BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF PACIFICORP DBA UTAH POWER & LIGHT COMPANY FOR APPROVAL OF CHANGES TO ITS ELECTRIC SERVICE SCHEDULES	) CASE NO. PAC-E-05-1)) Direct Testimony of Bruce N. Williams))

PACIFICORP

CASE NO. PAC-E-05-1

January 2005

Q. Please state your name, business address and present position with PacifiCorp (the Company).

A. My name is Bruce N. Williams. My business address is PacifiCorp, 825 N.E. Multnomah, Portland, Oregon 97232, Suite 1900. I was elected Treasurer by the Board of Directors in February 2000. Prior to my election as Treasurer, I served as Assistant Treasurer for several years.

Qualifications

Q. Please briefly describe your education and business experience.

A. I received a Bachelor of Science degree in Business Administration with a concentration in Finance from Oregon State University in June 1980. I also received the Chartered Financial Analyst designation upon passing the examination in September 1986. I have been employed by PacifiCorp for 19 years. My business experience has included financing of PacifiCorp's electric operations, investment management, and investor relations.

Q. Please describe your present duties.

A. I am responsible for the Company's treasury, pension and other investment management activities. In this matter, I am responsible for the preparation of the Company's embedded cost of debt and preferred equity and the Company's capital structure.

Purpose of Testimony

Q. What is the purpose of your testimony?

A. I will first present a financing overview of the Company. Next, I will discuss the planned amounts of common equity, debt, and preferred stock to be included in the Company's planned capital structure. I will then analyze the embedded cost of debt and preferred stock supporting PacifiCorp's electric operations in the State of Idaho as of September 30, 2004, updated through the period ending September 30, 2005. This analysis includes the use of forward interest rates, historical relationship of security trading patterns, and known and measurable changes to the debt and preferred stock portfolios.

Q. What time period does your analysis cover?

A. The historical test period used in this case is twelve months ending March 31, 2004, updated with known and measurable changes. To appropriately match the Company's costs with customers' rates, the capital structure applied in this case is the Company's planned capital structure as of September 30, 2005. This capital structure represents the Company's actual capital structure as of the case filing date with known and measurable changes occurring up through the time period when rates reflecting requested changes from this case are expected to become effective. This time period captures significant transactions between the end of the historical test period and the rate effective period that support expected new financing. The Company believes it is appropriate to include these transactions in this proceeding.

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

A. PacifiCorp is proposing an overall cost of capital of 8.633 %. This cost includes the Return on Equity recommendation from Dr. Hadaway and the following capital structure and costs.

PacifiCorp
Overall Cost of Capital

Component	Percent of Total	% Cost	Weighted Average
Long Term Debt	51.0%	6.343%	3.235%
Preferred Stock	1.2%	6.635%	0.080%
Common Stock Equity	47.8%	11.125%	5.318%
Total	100.0%		8.633%

Financing Overview

Q. How does PacifiCorp finance its electric utility operations?

A. PacifiCorp finances the cash flow requirements of its regulated utility operations utilizing a reasonable mix of debt and equity securities designed to provide a competitive cost of capital and predictable capital market access.

Q. How does PacifiCorp meet its non-common equity financing requirements?

A. PacifiCorp relies on a mix of first mortgage bonds, secured debt, tax exempt debt, unsecured debt and preferred stock to meet its long-term debt and preferred stock financing requirements.

The Company has concluded the majority of its long-term financing utilizing secured first mortgage bonds issued under the PacifiCorp Mortgage Indenture dated January 9, 1989. Exhibit No. 5 shows that, as of September 30, 2005, PacifiCorp is projected to have approximately $3,240 million of first mortgage bonds outstanding, with an average cost of 6.791 percent and average maturity of 11.9 years. Currently, all of PacifiCorp's first mortgage bonds bear interest at fixed rates. Proceeds from the issuance of the first mortgage bonds (and other financing instruments) are used to finance the combined utility operation.

Another important source of financing has been the tax exempt financing associated with certain qualifying equipment at PacifiCorp's power generation plants. Under arrangements with the local counties and other tax-exempt entities, PacifiCorp borrows the proceeds and guarantees the repayment of their long-term debt in order to take advantage of their tax-exempt status in financings. As of September 30, 2005, PacifiCorp's tax-exempt portfolio is projected to be $698 million with an average cost of 4.261 % (which includes the cost of issuance and credit enhancement).

