

Docket No. 09-\_\_\_\_\_  
Exhibit No. PPL/300  
Witness: Bruce N. Williams

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA

PACIFICORP

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Direct Testimony of Bruce N. Williams

Capital Structure

Cost of Debt and Preferred

November 2009

1 **Q. Please state your name, business address and present position with**  
2 **PacifiCorp (“Company”).**

3 A. My name is Bruce N. Williams. My business address is 825 N.E. Multnomah,  
4 Suite 1900, Portland, Oregon 97232. My present position is Vice President and  
5 Treasurer.

6 **Qualifications**

7 **Q. Please describe your education and business experience.**

8 A. I received a Bachelor of Science degree in Business Administration with a  
9 concentration in Finance from Oregon State University in June 1980. I also  
10 received the Chartered Financial Analyst designation upon passing the  
11 examination in September 1986. I have been employed by the Company for 24  
12 years. My business experience has included financing of the Company’s electric  
13 operations and non-utility activities, responsibility for the investment  
14 management of the Company’s qualified and non-qualified retirement plan assets,  
15 and investor relations.

16 **Q. Please describe your present duties.**

17 A. I am responsible for the Company’s treasury, credit risk management, pension  
18 and other investment management activities. I am also responsible for the  
19 preparation of PacifiCorp’s embedded cost of debt and preferred equity and any  
20 associated testimony related to capital structure for regulatory filings in all of  
21 PacifiCorp’s state and federal jurisdictions.

1 **Qualifications**

2 **Q. What is the purpose of your testimony?**

3 A. I first present a financing overview of the Company. Next, I discuss the planned  
4 amounts of common equity, debt, and preferred stock included in the Company's  
5 proposed capital structure. I then analyze the embedded cost of debt and  
6 preferred stock supporting PacifiCorp's electric operations in the state of  
7 California for the test period. This analysis includes the use of forward interest  
8 rates, the historical relationship of security trading patterns, and known and  
9 measurable changes to the debt and preferred stock portfolios.

10 **Q. What time period do your analyses cover?**

11 A. The test period in this proceeding is the twelve months ending December 31,  
12 2011. To appropriately match the Company's costs with customer prices during  
13 the period, I determined the capital structure and costs of long-term debt and  
14 preferred stock using an average of the five quarter-ending balances spanning the  
15 test period.

16 **Q. What is the overall cost of capital that you are proposing in this proceeding?**

17 A. The Company is proposing an overall cost of capital of 8.69 percent. This cost  
18 includes the return on equity recommendation from Company witness Dr. Samuel  
19 C. Hadaway and the following capital structure and costs:

Overall Cost of Capital

Component	\$ (millions)	Percentage of Total	Cost	Weighted Average
Long Term Debt	\$6,686	45.3%	5.94%	2.69%
Preferred Stock	41	0.3%	5.41%	0.02%
Common Stock Equity	<u>8,028</u>	<u>54.4%</u>	11.00%	<u>5.98%</u>
Total	\$14,755	100.0%		8.69%

1 **Financing Overview**

2 **Q. Please explain the Company's requirements to generate new capital.**

3 A. As described in Company witness Ms. Andrea L. Kelly's testimony, the Company  
4 is in the process of completing or adding significant new generation and  
5 transmission facilities as well as local distribution facilities. The test period in  
6 this case shows that the Company is expecting to add approximately \$3.727  
7 billion in total-Company capital additions from June 2009 actual levels to the  
8 calendar year 2011 test period. These and future capital additions will require the  
9 Company to raise funds by issuing significant amounts of new long-term debt in  
10 the capital markets, retaining earnings and obtaining new capital contributions  
11 from its parent company, MidAmerican Energy Holdings Company ("MEHC").  
12 Funds will also be made available by the continued absence of any dividends or  
13 distributions by PacifiCorp to its parent company during this same period. Since  
14 the acquisition of PacifiCorp by MEHC in March 2006, there has been no  
15 common stock dividends or distributions to MEHC, PacifiCorp has received \$865  
16 million in additional cash equity contributions from MEHC and \$1.5 billion of  
17 earnings have been retained in PacifiCorp. These figures are expected to increase  
18 as PacifiCorp continues to retain earnings and additional equity contributions are  
19 made by MEHC prior to the end of the test period. These actions have been  
20 critical to credit quality and for PacifiCorp to remain well-positioned to support  
21 the additional investments that have been and will continue to need to be made in  
22 the Company's service territory and the state of California.

