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State of Utah
Department of Commerce
Division of Public Utilities

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Executive Director

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Director, Division of Public Utilities

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: August 27, 2018

Re: Docket No. 18-999-01. PacifiCorp Dividend Declaration with Intended Payment on September 19, 2018.

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 August 20, 2018, PacifiCorp (Utility) informed the Commission that its board of directors had declared a dividend on August 20, 2018 amounting to \$50 million payable September 19, 2018 to its sole common shareholder, PPW Holdings LLC, a wholly owned subsidiary of Berkshire Hathaway Energy (BHE). PacifiCorp previously has paid dividends

totaling of \$350 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, 2017 and the SEC Form 10Q for the second quarter ended June 30, 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; in 2012, 2013, 2014, 2015, 2016 and 2017 PacifiCorp paid \$200, \$500, \$725, \$950, \$875, and \$600 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. 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. 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. Recent statements by Rocky Mountain Power in Docket No. 17-035-69 concerning the effects of immediate refunds of decreased

deferred income tax amounts suggest that significant payments might result in impairment, particularly given the upcoming addition of significant capital investments.¹

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. PacifiCorp'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 -.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. PacifiCorp'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 billion, 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

¹ Public Testimony of Nikki Kobliha, Docket No. 17-035-69, April 18, 2018 Hearing Transcript at 18-19.

December 31, 2017. Total current assets amounted to \$1.47 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 PacifiCorp 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 \$4.17 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.

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 had been consistently one or more percentage points below PacifiCorp'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 PacifiCorp'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.

PacifiCorp's SEC Form 10Q for the second quarter of 2018 (ended June 30, 2018), indicates a year over year decline in revenues of almost 6.0 percent. Net income was also lower by over 6.0 percent in spite of a much lower income tax rate. As explained in the Company's SEC filings, this reduction is primarily due to refund accruals related to the 2017 federal tax reform.² Operating expenses declined slightly from the first six months of 2017, but not nearly enough to offset the decline in revenue. Total assets increased by \$39 million between December 31, 2017 and June 30, 2018.

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

² Berkshire Hathaway Energy Company, SEC Form 10-Q, June 30, 2018, page 33.

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.

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 PacifiCorp's parent. Alternatively, regulators may work to have PacifiCorp reduce the equity portion in its capital structure as PacifiCorp's borrowing needs should decline, reducing the need for the balance sheet to be quite as strong.³

PacifiCorp's capital expenditure program since 2006 has required that PacifiCorp obtain funding from the debt markets as well as the receipt of equity contributions from BHE. However, beginning in 2011 PacifiCorp resumed dividend payments, which likely ended further capital contributions from BHE. PacifiCorp in its most recent Integrated Resource Plan cycles has indicated that it believes long-term load growth will be noticeably lower than PacifiCorp's earlier expectations. If this is correct, then PacifiCorp'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 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 proposed wind repowering projects and the expected new Wyoming wind generation and transmission projects. This may result in lower dividends being paid over the next few years as PacifiCorp funds the repowering, new wind and transmission projects. The forecast has been adjusted for slower growth that has occurred in the last two or three full calendar years and which has continued in the second quarter of 2018. The forecast also includes an estimate of the effects due to changes in the

³ 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 PacifiCorp's 51.2 percent book percentage (SEC basis, as of December 31, 2015).
<https://www.utc.wa.gov/docs/Pages/PacificPowerandLightPacifiCorp%28GRC%29%2cDocketUE-152253.aspx>
last accessed November 22, 2016.

Federal Income Tax Code since the 2018 forecast revenues are based upon the first six months results for 2018, which as indicated above, includes accruals for refunds due to the change in the income tax rates.

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 be requiring 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. As highlighted above, profitability was on a downward trend before reversing in 2013-2016. 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