Calculation Methodologies

Q. How did you determine the amount of debt and preferred stock to be included in your calculation of the Company's embedded costs of debt and preferred stock?

A. As a regulated utility, PacifiCorp has a duty and an obligation to serve customers in its service territory while balancing cost, reliability and risk. Significant capital expenditures for new generating resources, power delivery infrastructure, clean air investments, and hydro relicensing activities are required for PacifiCorp to fulfill this obligation. Through its planning process, PacifiCorp determined the amounts of necessary new financing needed to support these activities and calculated the required equity and debt amounts required to maintain our 'A-' credit rating.

Q. Please describe the changes to the level of equity financing.

A. Beginning in June 2005, PacifiCorp is planning to receive four quarterly cash infusions of $125 million from PHI, its parent company. Based on the latest approved budgets and plans, these amounts will be required to support the A- credit rating. PHI will be requested to inject the equity and PacifiCorp will, in turn, issue new shares of common equity to PHI. This will result in an additional $500 million of new common equity in PacifiCorp at the end of our fiscal year 2006. On September 30, 2005 – the approximate date customer rates are expected to change to reflect requested changes in this filing – PHI will have made two of these quarterly infusions resulting in $250 million of new common equity. This new $250 million of common equity has been reflected in PacifiCorp's proposed capital structure in this filing.

Q. Does the Company also expect changes to the Company's levels of debt financing during this period?

A. Yes. Over the next several months through the rate effective period, the balance of the outstanding long-term debt will change through maturities, principal amortization and sinking fund requirements, and issuance of new securities. Based upon the long-term debt series outstanding at September 30, 2004, I have calculated the reduction to the outstanding balances for maturities, debt called for redemption, principal amortization and sinking fund requirements which are scheduled to occur during the period ending September 30, 2005. The total long-term debt maturities, redemptions and principal amortized over this period are $226.3 million. In addition, I removed $148.5 million of long-term debt that will mature over the twelve months following September 30, 2005. Then I added $368.5 million of long-term debt issuances necessary to fund our operations and to refinance the matured debt and debt that would be currently maturing at September 30, 2005. This amount of debt financing is consistent with the projected increase in equity provided through the two cash infusions from PacifiCorp's parent company, as discussed above, as well as increased retained earnings.

Q. Please describe the changes to the Company's level of preferred equity financing.

A. For preferred stock, I started with the balance outstanding at September 30, 2004, and made a reduction of $3.75 million of preferred stock to reflect the sinking fund requirements of the $7.48 Series No Par Serial Preferred Stock. This sinking fund payment will occur on June 15, 2005.

Q. How does this projected capital structure compare to comparable electric utilities?

A. The projected capital structure is consistent with the comparable group that Dr. Hadaway has selected in his estimate of Return on Equity. Both PacifiCorp and the group of comparable companies show an increasing percentage of common equity in their capital structures. The Value Line 2007-2009 estimate of common equity ratio for the comparable group is 52.4 percent.

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

A. Yes. This planned capital structure is intended to enable PacifiCorp to deliver its required capital expenditures while maintaining credit ratios that support the continuance of our current 'A-' credit rating.

Q. Has PHI previously made equity infusions into the Company?

A. Yes. In December 2002, PHI increased its investment in the Company with an equity infusion of $150 million, shoring up PacifiCorp's capital structure. This was in addition to equity impacts associated with the Company's elimination of dividends during fiscal year 2003. These actions significantly supported PacifiCorp's financial condition, which had deteriorated during and after the energy crisis and likely prevented further downgrades of the Company's debt.

Q. How does maintenance of a strong credit rating benefit ratepayers?

A. The credit rating given to a company has a direct impact on the price that company pays to attract the capital necessary to support its current and future operating needs. A strong credit rating directly benefits ratepayers by reducing immediate and future borrowing costs related to the financing needed to support regulatory operations.