1 **Q. How does the Company finance its electric utility operations?**

2 A. The Company finances its regulated utility operations utilizing roughly a 50/50  
3 percent mix of debt and common equity capital. Immediately prior to and during  
4 periods of significant capital expenditures, the Company may allow the common  
5 equity component of the capital structure to increase. This provides more  
6 flexibility regarding the type and timing of debt financing, better access to the  
7 capital markets, a more competitive cost of debt, and over the long-run, more  
8 stable credit ratings; all of which assist in financing such expenditures. In  
9 addition, all else being equal, the Company will need to have a greater common  
10 equity component to offset various adjustments that rating agencies make to the  
11 debt component of the Company's published financial statements. I will discuss  
12 these adjustments in greater detail later in this testimony.

13 **Q. What type of debt and preferred equity securities does the Company employ**  
14 **in meeting its financing requirements?**

15 A. The Company relies on a mix of first mortgage bonds, other secured debt, tax-  
16 exempt debt, and preferred stock to help meet its long-term financing  
17 requirements. These securities employ various maturities in order to provide  
18 flexibility and mitigate refinancing risks. The Company has completed the  
19 majority of its long-term financing utilizing secured first mortgage bonds issued  
20 under the Mortgage Indenture dated January 9, 1989. Exhibit PPL/301 shows  
21 that, over the twelve months ending December 31, 2011, the Company is  
22 projected to have an average of approximately \$5.9 billion of first mortgage  
23 bonds outstanding, with an average cost of 6.31 percent. Presently, all

1 outstanding first mortgage bonds bear interest at fixed rates. Proceeds from the  
2 issuance of the first mortgage bonds (and other financing instruments) are used to  
3 finance the combined utility operation.

4 Another important source of financing has been the tax-exempt financing  
5 associated with certain qualifying equipment at power generation plants. Under  
6 arrangements with local counties and other tax-exempt entities, these entities  
7 issue securities, the Company borrows the proceeds of these issuances and  
8 pledges its credit quality to repay the debt in order to take advantage of the tax-  
9 exempt status of the financings. During the twelve months ending December 31,  
10 2011, PacifiCorp's tax-exempt portfolio is projected to be \$738 million in  
11 principal with an average cost of 2.95 percent, including the cost of issuance and  
12 credit enhancement.

### 13 **Capital Structure**

14 **Q. How did the Company determine the capital structure proposed in this**  
15 **proceeding?**

16 A. The capital structure is based on the actual capital structure at June 30, 2009,  
17 adjusted for known and measurable changes through December 31, 2011,  
18 including maturities of certain debt issues that were outstanding at June 30, 2009,  
19 capital contributions from MEHC, and the retention of earnings. This produces a  
20 capital structure consisting of 54.4 percent common equity, 45.3 percent debt and  
21 0.3 percent preferred stock. This represents the Company's forecast of capital  
22 structure at the time this filing was being prepared.

1 **Q. Why is the Company using a five-quarter average to determine the proposed**  
2 **capital structure rather than an average of the beginning and ending points**  
3 **as in previous cases?**

4 A. As the Company has been faced with the need for significant investment, its  
5 capital expenditure program has increased significantly from historical levels  
6 which, in turn, has required new financings to also be larger. These larger  
7 financings are usually more efficient due to lower transactional costs, and better  
8 received by investors who value the greater liquidity that larger financings  
9 typically offer. However, the trade-off is greater impact on the Company's capital  
10 structure ratios, particularly at quarter-ends following sizable financings. As  
11 such, the Company is proposing in this case to use a capital structure that employs  
12 an average of the five-quarter ending balances over the test period to help smooth  
13 out these changes.

14 **Q. How does this capital structure compare to the capital structure that was**  
15 **filed in the Company's most recent rate case (Application 05-11-022)?**

16 A. As shown in the table below, the proposed capital structure in this case has a  
17 slightly higher common equity component. The Company's continued investment  
18 in generation, transmission facilities and the local distribution network combined  
19 with additional adjustments made by the rating agencies require a slightly higher  
20 equity level necessary to produce financial ratios that meet rating agency targets  
21 for our current ratings.

