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State of Utah
Department of Commerce
Division of Public Utilities

FRANCINE GIANI
Executive Director

THOMAS BRADY
Deputy Director

CHRIS PARKER
Director, Division of Public Utilities

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: August 31, 2017

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

RECOMMENDATION

PacifiCorp (Company) failed to timely notify the Commission of its \$300 million dividend declaration pursuant to UCA 54-4-27(2)(a). Accordingly, its declaration of dividend was ineffective and the Commission should require a new declaration of dividend followed by proper notice to the Commission. Alternatively, the Commission may wish to order a delay in payment of the dividend matching the delay in the required notification. Depending on the Company's response, the Commission may need to file to enforce this provision in district court. Although the alternative of delaying payment might not be specifically authorized by statute, it might be preferable to the Company over the longer delay a new declaration and notification might cause. At a minimum and perhaps in addition to the above, the Commission should impose a penalty under Section 54-7-25 for each day of the delay in notification. Given the magnitude of the dividend, the penalty should be in the statutory maximum of \$2,000 per day.

With respect to the financial requirements of UCA 54-4-27(3), based upon the following analysis, the Division finds no indication that the capital and operations of PacifiCorp will be impaired. Therefore the Division recommends that the Public Service Commission of Utah (Commission) take no action with respect to these financial considerations once the statute's procedural requirements have been satisfied.

ISSUE

In a letter dated August 17, 2017, PacifiCorp (Company) informed the Commission that its board of directors had declared a dividend on August 8, 2017 amounting to \$300 million payable September 7, 2017 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 \$200 million; total dividends in 2016 amounted to \$875 million.

Discussion

The Division notes that the Company is not in compliance with UCA 54-4-27, which states in part:

54-4-27. Payment of dividends -- Notice -- Restraint.

- (1) No gas or electric corporation doing business in this state shall pay any dividend upon its common stock prior to 30 days after the date of the declaration of such dividend by the board of directors of such utility corporation.
- (2) Within five days after the declaration of such dividend the management of such corporation shall:
 - (a) notify the utilities commission in writing of the declaration of said dividend, the amount thereof, the date fixed for payment of the same;

The Company waited nine days before notifying the Commission. The Company's declaration of dividend and subsequent notice plainly did not comply with the statute and is ineffective.

Though the statute provides no description of the consequence of failure to timely file, if the delay in notification does not lead to a consequence, the statutory provision is rendered meaningless. Without proper notification, the utility can unilaterally shorten the Commission's time for review by delaying its notification. Given that the statute says the Commission must find impairment to stop the payment of a dividend, this shortening of the time for Commission review is unacceptable. If delay in notification is tolerated, regulators' ability to prevent finance-impairing dividends is significantly diminished. Thus, the Commission should reject the filing as ineffective, instructing the Company to re-declare the dividend and properly notify the Commission. Alternatively, a delay in allowing payment of the dividend matching the length of delay in the notification might be preferable.

With respect to the purely financial and economic aspects of the Company's notice, 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 and the SEC Form 10Q as of June 30, 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 Division believes the current dividend paying capacity of the Company is not more than approximately \$650 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, 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 an average annual decrease of 0.72 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. This expense peaked in 2012 at \$1.24 billion and has trended downward since then. In the first half of 2017 other operations and maintenance expense was \$506 million, which would extrapolate to an annual amount of about \$1.0 billion.¹

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

¹ Simply multiplying \$506 million by four gives \$1,012 million. A slightly more sophisticated forecast is to note that in 2016, first half expenses were 49.62 percent of the annual total. Applying the 49.62 percent figure to \$506 million yields \$1.020 billion.

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 10.25 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.

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.

In its report dated November 2015, Fitch upgraded PacifiCorp's issuer default rating to "A-" from "BBB+". The "A-" rating was confirmed in the May 2017 Fitch report. 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 for the balance sheet to be quite as strong.²

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.

Generally, there were no big surprises in the six-month financial statements as set forth in the Company's SEC Form 10-Q. The Company's second quarter SEC Form 10-Q for the period ended June 30, 2017 shows that Company revenues grew to \$2.526 billion from \$2.485 billion in the first six months of 2016. Net income also grew to \$354 million compared to \$341 million for the same period last year. Net property, plant, and equipment declined to \$19.14 billion from \$19.16 billion as of December 31, 2016, primarily due to depreciation expense being larger than

² 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.

capital expenditures for the period. The Company's stated debt obligations³ declined \$322 million over the six month period. Total assets increased slightly from \$22.39 billion to \$22.46 billion (about \$70 million) between December 31, 2016 and June 30, 2017.

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. 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, and a new transmission line in Wyoming, which are the subjects of Docket Nos. 17-035-39 and 17-035-40, with the transmission line docket possibly forthcoming.

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.

Conclusion

The Company's filing should be rejected because of the Company's failure to follow the dividend statute. Alternatively, as an equitable remedy, the Commission may wish to order a delay in payment matching the delay in notification. The Commission should also impose a penalty for the Company's statutory violation. Without enforcement of the statute's notice

³ Long term debt including current obligations, and short term debt.

provision, the utility has the unilateral power to deprive regulators of a reasonable period to evaluate the Company's fitness for dividend payments.

The Division's preferred remedies are that the filing be rejected and the penalty be applied.

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