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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
Jeff Einfeldt, Utility Analyst

Date: March 5, 2018

Re: Docket No. 18-999-01. PacifiCorp Dividend Declaration with Intended Payment on March 14, 2018.

RECOMMENDATION

With respect to the financial requirements of UCA Section 54-4-27(3), based upon the following analysis, the Division finds no indication that the capital and operations of PacifiCorp will be impaired by payment of the proposed dividend. Therefore the Division recommends that the Public Service Commission of Utah (Commission) take no action.

ISSUE

In a letter dated February 12, 2018, PacifiCorp (Company) informed the Commission that its board of directors had declared a dividend on February 12, 2018 amounting to $250 million payable March 14, 2018 to its sole common shareholder, PPW Holdings LLC, a wholly owned

subsidiary of Berkshire Hathaway Energy (BHE). PacifiCorp previously has paid dividends in 2017 totaling $600 million; total dividends in 2016 amounted to $875 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 annual SEC Form 10K financial statements through December 31, 2017. The Division has also reviewed the Company's bond rating through the various bond rating agencies.

In approaching its assignment, the Division understands the terms "impaired" and "impairment" in UCA 54-4-27(3) 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.

PacifiCorp initiated dividend payments in 2011 with total dividends amounting to $550 million; in 2012, 2013, 2014, 2015 and 2016 the Company paid $200, $500, $725, $950 and $875 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 total dividends paid in 2014, 2015 and 2016 exceeded the Company's net income for each of those years, which is not sustainable over the long term. The dividends paid in 2017 amounted to $600 million, an annual amount that the Division believes is sustainable. The Division believes the current dividend paying capacity of the Company is not more than approximately $600 to $700 million annually unless there is a noticeable acceleration in the growth of revenues and earnings.

Exhibit 1 sets forth financial results for the fiscal years ended December 31, 2012 through 2017. Revenues have grown at an annual rate of 1.41 percent, from about $4.88 billion in 2012 to $5.24 billion in 2017. The Company's actual energy costs have declined from $1.82 billion in 2012 to $1.77 billion in 2017. This result in energy costs is likely due to the significant decline in natural gas commodity prices in recent years and the slowing of load growth, which showed up as declining energy costs over the last two years. Total operating expenses also declined at a -0.45 percent rate annually over 2012 to 2017. One reason for the decline in operating expenses is that "Other operations and maintenance" expense, which is about 20 to 25 percent of total revenues, exhibited an average annual decrease of -4.01 percent over the time period surveyed.

Earnings from operations grew from approximately $1.02 billion to $1.46 billion over the 2012 to 2017 time period; the average annual growth rate for that period is 7.44 percent. From 2012 to 2016 interest expense has been fairly stable between 350 and 367 million per year, but increased to $381 million in 2017. The Company's net income has grown from $537 million in 2012 to a high of $768 million in 2017. Overall the growth rate for net income has been 7.42 percent annually. The 2016 net income exceeded $700 million for the first time. Largely due to a decline in energy costs and operations and maintenance. This trend in operations and maintenance costs continued in 2017, although energy costs were up slightly.

The lower operations and maintenance expense may be a concern if it eventually leads to reduced service quality and reductions in other services. This expense peaked in 2012 at $1.24 billion and has trended downward since then. In 2017 other operations and maintenance expense was $1,012 million, a new five-year low.

The balance sheet information on pages 3 and 4 of Exhibit 1 indicates that the cash and equivalent balances have fluctuated widely between $80 million as of December 31, 2012 and $12 million as of December 31, 2015. The cash and equivalent balance was $14 million as of December 31, 2017. Total current assets amounted to $1.48 billion in 2012, but have declined to $1.32 billion as of December 31, 2017. Current liabilities balances have fluctuated over the 2012

to 2017 time period, but overall had been trending downward through 2016 before increasing to $1.62 billion in 2017 due to an increase of over $500 million in current maturities.

Net plant and equipment grew from $18.06 billion to $19.20 billion over the 2012 to 2017 period. Other assets have decreased from $2.20 billion in 2012 to $1.40 billion in 2017. Total assets grew at a negligible 0.18 percent annual rate over the 2012 to 2017 time period, ending at $21.92 billion at the end of 2017.

Long-term debt (excluding the current portion) grew steadily from $6.59 billion in 2012 to $7.02 billion in 2016, before declining to $6.44 billion at the end of 2017 due to an increase in current maturities. The large amount of current maturities suggests that the Company will be issuing new debt in 2018 in an amount approximating $600 million. Deferred income taxes, which represent the accumulation of a positive cash flow item, has increased from $3.86 billion in 2012 to $4.88 billion in 2016 before declining to $2.58 billion largely as a result of the change in the federal income tax rate. Common equity was essentially flat for the period ending at $7.55 billion at the end of 2017. 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 the Division expects common equity balances to grow relatively slowly going forward. The decline in common equity between 2014 and 2016 was primarily due to the relatively high level of dividend payments for those years last three years.

The financial ratios on page 7 of 7 of Exhibit 1 show that while there have been year-to-year variations, most of the long-term liquidity ratios have been basically flat. The short-term liquidity ratios, with the exception of Days revenues receivable, have declined as the level of cash balances have declined significantly. From a bond-rating perspective, one of the crucial measurements, times-interest-earned, made a five year low in 2012 at 3.09 times, but rebounded to above 3.80 times since 2013 and ended 2016 at 4.02; its 2012 to 2017 average is 3.76 times.