<b>Comparison of Capital Structures</b>		
	<b>A.05-11-022</b>	<b>2009 General Rate Case</b>
<b>Long-Term Debt</b>	<b>46.2%</b>	<b>45.3%</b>
<b>Preferred Stock</b>	<b>1.0%</b>	<b>0.3%</b>
<b>Common Equity</b>	<b>52.8%</b>	<b>54.4%</b>
<b>Totals</b>	<b>100.0%</b>	<b>100.0%</b>

1 **Q. How does the Company determine the amount of common equity, debt and**  
2 **preferred stock to be included in its capital structure?**

3 A. As a regulated utility, the Company has a duty and an obligation to provide safe,  
4 adequate and reliable service to customers in its California service territory while  
5 prudently balancing cost and risk. Significant capital expenditures for new plant  
6 investment, including new renewable resources and environmental investments on  
7 existing generation units and operating and maintenance costs for new and  
8 existing utility plant assets are required to fulfill this obligation. Through its  
9 planning process, the Company determined the amounts of necessary new  
10 financing needed to support these activities and calculated the required equity and  
11 debt ratios necessary to maintain continued access to the financial markets.

12 **Q. Has the Company's common equity balance increased following the**  
13 **acquisition by MEHC?**

14 A. Yes. Following the acquisition by MEHC the Company has received, through  
15 June 30, 2009, a total of \$865 million of cash capital contributions from MEHC  
16 via the Company's direct parent company, PPW Holdings, LLC and has retained  
17 an additional \$1.5 billion of earnings. The Company expects to receive additional  
18 cash capital contributions from MEHC and to continue to retain all earnings  
19 through the end of the test period in this case.

1 **Q. Why is there a need for additional equity in the proposed capital structure?**

2 A. PacifiCorp's need for extensive capital expenditures was discussed during the  
3 MEHC acquisition. The Company is continuing to follow through on those  
4 capital expenditure requirements and the capital structure reflects the significant  
5 new capital investments described in this case. These new costs, coupled with the  
6 credit rating agencies' expectations for credit metrics and balance sheet strength,  
7 mean the Company cannot finance itself solely with new debt. Additional equity  
8 is required along with improved business results and other considerations to  
9 support PacifiCorp's current senior secured 'A' credit rating from Standard &  
10 Poor's ("S&P"), 'A2' rating from Moody's Investors Service ("Moody's"), and  
11 'A-' from Fitch Ratings.

12 **Q. Please describe the changes to the amount of outstanding long-term debt.**

13 A. During the period ending December 31, 2011, the balance of the outstanding long-  
14 term debt will change through maturities, principal amortization and issuance of  
15 new securities. Based upon the long-term debt series outstanding at June 30, 2009,  
16 I have calculated the reduction to the outstanding balances for maturities, principal  
17 amortization and sinking fund requirements, which are scheduled to occur during  
18 the period ending December 31, 2011. The total long-term debt maturities and  
19 principal amortized over this period is \$739.7 million. I then added \$1.3 billion of  
20 long-term debt issuances necessary to fund operations and to refinance the debt  
21 maturing through the test period. This new debt financing is balanced by the  
22 projected increase in equity provided through the cash contributions from MEHC,  
23 as discussed above, as well as increased retained earnings.

1 **Q. Is the proposed capital structure consistent with the Company's current**  
2 **credit rating?**

3 A. Yes. This capital structure is intended to enable the Company to deliver its  
4 required capital expenditures while maintaining credit ratios that support the  
5 continuance of PacifiCorp's current credit ratings.

