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 4, 2019

Re: Docket No. 19-999-01. PacifiCorp Dividend Declaration with Intended Payment on March 28, 2019.

RECOMMENDATION (No Action)

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 27, 2019, PacifiCorp (Utility) informed the Commission that its board of directors had declared a dividend on February 26, 2019 amounting to $175 million payable March 28, 2019 to its sole common stock shareholder, PPW Holdings LLC, a wholly owned subsidiary of Berkshire Hathaway Energy (BHE). PacifiCorp previously has paid dividends

totaling of $450 million in 2018. Dividends in 2017 and 2016 totaling $600 million and $875 million, respectively, were paid by the Utility.

Discussion

The Division of Public Utilities (Division) has investigated the effects of the dividend on the capital and cash flows of PacifiCorp using the annual SEC Form 10K financial statements through December 31, 2018. The Division has also reviewed PacifiCorp'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 PacifiCorp 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 PacifiCorp 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. Over the last five years, 2014-2018, PacifiCorp paid dividends of $725, $950, $875, $600 and $450 million, respectively. Prior to 2011, PacifiCorp last paid a dividend in March 2006. Going forward, there is an expectation that PacifiCorp will continue to pay dividends to its parent, although as discussed below, dividends will likely be significantly reduced, or omitted, over the years 2019-2021 as the Utility funds its wind repowering and Wyoming wind and transmission projects. The total dividends paid in 2014, 2015 and 2016 exceeded PacifiCorp'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, absent any large expansion capital expenditures. As the Utility gears up its wind projects capital expenditure program, it paid a reduced dividend of $450 million in 2018. The Division believes the current dividend paying capacity of PacifiCorp 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, 2013 through 2018. Revenues declined slightly from about $5.15billion in 2013 to $5.03 billion in 2018. Part of the decline is due to changes in federal income tax law that resulted in PacifiCorp collecting less revenues as part of refunds to ratepayers ordered by various commissions. PacifiCorp's actual energy costs have declined from $1.92 billion in 2013 to $1.76 billion in 2018. This result in energy costs is likely due to the significant decline in natural gas commodity prices in recent years, the slowing of load growth, and the increase in wind and solar generation. Total operating expenses also increased at a modest 0.47 percent rate annually over 2013 to 2018. By far the biggest driver of any increase at all in total operating expenses is the increase in depreciation expense between 2017 and 2018, which increased from $796 million in 2017 to $979 million in 2018. While increasing a bit in 2018, "other operations and maintenance" expense, which is about 20 percent of total revenues, exhibited an average annual decrease of -1.40 percent over the time period surveyed. The downward trend in operations and maintenance expense has been noted by the Division for a couple years now since, if the trend continues, it could mean that the Utility may not be appropriately maintaining its system.

Earnings from operations declined from approximately $1.26 billion to $1.05 billion over the 2013 to 2018 time period; the average annual growth rate for that period is -3.62 percent. Interest expense has trended upward over the period going from $350 million in 2013 to $384 million in 2018. PacifiCorp's net income has grown from $685 million in 2013 to a high of $768 million in 2017, before declining to $738 million in 2018. Overall the growth rate for net income has been 1.56 percent annually.

The balance sheet information on pages 3 and 4 of Exhibit 1 indicates that the cash and equivalent balances have fluctuated widely between $77 million as of December 31, 2018 and $12 million as of December 31, 2015. Total current assets amounted to $1.44 billion in 2013 but have declined slightly to $1.36 billion as of December 31, 2018. Current liabilities balances have fluctuated over the 2013 to 2018 time period, but overall had been trending growing at 3.53 percent annual rate standing at $1.52 billion as of December 31, 2018.

Net plant and equipment grew from $18.51 billion to $19.59 billion over the 2013 to 2018 period. Other assets have decreased from $1.71 billion in 2013 to $1.36 billion in 2018. Total assets grew at a 0.60 percent annual rate over the 2013 to 2018 time period, ending at $22.31 billion at the end of 2018.

Long-term debt (excluding the current portion) while fluctuating somewhat was essentially flat over 2013-2018; the ending balance on December 31, 2018 amounted to $6.68 billion. Deferred income taxes, which represent the accumulation of a positive cash flow item, declined sharply between 2016 and 2017 going from $4.88 billion in 2016 to $2.58 billion in 2017 largely as a result of the change in the federal income tax rate. Deferred income taxes were down again, slightly, in 2018 ending at $2.54 billion. Common equity was essentially flat for the period ending at $7.84 billion at the end of 2018. 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.

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, before recovering somewhat in 2018. From a bond-rating perspective, one of the crucial measurements, times-interest-earned, made a five year low in 2018 at 2.93 times; it averaged a reasonably healthy 3.73 times over 2013-2018. 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 averaging 5.87 times for the 2013-2018 period, but also hitting a five year low of 5.48 times in 2018.

All of the profitability ratios had been trending upward over the 2013-2018 period. Returns on total assets and total capital were at their highest levels in 2018. Return on common equity declined to 9.59 percent (SEC reporting basis) in 2018 from its high of 10.28 percent in 2017, but still was slightly above its five year average of 9.51 percent. 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. PacifiCorp 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". PacifiCorp's senior secured debt was raised from "A" to "A+". The outlook is stable. Most of PacifiCorp's debt would be considered senior secured debt. It should be noted that these ratings are in part based upon the benefit of PacifiCorp'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. There have been no recent changes in ratings for PacifiCorp.

As indicated on Exhibit 1 page 5, PacifiCorp's capital expenditures have been declining through 2017 when they bottomed at $769 million. Capital expenditures rebounded to $1.26 billion in 2018, probably in part due to wind repowering and other wind-related projects. Capital expenditures are expected to rise over the next 2-3 years as the Utility builds out its Wyoming wind projects.

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 PacifiCorp include modest growth in revenues and net income and maintaining approximately the current level of profitability.

The forecast assumes and estimates the effects of PacifiCorp's wind repowering projects and the new Wyoming wind generation and transmission projects. These projects will likely result in lower dividends being paid over the next few years as PacifiCorp funds the repowering and new wind and transmission projects. The Division's forecast also assumes that the Utility's borrowing costs will not increase substantially over the next few years. The forecast has been adjusted for

slower growth that has occurred in the last two or three full calendar years. The forecast also includes an estimate of the effects due to changes in the Federal Income Tax Code.

Based upon these assumptions, it appears that there should be no significant effect on PacifiCorp's financial health due to the payment of the currently announced dividend. It appears that PacifiCorp can maintain a program of dividend payments even through the wind repowering and Wyoming wind and transmission projects that will make a substantial demand on cash flows over the next few years.

Conclusion

With respect to the financial status of PacifiCorp, PacifiCorp has grown significantly over the past few years and has made some improvements to its balance sheet. Profitability has generally been improving over the recent five years. Consequently, PacifiCorp does appear to be able to make the proposed dividend payment and probably continue a regular dividend payment program, adjusted for the expansion and repowering projects mentioned above, without impairing its assets or operations.

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