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# 17-01002

Public Utilities Commission of Nevada
Electronic Filing
Submitted: 5/12/2017 10:08:59 AM

Reference: b581ff74-2fdd-43cd-8203-7f6082ed3398
Reference:
Filed For: NPC

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ACCEPTED

# BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

Annual Reports for calendar year 2016 submitted by Electric, Natural Gas, LPG, Geothermal, Alternative Sellers and Railroad companies operating in Nevada pursuant to NRS 703.191 and NAC 704.225.

Docket No. 17-01002

## VOLUME 3 OF 3

## NEVADA POWER COMPANY D/B/A NV ENERGY

# FORM 10-K PART 2

*For 2016 compared to 2015,* regulated electric gross margin increased $172 million primarily due to:

(1) Higher retail gross margin of $118 million due to -

- an increase of $47 million from higher electric rates in Iowa effective January 1, 2016, for the third step of a 2014 Iowa rate increase;
- an increase of $33 million primarily from non-weather-related usage factors, including higher industrial sales volumes;
- an increase of $27 million from the impact of temperatures;
- an increase of $13 million from lower retail energy costs due to a lower average cost of fuel for generation and lower coal-fueled generation; partially offset by
- a decrease of $2 million from lower recoveries through bill riders;

(2) Higher wholesale gross margin of $37 million due to higher margins per unit from greater availability of lower cost generation for wholesale purposes, partially offset by lower sales volumes attributable to lower coal-fueled generation; and

(3) Higher MVP transmission revenue of $17 million, which is expected to increase as projects are constructed.

*For 2015 compared to 2014,* regulated electric gross margin increased $119 million as follows:

(1) Higher retail gross margin of $109 million due to -

- an increase of $70 million from higher electric rates, reflecting higher rates of $45 million annually, effective January 2015, for the second step of a 2014 Iowa rate increase, $16 million annually in Illinois, effective December 2014, and an increase from the full-year impact of changes in Iowa rate structure related to seasonal pricing, which were effective with the implementation of final Iowa base rates in August 2014 that resulted in a greater differential between summer rates from June to September and rates in the remaining months;
- an increase of $32 million from lower retail energy costs primarily due to a lower average cost of fuel for generation and lower purchased power costs;
- an increase of $11 million from non-weather-related usage factors;
- an increase of $8 million principally from higher recoveries through bill riders; and
- a decrease of $8 million from the impact of temperatures;

(2) Higher MVP transmission revenue of $25 million, which is expected to increase as projects are constructed; partially offset by

(3) Lower wholesale gross margin of $15 million due to decreases of -

- $9 million from lower sales volumes; and
- $6 million from lower average prices.

Regulated Gas Gross Margin

A comparison of key results related to regulated gas gross margin is as follows for the years ended December 31:

| | 2016 | 2015 | Change | | 2015 | 2014 | Change | |
|---|---|---|---|---|---|---|---|---|
| **Gross margin (in millions):** | | | | | | | | |
| Operating revenue | $ 637 | $ 661 | $ (24) | (4)% | $ 661 | $ 996 | $ (335) | (34)% |
| Cost of gas sold | 367 | 397 | (30) | (8) | 397 | 720 | (323) | (45) |
| Gross margin | $ 270 | $ 264 | $ 6 | 2 | $ 264 | $ 276 | $ (12) | (4) |
| **Natural gas throughput (000's Dths):** | | | | | | | | |
| Residential | 46,020 | 46,519 | (499) | (1)% | 46,519 | 56,224 | (9,705) | (17)% |
| Commercial | 23,345 | 23,466 | (121) | (1) | 23,466 | 28,256 | (4,790) | (17) |
| Industrial | 5,079 | 4,833 | 246 | 5 | 4,833 | 5,335 | (502) | (9) |
| Other | 37 | 37 | — | — | 37 | 48 | (11) | (23) |
| Total retail sales | 74,481 | 74,855 | (374) | — | 74,855 | 89,863 | (15,008) | (17) |
| Wholesale sales | 38,813 | 35,250 | 3,563 | 10 | 35,250 | 25,346 | 9,904 | 39 |
| Total sales | 113,294 | 110,105 | 3,189 | 3 | 110,105 | 115,209 | (5,104) | (4) |
| Gas transportation service | 83,610 | 80,001 | 3,609 | 5 | 80,001 | 82,314 | (2,313) | (3) |
| Total gas throughput | 196,904 | 190,106 | 6,798 | 4 | 190,106 | 197,523 | (7,417) | (4) |
| Average number of retail customers (in thousands) | 742 | 733 | 9 | 1 % | 733 | 726 | 7 | 1 % |
| Average revenue per retail Dth sold | $ 6.85 | $ 7.12 | $ (0.27) | (4)% | $ 7.12 | $ 9.24 | $ (2.12) | (23)% |
| Average cost of natural gas per retail Dth sold | $ 3.70 | $ 4.03 | $ (0.33) | (8)% | $ 4.03 | $ 6.54 | $ (2.51) | (38)% |
| Combined retail and wholesale average cost of natural gas per Dth sold | $ 3.24 | $ 3.61 | $ (0.37) | (10)% | $ 3.61 | $ 6.25 | $ (2.64) | (42)% |
| Heating degree days | 5,616 | 5,913 | (297) | (5)% | 5,913 | 7,209 | (1,296) | (18)% |