6 **Q. Are PacifiCorp's stand-alone credit metrics consistent with the Company's**  
7 **current credit ratings?**

8 A. No. As stated by S&P "[while] the.... utility's credit metrics are more consistent  
9 on a stand-alone basis with a 'BBB' category rating, the ratings benefit from the  
10 implicit and explicit support available to MEHC...from its parent, Berkshire  
11 Hathaway... As a result, the ratings assigned to PacifiCorp are higher than would  
12 be warranted..." Clearly, PacifiCorp and its customers benefit from the  
13 ownership by MEHC and its parent, Berkshire Hathaway. Another important  
14 element supporting the Company's current ratings is the rating agencies'  
15 expectations that PacifiCorp will receive supportive regulatory treatment  
16 including reasonable outcomes in rate proceedings. Absent ownership by MEHC  
17 and constructive regulatory treatment, PacifiCorp's credit ratings would likely  
18 suffer at least a one rating-level downgrade.

19 Maintaining the existing ratings however, is becoming more challenging  
20 due to the additional adjustments that rating agencies are making to PacifiCorp's  
21 published financial results. I will discuss these adjustments in more detail later in  
22 this testimony.

1 **Q. How does maintenance of the Company's current credit rating benefit**  
2 **customers?**

3 A. The credit rating of a utility has a direct impact on the price that a utility pays to  
4 attract the capital necessary to support its current and future operating needs. A  
5 solid credit rating directly benefits customers by reducing immediate and future  
6 borrowing costs related to the financing needed to support regulatory obligations.

7 **Q. Are there other benefits?**

8 A. Yes. During periods of capital market disruptions, higher-rated companies are  
9 more likely to have ongoing, uninterrupted access to capital and access at lower  
10 costs. This is not always the case with lower-rated companies, which find  
11 themselves either unable to secure capital or able to secure capital only on  
12 unfavorable terms and conditions during such periods. I will discuss how  
13 PacifiCorp's current ratings have assisted it in accessing the market for new long-  
14 term debt at attractive levels later in my testimony.

15 In addition, higher-rated companies have greater access to the long-term  
16 markets for power purchases and sales. Such access provides these companies  
17 with more alternatives when attempting to meet the current and future load  
18 requirements of their customers.

19 Finally, a company with strong ratings will often avoid having to meet  
20 costly collateral requirements that are typically imposed on lower-rated  
21 companies when securing power in these markets.

22 **Q. Did S&P and Moody's recently change the Company's credit ratings?**

23 A. Yes. S&P upgraded PacifiCorp's senior secured debt to 'A' while it downgraded

1 PacifiCorp's short-term debt rating to 'A-2'. Similarly, Moody's recently  
2 upgraded PacifiCorp's senior secured debt to 'A2'.

3 **Q. Please explain these rating changes.**

4 A. The upgrade to PacifiCorp's senior secured debt merely reflects a change in  
5 S&P's methodology rather than a change in PacifiCorp's credit quality or  
6 financial metrics. S&P changed its approach to estimating the amount of  
7 collateral available to senior secured debt holders in the event of a default by  
8 PacifiCorp on its first mortgage bonds.

9 S&P continues to be cautious about PacifiCorp's credit metrics and, as  
10 noted previously, views the Company's credit metrics on a stand-alone basis as  
11 more consistent with a 'BBB' rating. Indeed, in downgrading the Company's  
12 short-term debt rating, S&P cited a need to take a firmer view on linking  
13 PacifiCorp short-term ratings to stand-alone credit quality. S&P sustained their  
14 current 'A-' corporate credit rating based on their expectation "that management  
15 will achieve cash flow metrics more consistent with an 'A' rating over the next  
16 several years."

17 Moody's upgrade of PacifiCorp's senior debt was part of an industry-wide  
18 action in which the majority of senior secured debt ratings of investment-grade  
19 regulated utilities were upgraded by one level. The action was a result of an  
20 analysis of the history of regulated utility defaults and was not specific or unique  
21 to the Company.

1 **Q. Do these rating agency actions change the Company's need to add equity to**  
2 **its capital structure and improve its financial metrics?**

3 A. No. Without continued improvement in financial metrics along with supportive  
4 state regulatory outcomes in rate cases, the ratings direction is likely to be lower  
5 rather than higher for PacifiCorp.