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 4.91 times in 2012 to a high of 6.13 times in 2016 with a five year average of 5.77.

All of the profitability ratios had been trending downward through 2012 before rebounding in 2013. Until 2016, the level of return on equity has consistently been one or more percentage points below the Company's authorized returns since the acquisition of PacifiCorp by Berkshire Hathaway Energy. 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 2016. The return on equity in 2016 was calculated at 10.25 percent rising to 10.28 percent in 2017, on an SEC reporting basis, compared to a low of 7.19 percent in 2012. Currently, the authorized return in Utah is 9.80 percent on regulatory rate base.

Fitch Ratings in a May 2, 2017 report on Berkshire Hathaway Energy Company and subsidiaries gave PacifiCorp an "A-" issuer rating with a "stable" outlook. Fitch's comments on page 13 of its report includes the following on PacifiCorp:

> Regulatory outcomes across PPW's (PacifiCorp's) multistate service territory have been and are expected to remain balanced from a credit perspective, with the exception of Washington. Various riders are in place to facilitate recovery of certain costs outside of GRC proceedings, including fuel adjustment clauses that mitigate commodity price exposure in all of PPW's regulatory jurisdictions. GRC filings have slowed, reflecting management focus on rate stability and lower capex. No GRCs are currently pending across PPW's six-state service territory.

Moody's in its April 7, 2017 credit opinion continues to give PacifiCorp's first mortgage debt an "issuer rating" of "A3", which is unchanged from its May 2015 opinion. The large majority of PacifiCorp's debt is made up of first mortgage securities that historically have been given a higher rating than the "issuer rating," but the April 2017 opinion gives no separate first mortgage rating. Moody's summarizes its ratings' rationale as follows:

> PacifiCorp's ratings are supported by the stability of the utility's regulated cash flows, the geographically diverse and reasonably supportive regulatory environments in which it operates, the diversification of its generation portfolio, and stable credit metrics. The company has the capacity to generate free cash flow. The rating also takes into account PacifiCorp's position as the largest subsidiary of Berkshire Hathaway Energy Company…, a holding company whose subsidiaries are primarily engaged in regulated activities, and the benefits of its affiliation with Berkshire Hathaway Company….

Standard & Poor's, in its February 19, 2016 report on Berkshire Hathaway Energy, PacifiCorp's parent, raised PacifiCorp's corporate rating from "A-" to "A". The Company's senior secured debt was raised from "A" to "A+". The outlook is stable. Most of the Company's debt would be considered senior secured debt. 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 can be seen from the above discussion the major ratings agencies currently have a very favorable view of PacifiCorp from a credit perspective.

As indicated on Exhibit 1 page 5, PacifiCorp's capital expenditures were $1.35 billion in 2012 and declined each year with capital expenditures totaling $769 million in 2017. This apparent reduced need to invest in plant and equipment might free up funds for higher dividend payments to the Company's parent. Alternatively, regulators may work to have the Company reduce the equity portion in its capital structure as the Company's borrowing needs should decline, reducing the need for the balance sheet to be quite as strong.[1]

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,

[1] In its September 1, 2016 "Order 12" in docket UE 152253 the Washington Utilities and Transportation Commission sustained a 49.10 percent equity market structure, which is lower than the Company's 51.2 percent book percentage (SEC basis, as of December 31, 2015). https://www.utc.wa.gov/docs/Pages/PacificPowerandLightCompany%28GRC%29%2cDocketUE-152253.aspx last accessed November 22, 2016.

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 cycles has indicated that it believes long-term load growth will be noticeably lower than the Company's earlier expectations. If this is correct, then the Company's growth may not pick up much from what has been observed in recent years.

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 and expectations. The economic assumptions made in the forecast include a benign inflationary environment for the period of the forecast, modest growth in gross domestic product in the United States, and continued relatively low interest rates. The assumptions for the Company include modest growth in revenues and net income and maintaining approximately the current level of 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 keeping recent levels of profitability.

NOTE:

The forecast does not include changes to the Company's financial statements that would result from the proposals by the Company for wind repowering, new Wyoming wind resources, and a new transmission line in Wyoming, which are the subjects of Docket Nos. 17-035-39 and 17-035-40. If fully implemented as planned, these projects would add approximately $3 billion in new assets to the Company's balance sheet and would likely be funded with between $1 billion and $2 billion in additional debt that is not accounted for in these forecasts. According to direct testimony filed by Division witness Charles E. Peterson in those dockets, the Division believes that the Company has the financial capacity to perform on these projects, but will likely need to

significantly reduce or eliminate dividends, or receive comparable capital contributions from its parent, for two or three years, or so, before resuming regular dividend payments.

The forecast does include an estimate of the effects due to changes in the Federal Income Tax Code. Among other changes the forecasts adds an estimated $61 million in excess deferred income tax amortization to the income statement forecast. This $61 million amortization is very preliminary in nature and will be modified as additional information becomes available.

Conclusion

With respect to the financial status of PacifiCorp, the Company has grown significantly over the past few years and has made some improvements to its balance sheet. As highlighted above, profitability was on a downward trend before reversing in 2013-2016. Consequently, the Company does appear to be able to make the proposed dividend payment and probably continue a regular dividend payment program without impairing its assets or operations.

cc: Jana Saba, PacifiCorp
Michele Beck, Office of Consumer Services