Regulated gas revenue includes PGAs through which MidAmerican Energy is allowed to recover the cost of gas sold from its retail gas utility customers. Consequently, fluctuations in the cost of gas sold do not directly affect gross margin or net income because regulated gas revenue reflects comparable fluctuations through the PGAs. For 2016, MidAmerican Energy's combined retail and wholesale average per-unit cost of gas sold decreased 10%, resulting in a decrease of $42 million in gas revenue and cost of gas sold compared to 2015. For 2015, MidAmerican Energy's combined retail and wholesale average per-unit cost of gas sold decreased 42%, resulting in a decrease of $290 million in gas revenue and cost of gas sold compared to 2014. Additionally, fluctuations in gas wholesale sales impact gas revenue and cost of gas sold but do not affect regulated gas gross margin.

*For 2016 compared to 2015,* regulated gas gross margin increased $6 million due to higher DSM recoveries. Lower retail sales volumes due to warmer winter temperatures in 2016 reduced gas gross margin by $3 million but was substantially offset by higher sales volumes from non-weather-related usage factors and higher transportation revenue.

*For 2015 compared to 2014,* regulated gas gross margin decreased $12 million primarily due to $20 million from lower retail sales volumes reflecting warmer winter temperatures in 2015; partially offset by $7 million from an increase due to non-weather-related usage factors.

Regulated Operating Costs and Expenses

*Operations and maintenance* decreased $12 million for 2016 compared to 2015 due to $24 million of lower fossil-fueled generation maintenance from the timing of planned outages, $7 million of lower generation operations, $7 million of lower health care, information technology and other administrative costs and $6 million of lower electric and gas distribution costs, partially offset by $11 million of higher DSM program costs and $9 million of higher transmission operations costs from MISO, both of which are recoverable in bill riders and matched by increases in revenue, and $13 million of higher wind-powered generation maintenance due to the addition of wind turbines.

*Operations and maintenance* decreased $12 million for 2015 compared to 2014 substantially due to $10 million of lower fossil-fueled generation maintenance costs from planned outages in 2014, $9 million of lower electric distribution costs due to less inclement weather and emergency storm restoration, $8 million for lower expense resulting from a one-time refund in June 2014 to MidAmerican Energy's customers for insurance recoveries related to environmental matters, $4 million of lower pension and postretirement costs and $3 million of lower healthcare benefit costs, partially offset by $10 million of higher wind-powered generation costs due to the addition of facilities and increases in transmission operations costs from MISO and DSM program costs of $7 million and $5 million, respectively, both of which are recoverable in bill riders and matched by increases in revenue.

*Depreciation and amortization* increased $72 million for 2016 compared to 2015 primarily due to additional wind-powered generating facilities placed in service in the second half of 2015 and the fourth quarter of 2016 and $34 million for accruals for regulatory arrangements in Iowa that reduce electric utility net plant.

*Depreciation and amortization* increased $56 million for 2015 compared to 2014 primarily due to additional wind-powered generating facilities placed in service in the second half of 2014 and the second half of 2015.

Other Income and (Expense)

MidAmerican Energy -

*Interest expense* increased $13 million for 2016 compared to 2015 primarily due to higher interest expense from the issuance of $650 million of first mortgage bonds in October 2015, partially offset by the payment of a $426 million turbine purchase obligation in December 2015. Refer to Note 9 of Notes to Financial Statements in Item 8 of this Form 10-K for further discussion of first mortgage bonds.