6 **Impacts of Economic Crises on PacifiCorp**

7 **Q. How has the recent liquidity or credit crisis impacted PacifiCorp?**

8 A. Very significantly. Although the Company was able to continue to fund its  
9 working capital and long-term needs, it was anything but "business as usual." For  
10 example, at times during October 2008 the Company was unable to find investors  
11 for its commercial paper. Fortunately, the Company had previously arranged  
12 multi-year, committed revolving credit agreements and was able to borrow under  
13 those facilities in order to provide liquidity and daily cash needs normally met by  
14 the commercial paper markets. However, even these credit facilities were  
15 impacted by the credit crisis as the banks themselves were struggling to deal with  
16 the market conditions. The bankruptcy of Lehman Brothers, Inc. during  
17 September 2008 resulted in the Company's revolving credit agreements being  
18 effectively reduced by over \$100 million.

19 When the commercial paper market was available, rates were significantly  
20 higher than just a few months earlier. During November 2008, the Company's  
21 commercial paper rates were at an average spread of approximately 250 basis  
22 points (2.5 percent) higher than issuances through the middle of July 2008. While  
23 short-term funding for the Company subsequently improved from these harsh

1 conditions, the Company was initially limited to overnight commercial paper  
2 issuances rather than a range of maturities of up to 270 days as in prior markets.

3           Similar to the commercial paper market, the market for tax-exempt debt  
4 was also “frozen” for a period of time. As I discussed earlier in this testimony,  
5 the Company has over \$700 million of low-cost tax-exempt financing  
6 outstanding. A portion of this debt is variable rate and re-prices through periodic  
7 remarketings. However, this market also was shaken by the credit crisis resulting  
8 in extremely high resets of interest rates or failed remarketings when there was  
9 insufficient investor demand. PacifiCorp chose to acquire approximately \$216  
10 million of these obligations to avoid paying rates that were unimaginable just a  
11 few months earlier. The Company subsequently completed the remarketing of  
12 these bonds following an improvement in the bonds’ credit enhancements,  
13 including the addition of letters of credit for the benefit of investors. Other  
14 utilities have found this market totally closed to them and delayed or cancelled  
15 previously scheduled tax-exempt bond offerings. Fortunately, PacifiCorp enjoys  
16 the benefits of sound credit ratings and was able to lessen the impact on customers  
17 by temporarily acquiring the bonds, arranging for these letters of credit despite  
18 extremely difficult conditions for the banks themselves, and then successfully  
19 remarketing the bonds.

20 **Q. Was PacifiCorp able to issue new long-term debt during this period?**

21 A. Yes. In early January 2009, the Company issued \$350 million of first mortgage  
22 bonds with a ten-year maturity at a coupon rate of 5.5 percent and \$650 million of  
23 thirty-year first mortgage bonds with a coupon of 6.0 percent.

1 **Q. What are your observations about this long-term debt issuance?**

2 A. First, the issuance demonstrated the importance of PacifiCorp's solid investment  
3 grade credit ratings during a period of time in which the markets have been  
4 extremely volatile. Many lower rated issuers were not able to access the debt  
5 markets or found the terms and conditions prohibitive. The Company's sound  
6 investment-grade rating allowed it continued access to the credit markets,  
7 although at credit spreads higher than historical levels.

8 Second, as noted in Dr. Hadaway's testimony, recent increases in credit  
9 spreads have impacted the Company's cost of equity and debt. His testimony  
10 includes a table that shows recent utility debt issuances and their corresponding  
11 credit spreads. While the Company's credit spreads on its recent long-term debt  
12 issuance was better than the range seen in issuances by other utilities during that  
13 time period, it is still among the highest credit spreads the Company has  
14 experienced.

15 **Q. How do the terms of the Company's debt issuance compare to other utility**  
16 **debt issuances from that period?**

17 A. PacifiCorp was able to issue debt at interest rates below rates that other borrowers  
18 have achieved. For example, Nevada Power (rated Baa3/BBB) issued new debt  
19 two days following PacifiCorp and was required by investors to pay a coupon of  
20 7.375 percent for a five-year maturity. Subsequently, Puget Sound Energy (rated  
21 Baa2/A-) issued new seven-year debt at a spread of Treasuries plus 480.3 basis  
22 points resulting in a coupon 6.75 percent. Further lower-rated borrowers were  
23 shut out entirely from the market. For example, Arizona Public Service Company

1 (rated Baa2/BBB-) filed a letter with the Arizona Corporation Commission  
2 explaining that the commercial paper market was completely closed to them and  
3 they likely could not successfully issue long-term debt. (See Exhibit PPL/302).