Q. Are there other benefits?

A. Yes. During periods of capital market disruptions, higher rated companies are more likely to have on-going, uninterrupted access to capital. This is not always the case with lower rated companies, which during such periods find themselves either unable to secure capital or only able to secure capital on unfavorable terms and conditions. In addition, higher rated companies have greater access to the long-term markets for power purchases and sales. Such access provides these companies with more alternatives when attempting to meet the current and future load requirements of their customers. Finally, a company with strong ratings will often avoid having to meet costly collateral requirements that are typically imposed on lower rated companies when securing power in these markets.

Q. **What steps has the Company taken to implement the financing strategy set forth in its plans?**

A. The Company has obtained PacifiCorp Board approval for debt and equity issuances included in the budget. The Company is preparing applications for regulatory approval to increase the authorized amounts of equity and debt that it may issue. These planned increased levels of debt and equity have also been included in presentations to rating agencies. These agencies have used this information as part of their determination of PacifiCorp's credit ratings.

Q **Is PacifiCorp subject to rating agency debt imputation associated with Purchased Power Agreements?**

A. Yes. Rating agencies and financial analysts consider Purchased Power Agreements (PPAs) to be debt-like and will impute debt and related interest when calculating financial ratios. For example, S&P will adjust PacifiCorp's published results and add in debt and interest resulting from PPAs when assessing PacifiCorp's creditworthiness. They do so in order to obtain a more accurate assessment of a company's financial commitments and fixed payments. Exhibit No. 6 is the May 12, 2003 publication by S&P detailing its view of the debt aspects of PPAs.

Q. **How does this impact PacifiCorp?**

A. During our most recent ratings review, S&P evaluated our PPAs and other related long-term commitments. This resulted in approximately $520 million of additional debt and $52 million of interest expense being added to our debt and coverage tests.

Q. How would the inclusion of this PPA related debt affect the Company's capital structure?

A. By including the $520 million of imputed debt resulting from PPAs, the Company's capital structure would have a lower equity component as a corollary to the higher debt component.

Financing Cost Calculations

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

A. I calculated the embedded costs of debt and preferred stock using the same methodology used in the Company's recently filed rate cases in other jurisdictions.

Q. Please explain the cost of debt calculation.

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

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

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

Q. Upon review of the Company's debt portfolio, a portion of those securities bear variable rates. What is the basis for the projected interest rates provided by the Company?

A. The majority of the Company's variable rate debt is in the form of tax-exempt debt. Exhibit No. 7 shows that these securities had been trading at approximately 85 percent of the 30-day LIBOR (London Inter Bank Offer Rate) for the period October 1998 through September 2004. Therefore, the Company has applied a factor of 85 percent to the forward 30-day LIBOR Rate and added the respective credit enhancement and remarketing fees for each floating rate tax-exempt bond. Credit enhancement and remarketing fees are included in the interest component because these are costs which contribute directly to the interest rate on the securities.

Q. Regarding the $368.5 million of new long-term debt issuances mentioned above, how did you determine the interest rate for this new long-term debt?

A. I assumed $368.5 million would be issued at the Company's estimated December 2004 credit spreads over the projected twenty-year Treasury rates as of September 30, 2005. Finally, I added in the effect of issuance costs. This reflects the Company's best estimate of the cost of new debt, assuming the Company's senior secured long-term debt ratings remain unchanged. Currently the Company's senior secured long-term debt is rated A- and A3 by Standard & Poor's and Moody's, respectively, and has a negative outlook by Moody's.

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

A. The Company's estimated December 2004 credit spread for twenty-year notes was .85 percent. The forward twenty-year Treasury rate for September 30, 2005 is 4.96 percent. Issuance costs for this type of note add approximately 10 basis points (i.e., .10 percent) to the all-in cost. In addition, the redemption expenses including unamortized costs of debt retired before its maturity date are also included in the all-in cost. Therefore the projected cost of replacement debt is (.85 % +4.96 %+0.10 %+.02) = 5.93 percent.

Q. How does this compare to the cost of the debt that is maturing through September 30, 2005?

A. The $226.3 million of maturing debt has an average cost of 7.45 percent.

Embedded Cost of Long-Term Debt

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

A. Exhibit No. 5 shows the embedded cost of long-term debt at September 30, 2005 at 6.343 %.

Embedded Cost of Preferred Stock

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

A. Exhibit No. 8 shows the embedded cost of preferred stock at September 30, 2005 at 6.635 %.

Q. Does this conclude your direct testimony?

A. Yes.