State of Utah
Department of Commerce
Division of Public Utilities

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MEMORANDUM

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 2, 2017

Re: Docket No. 17-999-01. PacifiCorp Dividend Declaration with Intended Payment on March 7, 2017.

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 Public Service Commission of Utah (Commission) take no action.

ISSUE

In a letter dated February 8, 2017, PacifiCorp (Company) informed the Commission that its board of directors had declared a dividend amounting to $100 million payable March 7, 2017 to its sole common shareholder, PPW Holdings LLC, a wholly owned subsidiary of Berkshire Hathaway Energy (BHE). PacifiCorp previously paid dividends in 2016 totaling to $875 million, and dividends in 2015 amounting to $950 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, 2016. 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, 2011 through 2016. Revenues have grown at an annual rate of 2.55 percent, from about $4.59 billion in 2011 to $5.2 billion in 2016. The Company's actual energy costs have been growing at a slower rate than revenues between 2011 and 2016 where they have increased at a 1.37 percent annual rate, this includes actual declines in energy costs in 2015 and 2016. 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 grew 1.51 percent annually over 2011 to 2016, which is also slower than revenue growth. One reason for the relatively slower growth in operating expenses is that "Other operations and maintenance" expense, which is about 20 to 25 percent of total revenues, exhibited a net decrease of -.72 percent over the time period surveyed.

Earnings from operations grew from approximately $1.08 billion to $1.43 billion over the 2011 to 2016 time period; the average annual growth rate for that period is 5.64 percent. From 2011 to 2016, interest expense has been fairly stable between 350 and 367 million per year. The

Company's net income has grown from $555 million in 2011 to a high of $763 million in 2016. Overall the growth rate for net income has been 6.57 percent annually. The 2016 net income exceeded $700 million for the first time, and on lower revenues. Part of this result is due to a $117 million decline in energy costs and an $18 million decline in operations and maintenance expense. The lower operations and maintenance expense may be a concern if it eventually leads to reduced service quality and reductions in other services.

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 2015 and 2016 exceed the amount the Division believes is the likely long-run dividend paying capacity of the Company. After 2016, the Division believes that annual dividend payments will average approximately $650 to $700 million for several years unless there is a noticeable acceleration, or deceleration, in the expected 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 $80 million as of December 31, 2012 and $12 million as of December 31, 2015. The cash and equivalent balance was $17 million as of December 31, 2016. Total current assets amounted to $1.48 billion in 2011, but have declined to $1.35 billion as of December 31, 2016. Current liabilities balances have fluctuated over the 2011 to 2016 time period, but overall have been trending downward. In 2011 the current liabilities balance was $1.81 billion and have declined to $1.2 billion as of December 31, 2016.

Net plant and equipment grew from $17.37 billion to $19.16 billion over the 2011 to 2016 period. Other assets have decreased from $2.25 billion in 2011 to $1.88 billion in 2016. Total assets grew at a 1.19 percent annual rate over the 2011 to 2016 time period, ending at $22.39 billion at the end of 2016.

Long-term debt (excluding the current portion) has also grown steadily from $6.19 billion in 2011 to $7.02 billion in 2016. Deferred income taxes, which represent the accumulation of a positive cash flow item, has increased from $3.86 billion in 2011 to $4.88 billion in 2016. Common equity increased from $7.27 billion in 2011 to $7.75 billion in 2014, but declined to $7.39 billion at the end of 2016. 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 decline in common equity between 2014 and 2016 was primarily due to the relatively high level of dividend payments for the 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 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 to above 3.80 times since 2013 and ended 2016 at 4.02; its 2011 to 2016 average is 3.61 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 4.76 times in 2011 to a high of 6.13 times in 2016 with a five year average of 5.56.

All of the profitability ratios trended downward for 2011 and 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 10.08 percent, on an SEC reporting basis, compared to a low of 7.19 percent in 2012, also calculated on an SEC reporting basis. Currently, the authorized return in Utah is 9.80 percent on regulatory rate base.

Moody's in its May 7, 2015 credit opinion rates PacifiCorp's first mortgage debt "A1" and gives it an "issuer rating" of "A3". The large majority of PacifiCorp's debt is made up of first mortgage securities. 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 will have the capacity to generate free cash flow over the next few years as it reduces capital spending, The rating also takes into account PacifiCorp's position as a subsidiary of BHE [Berkshire Hathaway Energy Company], a holding company whose subsidiaries are primarily engaged in regulated activities, and the benefits of its affiliation with BRK [Berkshire Hathaway, Inc.].

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.

In its latest report dated November 2015, Fitch upgraded PacifiCorp's issuer default rating to "A-" from "BBB+". PacifiCorp's senior secured debt was upgraded to "A+" from "A". Fitch's explanation of its ratings for PacifiCorp mirrors closely Moody's and Standard & Poor's. 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 $1.5 billion in 2011 and declined each year with capital expenditures totaling $.9 billion in 2016. According to its 2016

SEC Form 10K, the Company's forecast capital expenditures for 2016-2018 will continue to decline and are expected to average about $807 million over those three years. This is a little lower than the 2014 10K forecast where, for example, the 2017 capital expenditures were projected to be $789 million, but now are forecast to be $780 million. 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 to maintain quite as strong a balance sheet.[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, 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 be slower than 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, continued relatively low interest rates, modest 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.

[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.

Conclusion

The Company has grown significantly over the past few years and has made some improvements to its balance sheet. On the negative side, profitability as measured by returns on equity and total capital until recently has not shown sustained improvement. Indeed, 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 operations.

cc: Bob Lively, PacifiCorp
Michele Beck, Office of Consumer Services