4 **Q. What do you conclude from this comparison?**

5 A. This period of market volatility has underscored the critical importance to utilities  
6 of maintaining solid credit ratings. The customers of lower-rated utilities paid  
7 dearly for their utility's more tenuous credit positions because the utility could not  
8 access capital or could do so only at very high prices. This confirms the  
9 importance of PacifiCorp's ongoing plan to maintain a balanced capital structure.  
10 It also highlights PacifiCorp's need for supportive and constructive regulatory  
11 treatment from its regulatory commissions.

## 12 **Purchase Power Agreements**

13 **Q. Is the Company subject to rating agency debt imputation associated with**  
14 **Purchase Power Agreements?**

15 A. Yes. Rating agencies and financial analysts consider Purchase Power Agreements  
16 ("PPAs") to be debt-like and will impute debt and related interest when  
17 calculating financial ratios. For example, S&P will adjust the Company's  
18 published financial results and impute debt balances and interest expense resulting  
19 from PPAs when assessing creditworthiness. They do so in order to obtain a  
20 more accurate assessment of a company's financial commitments and fixed  
21 payments. Exhibit PPL/303 is the May 7, 2007, publication by S&P detailing its  
22 view of the debt aspects of PPAs.

1 **Q. How does this impact the Company?**

2 A. In their April 1, 2009 Ratings Direct report, S&P evaluated the Company's PPAs  
3 and other related long-term commitments. Approximately \$425 million of  
4 additional debt and related interest expense of \$27 million were added to the  
5 Company's debt and coverage tests solely as a result of PPAs. There were also  
6 other adjustments made by S&P that resulted in a total of approximately \$1  
7 billion of debt and \$73 million of interest being imputed into PacifiCorp's credit  
8 ratios. Exhibit PPL/304 is the April 1, 2009 Standard & Poor's Rating Direct  
9 publication.<sup>1</sup>

10 **Q. How would the inclusion of this PPA-related debt and these other**  
11 **adjustments affect the Company's capital structure as S&P reviews credit**  
12 **metrics?**

13 A. By including the imputed debt resulting from PPAs and these other adjustments,  
14 the Company's capital structure has a lower equity component as a corollary to  
15 the higher debt component, lower coverage ratios and reduced financial flexibility  
16 than what might otherwise appear to be the case from a review of the book value  
17 capital structure. For example, if one were to add the total \$1 billion of debt  
18 adjustments that S&P makes to the Company's capital structure in this case, the  
19 resulting common equity percentage would decline from 54.4 percent to 50.8  
20 percent. The table below shows the proposed capital structure and how the S&P  
21 adjustments impact the components.

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<sup>1</sup> Standard & Poor's published an update report on PacifiCorp October 30, 2009 in which it reiterated its credit views including "supportive rate case outcomes remain key to maintaining and improving upon the Company's financial performance."

Illustration of Rating Agency Adjustments to PacifiCorp's Capital Structure (\$ in millions)			
	Book Values/Ratios	Rating Agency Adjustments	Adjusted Book Values/Ratios
Long-Term Debt	\$6,686 /45.3%	\$1,034	\$7,720/48.9%
Preferred Stock	\$41/0.3%	0	\$41/0.3%
Common Equity	\$8,028/54.4%	0	\$8,028/50.8%
Totals	\$14,755/100%		\$15,789/100.0%

1 **Financing Cost Calculations**

2 **Q. How did you calculate the Company's costs of long-term debt and preferred**  
3 **stock?**

4 A. I calculated the embedded costs of debt and preferred stock using the  
5 methodology relied upon in the Company's previous rate cases in California and  
6 other jurisdictions.

