 30, 2015. 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, 2009 through 2014.

Revenues have grown at an annual rate of 3.34 percent, from about $4.46 billion in 2009 to $5.25 billion in 2014. The Company's actual energy costs have been growing at a slightly faster rate than revenues between 2009 and 2014 where they have increased at a 3.55 percent annual rate. Total operating expenses grew 3.07 percent annually over 2009 to 2014.

Earnings from operations grew from approximately $1.06 billion to $1.30 billion over the 2009 to 2014 time period; the average annual growth rate for that period is 4.17 percent. From 2009 to 2014, interest expense has been essentially flat at around $350 million per year. The Company's net income has grown from $550 million in 2009 to $698 million in 2014, for a 4.88 percent growth rate.

The six month June 30, 2015 results show that net income declined by $24 million to $305 million from the June 30, 2014 period amount of $339 million. Revenues for the first six months of 2015 declined slightly from the year-earlier period from $2.53 billion to $2.52 billion. However, revenues for the six-month period ending June 30, 2015 was $1.27 billion, or about $26 million higher than the same period in 2014. These results suggest that the Company's 2015 annual revenues may be slightly lower than the $5.25 billion in 2014, and net income may decline to around $625 million compared to $698 million net income for all of 2014. Total results for 2015 may not reflect an extrapolation of the results for the first six months of the year.

PacifiCorp initiated dividend payments in 2011 with total dividends amounting to $550 million; in 2012, 2013, and 2014 the Company paid $200, $500, and $725 million, respectively. 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 Division did not expect the current additional dividend declaration in 2015 given that the Company had already declared and paid $700 million in 2015, certainly not a dividend totaling $250 million. The total dividends declared in 2015, to date, noticeably exceeds both the Company's December 2014 business plan forecast for 2015 dividends and the amount the Division believes is the likely long-run dividend paying capacity of the Company. After 2015, the Division continues to believe that annual dividend payments will average approximately $625 million for several years without a noticeable acceleration in the growth of revenues and earnings.

The balance sheet information on pages 3 and 4 of Exhibit 1 indicates that the cash and equivalent balances have fluctuated widely between $23 million as of December 31, 2014 and $117 million as of December 31, 2009. As of June 30, 2015 the cash balance increased to $96 million. Total current assets amounted to $1.57 billion in 2009, but have been fairly stable averaging about $1.5 billion since then. Current liabilities balances have fluctuated over the 2009 to 2014 time period, but overall have been relatively flat. In 2009 the current liabilities balance was $1.01 billion; in 2011 the balance was $1.81 billion. Current liabilities amounted to $1.12 billion as of December 31, 2014 before rising to about $1.29 on June 30, 2015.

Net plant and equipment grew from $15.54 billion to $18.72 billion over the 2009 to 2014 period; on June 30, 2015 the balance had risen to about $18.90 billion. Other assets have trended upward over the 2009 to 2014 time period, increasing from $1.86 billion to $2.02 billion. Total assets grew at a 3.26 percent annual rate over the 2009 to 2014 time period, ending at almost $22.27 billion at the end of 2014. As of June 30, 2015, total assets increased slightly from the balance of the previous December to $22.34 billion.

Long-term debt (excluding the current portion) has also grown steadily from $6.40 billion in 2009 to nearly $6.92 billion in 2014; long-term debt was approximately $7.12 billion as of June 30, 2015. Deferred income taxes, which represent the accumulation of a positive cash flow item, has increased from $2.62 billion in 2009 to almost $4.61 billion in 2014. As of June 30, 2015, the deferred income tax balance stood at almost $4.62 billion. Common equity increased from $6.69 billion in 2009 to $7.75 billion in 2014. The growth in common equity was facilitated by equity contributions from Berkshire Hathaway Energy (BHE) totaling almost $1.1 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 June 30, 2015 balance of common equity amounted to about $7.36 billion which reflects the payment of a $700 million in common dividends versus $305 million in net income during the first six months of the year.

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. 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 and 3.84 in 2014. Its 2009-2014 average is 3.38. For the six-month interim period ended June 30, 2015, this measure was calculated at 3.49. A similar measurement adds back depreciation to the earnings in the times-interest-earned ratio 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 4.71 times in 2009 to 5.90 times in 2014; with a five year average of 5.15.

All of the profitability ratios had been trending downward from 2009 to 2012 before rebounding in 2013 and 2014. For the six-months ended June 30, 2015, these interim period ratios softened from the year-end 2014 due to the lower profitability described earlier. The level of return on equity has consistently been one or more percentage points below the Company's authorized returns. The nearly constant annual rate increases among the states in its service territory and the Company's ability to implement energy balancing account programs in most of its states may be the primary contributing factors to this apparent recovery in profitability from the recent lows in 2012 to 2014. It remains to be seen whether the trend of the first six months in 2015 continues for the full year, in which case return on equity may approach 8.0 percent versus the Company's authorized return (on regulatory rate base) of 9.80 percent in Utah.

Asset utilization ratios have been essentially flat to slightly declining, if one starts with the 2009 values.

Standard & Poor's, in its June 30, 2014 report on PacifiCorp, rated PacifiCorp's business risk "Excellent" and its outlook "Stable." However, Standard & Poor's rates the Company's financial risk profile "significant" based the capital expenditure and dividend needs resulting in negative discretionary cash flows requiring external financing.

The Company's bond ratings for its senior secured debt (the large majority of the debt) is a Standard & Poor's "A" rating; and a "corporate" rating of "A-". Moody's in its May 7, 2014 opinion rated PacifiCorp A3 (similar to Standard & Poor's A-). It should be noted that these ratings are in part based upon the benefit of the Company's relationship as a subsidiary of BHE and, ultimately, Berkshire Hathaway.

As indicated on Exhibit 1 page 5, PacifiCorp, from 2009 to 2011, has been incurring capital expenditures at a rate of at least $1.51 billion annually. Capital expenditures declined to 1.35 billion in 2012; then declined to under $1.1 billion in 2013 and 2014. The Company's forecast capital expenditures for 2015-2017 have declined significantly in its 2014 SEC Form 10K versus the comparable forecast in the 2013 10K. In the 2013 10K, the Company projected that annual capital expenditures for 2014-2016 would average about $1.03 billion; specifically for 2015 and 2016 capital expenditures were projected to average 1.0 billion each year. Now in the 2014 10K, the projected capital expenditures for 2015-2016 decline by 13.1 percent to average $869 million; 2017 capital expenditures are projected to be $789 million. This apparent reduced need to invest in plant and equipment might free up funds for higher dividend payments to the Company's parent.

The Company's capital expenditure program since 2006 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 likely ended further capital contributions from BHE. The Company in its most recent Integrated Resource Plan cycle has indicated that it believes long-term 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 more because additional large new generation resources will not be needed.

Exhibit 2 sets forth a forecast of PacifiCorp's financial statements based upon assumptions made by the Division that seem reasonable in light of historical results, the expectation of low 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, continued relatively low interest rates, moderate growth in revenues and net income and improved profitability. Based upon these assumptions, it appears that there should be no significant effect 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 improving the levels of profitability. The equity portion of the capital structure is expected to decline about 2 percentage points from the current 50.2 percent to around 48.1 percent 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 shown sustained improvement. Indeed, as highlighted above, profitability was on a downward trend before reversing in 2013-2014. However, the results for the first two quarters of 2015 were not supportive of the apparent improving trend that began in 2013. Nevertheless, 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: Bob Lively, PacifiCorp
Michele Beck, Office of Consumer Services