

The McGraw-Hill Companies

**STANDARD
& POOR'S**

RatingsDirect®

RESEARCH

Summary:

PacifiCorp

Publication date:

22-Apr-2008

Primary Credit Analyst:

Anne Selting, San Francisco (1) 415-371-5009;
 anne_selting@standardandpoors.com

Credit Rating: A-/Stable/A-1

Rationale

The 'A-' corporate credit rating (CCR) on PacifiCorp reflects the consolidated credit profile of parent, MidAmerican Energy Holdings Company (MEHC; 'A-/Stable'). The rating incorporates MEHC's 'excellent' business risk position, an 'aggressive' financial profile, and the explicit and implicit support from Berkshire Hathaway ('AAA/Stable/A-1+'), which is the majority owner of MEHC. Explicit support from Berkshire Hathaway is in the form of a \$3.5 billion equity commitment agreement, which, in Standard & Poor's Ratings Services' view, would be called on -- if necessary -- to support MEHC's rating or that of its regulated subsidiaries, including PacifiCorp. Consolidated MEHC debt, including current maturities and short-term debt, totaled \$19.8 billion as of Dec. 31, 2007.

PacifiCorp serves 1.7 million customers in portions of the six western states of Utah, Oregon, Wyoming, Washington, Idaho, and California, operating as Pacific Power (Oregon, Washington, and California) and Rocky Mountain Power (Utah, Wyoming, and Idaho). The company's two largest markets, Utah and Oregon, comprise about 70% of the company's retail electric operating revenues. As of Dec. 31, 2007, the utility's standalone debt, including current maturities and preferred stock, was approximately \$5.2 billion.

MEHC purchased PacifiCorp from Scottish Power Plc. in March 2006 and owns the utility via PPW Holdings LLC, a special-purpose, nonrated entity with no debt outstanding. Through ring-fencing, PacifiCorp's CCR could potentially be as high as three notches above MEHC's rating, provided its standalone credit quality supported such an elevation. However, on a standalone basis, PacifiCorp currently has credit metrics that are in the 'BBB' category.

Funds from operations (FFO) rose modestly in 2007 to \$995 million from \$928 million in 2006. As of Dec. 31, 2007, PacifiCorp's adjusted FFO to total debt was 16.7%, and FFO interest coverage was 3.7x. Adjusted debt to total capitalization stood at about 54%, which includes adjustments to reflect debt-like obligations, the largest of which is the inclusion of \$450 million in power purchase payments. As part of the acquisition, PacifiCorp is limited in making dividends to MEHC unless it maintains a common equity ratio of 48.25% through 2008, decreasing annually to 44% by 2012. (These requirements exclude current maturities and short-term debt in the calculation of leverage.)

Key drivers of performance for the year included the 2006 settlement of rate cases in all six states it serves, which provided about \$270 million in rate relief (of which \$187 million flowed to the company in 2007); a 3% increase in energy sales driven by weather; customer growth of 2%; and improved plant availability. Revenues from wholesale sales were slightly down for the year at about \$1 billion.

Major challenges facing the utility include managing six separate regulatory environments to ensure timely recovery of costs, controlling fuel costs given the absence of power supply adjusters (PSAs) in Utah, Washington and Idaho, and executing on its large capital program.

In 2007, the company invested \$1.5 billion in capital projects that was funded with approximately \$1.0 billion of debt (total issuance in 2007, net of \$165 million in maturing debt and preferred stock), \$200 million in MEHC equity infusions, and the balance with operating cash flow. The company is embarking on a 10-year, \$20 billion capital program, of which an estimated \$14 billion will be incurred in the next five years. The largest component of investment is an estimated \$4.1 billion to build Energy Gateway, a 1,200-mile multistate transmission project that will be energized in phases from 2010 to 2014.

Other projects include investment in renewable generation to meet renewable portfolio standards. In 2007, the company placed into service the 140 MW Marengo wind project. Another seven projects, totaling 520 MW, are planned. As part of the company's integrated resource plan (IRP) filed in May 2007, the company has identified 3,870 MW needed by summer 2016. Utah has acknowledged the IRP, and Oregon, Idaho, and Washington regulators are expected to respond in 2008. The company's IRP does not contemplate any new coal-fired resources. Capital investment also includes environmental work; the company pledged \$812 million for emission reductions as part of MEHC's acquisition. About 64% of the company's power supply in 2007 was coal fired.

The company last week announced it has reached an agreement to buy a 500 MW plant. Details of the acquisition have not been disclosed. Its 2007 IRP identified a need for two approximately 500 MW gas plants in the 2012 timeframe. As a result, the transaction would require the company to close the purchase an estimated four years in advance of requiring the capacity. The company is currently seeking regulatory approval needed in Utah and Oregon to bypass the request for proposals process, which would allow it to purchase the plant without a formal bid solicitation process. In Utah state statute also permits preapproval of the acquisition.