7 **Q. Please explain the cost of long-term debt calculation.**

8 A. I calculated the cost of debt by issue, based on each debt series' interest rate and  
9 net proceeds at the issuance date, to produce a bond yield to maturity for each  
10 series of debt. It should be noted that in the event a bond was issued to refinance  
11 a higher-cost bond, the pre-tax premium and unamortized costs, if any, associated  
12 with the refinancing were subtracted from the net proceeds of the bonds that were  
13 issued. Each bond yield was then multiplied by the principal amount outstanding  
14 of each debt issue, resulting in an annualized cost of each debt issue. Aggregating  
15 the annual cost of each debt issue produces the total annualized cost of debt.  
16 Dividing the total annualized cost of debt by the total principal amount of debt  
17 outstanding produces the weighted average cost for all debt issues. This is the  
18 Company's embedded cost of long-term debt.

1 **Q. How did you calculate the embedded cost of preferred stock?**

2 A. I calculated the embedded cost of preferred stock by first determining the cost of  
3 money for each issue. This is the result of dividing the annual dividend rate by  
4 the per share net proceeds for each series of preferred stock. The cost associated  
5 with each series was then multiplied by the total par or stated value outstanding  
6 for each issue to yield the annualized cost for each issue. The sum of annualized  
7 costs for each issue produces the total annual cost for the entire preferred stock  
8 portfolio. I then divided the total annual cost by the total amount of preferred  
9 stock outstanding to produce the weighted average cost for all issues. This is the  
10 Company's embedded cost of preferred stock.

11 **Q. A portion of the securities in the Company's debt portfolio bears variable**  
12 **rates. What is the basis for the projected interest rates used by the**  
13 **Company?**

14 A. The Company's variable rate long-term debt in this case is in the form of tax-  
15 exempt debt. Exhibit PPL/305 shows that these securities on average had been  
16 trading at approximately 90 percent of the 30-day London Inter Bank Offer Rate  
17 (LIBOR) for the period January 2000 through September 2009. Therefore, the  
18 Company has applied a factor of 90 percent to the forward 30-day LIBOR rates at  
19 each of the quarter ends spanning the test period and then added the respective  
20 credit enhancement and remarketing fees for each floating rate tax-exempt bond.  
21 Credit enhancement and remarketing fees are included in the interest component  
22 because these are costs which contribute directly to the interest rate on the  
23 securities and are charged to interest expense. This method is consistent with the

1 Company's past practices when determining the cost of debt in previous  
2 California general rate cases as well as in the other states in which PacifiCorp  
3 operates.

4 **Q. Please explain how you determined the interest rate for the \$1.3 billion of**  
5 **new long-term debt mentioned previously.**

6 A. I projected that this new long-term debt would be issued at the Company's  
7 estimated recent credit spread over the projected long-term Treasury rates as of  
8 the months of expected issuances (May and November 2011). I next added in the  
9 issuance costs to the debt offering. This reflects our best estimate of the costs of  
10 new debt, assuming the Company's senior secured long-term debt ratings remain  
11 unchanged. As I previously discussed, currently the Company's senior secured  
12 long-term debt is rated A and A2 by S&P and Moody's respectively.

13 **Q. What is the resulting estimated interest rate for this new long-term debt?**

14 A. The Company's current estimated credit spread for thirty-year debt is 1.2 percent.  
15 The forward long-term Treasury rate for May 2011 and November 2011 are 4.58  
16 percent and 4.66 percent, respectively. Issuance costs for this debt is expected to  
17 add approximately 7 basis points (0.07 percent) to the all-in cost. Therefore the  
18 projected cost of this debt is calculated as 5.85 percent and 5.93 percent, as shown  
19 below.

Projected May 2011 Issuance

Forward Treasury Rate	4.58%
Credit Spread	1.20%
Issuance Costs	0.07%
All-in Cost	5.85%

Projected November 2011 Issuance

Forward Treasury Rate	4.66%
Credit Spread	1.20%
Issuance Costs	0.07%
All-in Cost	5.93%

1 **Embedded Cost of Long-Term Debt**

2 **Q. What is the Company's embedded cost of long-term debt?**

3 A. The cost of long-term debt is 5.94 percent for the period ending December 31,  
4 2011, as shown in Exhibit PPL/301.

5 **Embedded Cost of Preferred Stock**

6 **Q. What is the Company's embedded cost of preferred stock?**

7 A. The cost of preferred stock is 5.41 percent for the period ending December 31,  
8 2011, as shown in Exhibit PPL/306.

9 **Q. Does this conclude your direct testimony?**

10 A. Yes, it does.