The capital program underscores the need for what is expected to be sizable rate relief in the coming years. To date, PacifiCorp's new owners have been only modestly tested in their ability to manage rate case outcomes, as most of the rate cases resolved in 2007 were all initiated by ScottishPower. Utah will be an important state to monitor. By this summer, the company is expected to file its third rate case in less than three years. Cumulative rate increases over this period could be 17% or more. (A 10% retail rate increase was approved in late 2006, and the company's revised current request is for a 7% increase. It has not made public the amount it will seek in a proposed June 2008 filing.)

The case currently pending before the Utah Public Service Commission (UPSC) was originally filed in December 2007, and was based on a forecast, 12-month test year ending June 30, 2009. The company sought a \$161 million general request, or about an 11% rate increase. But in February 2008, the UPSC ruled that the test period should end on Dec. 31, 2008, which lowered the company's request to about \$100 million (a 7% increase). The revenue requirement portion of the case should be completed in early June with initial rates, if approved, going into effect August 2008. This month, PacifiCorp notified the UPSC that it expects to file another rate request around June 6, 2008. This implies that two cases may be pending before the UPSC at the same time.

In other states, PacifiCorp also has an active \$35 million rate case (a 15% increase) in Washington. Filed in February 2008, rates are expected to be in place no later than January 2009. The company was last granted a 6% increase in June 2007 as part of a fall 2006 filing.

In Wyoming, a final order is pending that codifies an oral ruling last month by the Wyoming Public Service Commission approving a \$23 million settlement. The settlement represents a 5% increase, relative to the original \$36 million PacifiCorp sought. New rates are expected to go into effect in May 2008. The last rate increase in the state was for 7%, granted to PacifiCorp in March 2006. PacifiCorp has no other active cases in the three other states it serves. (In Oregon, the company last had a rate increase of 5% in September 2006. In Idaho, a \$6 million rate increase, or 8%, authorized in late 2007 began on Jan. 1, 2008. In California, a \$5 million increase, or 7%, was approved in association with increases in energy and power costs and went into effect January 2008.)

Through an absence of PSAs in Utah, Washington, and Idaho (about 56% of its retail electric revenues in 2007), the company has below-average regulatory protection from fuel and purchased power cost escalation. In 2008, Wyoming regulators approved a PSA through April 2011, and in California the company benefits from PSA-like mechanisms that up costs ex-post to adjust for changes in operating costs. In Oregon there is also no true PSA, but the company does benefit from an annual proceeding that updates fuel and purchased power costs based on forecast costs, which mitigates the potential for sizable mismatch between actual fuel and purchased power costs and costs authorized in retail rates. In California, the company receives dollar-for-dollar recovery of costs in excess of rates, with some restrictions. The absence of PSAs is somewhat mitigated by the company's heavy reliance on coal, which exhibits reasonable cost stability, but the company's dependence on gas is expected to grow.

Rocky Mountain Power
Exhibit No. RMP____(ARW-1R-RR Page 3 of 3
Docket No. 07-035-93
Witness: A. Richard Walje

Short-term credit factors

PacifiCorp's 'A-1' short-term rating considers the equity commitment of MEHC's ultimate parent, Berkshire Hathaway, to which it has strong ties. Without these ties, the short-term rating on the company would be 'A-2'. Berkshire Hathaway's extremely strong liquidity position is assumed to be available to PacifiCorp via MEHC in the unlikely event that PacifiCorp could not repay its CP obligations. Explicit support exists in the form of a \$3.5 billion equity commitment agreement between Berkshire Hathaway and MEHC that could be called upon to support the liquidity requirements of MEHC's regulated subsidiaries, including PacifiCorp.

PacifiCorp cash and cash equivalents totaled \$228 million as of Dec. 31, 2007, in addition to an unsecured revolving credit agreement for \$800 million through July 2011, reduced to \$760 million in ending July 2012. The company also has a second credit agreement for \$700 million that is through October 2012. Both support the company's CP program and were undrawn at Dec. 31, 2007. CP balances were zero as of the same date. PacifiCorp is limited by regulators to having no more than \$1.5 billion in short-term debt.

The company also has \$518 million of standby letters of credit and standby bond purchase agreements available to support variable-rate pollution control bonds that were fully available at year-end 2007.

The company has two significant maturities in May and September 2008 of \$200 million each, with total maturities for the year at \$414 million, which includes capital lease obligations. PacifiCorp's large capital expenditure program will require substantial external funding, including equity contributions from MEHC. We expect that PacifiCorp will not be in a position to make distributions to its parent while it is executing its capital program.

Outlook

The stable outlook reflects our expectation that MEHC will deleverage PacifiCorp through equity infusions, as needed, and reinvest cash flow into its extensive capital expenditure program, as well as maintain regulatory relationships sufficient to support needed rate increases. It is also assumed that via MEHC Berkshire Hathaway will provide credit support and future investment capital, as needed, to PacifiCorp. PacifiCorp's rating could fall to a level commensurate with its standalone credit quality if MEHC's rating is lowered. PacifiCorp's rating has limited near-term upside, as its credit metrics on a standalone basis fall well short of the 'A' category.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Privacy Notice

Copyright © 2008 Standard & Poor's, a division of The McGraw-Hill Companies. All Rights Reserved.