*Interest expense* increased $9 million for 2015 compared to 2014 due to higher interest expense from the issuance of first mortgage bonds totaling $850 million in April 2014 and $650 million in October 2015, net of lower interest expense from the redemption of $350 million of 4.65% senior notes in May 2014.

*Allowance for borrowed and equity funds* decreased $27 million for 2015 compared to 2014 primarily due to lower construction work-in-progress balances related to the installation of emissions control equipment at a number of MidAmerican Energy's jointly owned generating facilities and the construction of wind-powered generating facilities.

*Other, net* increased $9 million for 2016 compared to 2015 due to a gain of $5 million on the redemption of MidAmerican Energy's investments in auction rate securities and higher returns from corporate-owned life insurance policies. Other, net decreased $5 million for 2015 compared to 2014 due to lower returns from corporate-owned life insurance policies.

MidAmerican Funding -

In addition to the fluctuations discussed above for MidAmerican Energy, MidAmerican Funding's *other, net* for 2016 reflects income of $2 million from a partnership's sale of a real estate investment, for 2015 reflects a $13 million pre-tax gain on the sale of an investment in a generating facility lease and, for 2014, reflects income related to the investment in a generating lease.

Income Tax Benefit

MidAmerican Energy -

MidAmerican Energy's income tax benefit on continuing operations decreased $15 million for 2016 compared to 2015, and the effective tax rate was (32)% for 2016 and (49)% for 2015. The change in the effective tax rate was substantially due to higher pre-tax income, partially offset by an increase of $39 million in production tax credits.

MidAmerican Energy's income tax benefit on continuing operations increased $31 million compared to 2014, and the effective tax rate was (49)% for 2015 and (41)% for 2014. The change in the effective tax rate was due to an increase of $27 million in production tax credits and the effects of ratemaking.

State utility rate regulation in Iowa requires that the tax effect of certain temporary differences be flowed through immediately to customers. Therefore, certain deferred tax amounts that would otherwise have been recognized in income tax expense have been included as changes in regulatory assets in recognition of MidAmerican Energy's ability to recover increased tax expense when such temporary differences reverse. This treatment of such temporary differences impacts income tax expense and effective income tax rates from year to year.

Federal renewable electricity production tax credits are earned as energy from qualifying wind-powered generating facilities is produced and sold based on a prescribed per-kilowatt rate pursuant to the applicable federal income tax law and are eligible for the credits for 10 years from the date the qualifying generating facilities are placed in service. Beginning in late 2014, some of MidAmerican Energy's wind-powered generating facilities surpassed the 10-year eligibility period and are no longer earning the credits. A credit of $0.023 per kilowatt hour was applied to 2016, 2015 and 2014 production, which resulted in $249 million, $210 million and $183 million, respectively, in production tax credits.

MidAmerican Funding -

MidAmerican Funding's income tax benefit on continuing operations decreased $11 million for 2016 compared to 2015, and the effective tax rate was (35)% for 2016 and (51)% for 2015. MidAmerican Funding's income tax benefit on continuing operations increased $28 million for 2015 compared to 2014, and the effective tax rate was (51)% for 2015 and (45)% for 2014. The change in effective tax rates was due principally to the factors discussed for MidAmerican Energy. Additionally, 2015 reflects income taxes on a $13 million gain from the sale of an investment in a generating facility lease.

**Liquidity and Capital Resources**

As of December 31, 2016, MidAmerican Energy's total net liquidity was $300 million consisting of $14 million of cash and cash equivalents and $605 million of credit facilities reduced by $220 million of the credit facilities reserved to support MidAmerican Energy's variable-rate tax-exempt bond obligations and $99 million of short-term debt outstanding. As of December 31, 2016, MidAmerican Funding's total net liquidity was $305 million, including MHC's $4 million credit facility.

Cash Flows From Operating Activities

MidAmerican Energy's net cash flows from operating activities were $1.40 billion, $1.35 billion and $823 million for 2016, 2015 and 2014, respectively. MidAmerican Funding's net cash flows from operating activities were $1.39 billion, $1.34 billion and $820 million for 2016, 2015 and 2014, respectively. Cash flows from operating activities increased for 2016 compared to 2015 primarily due to higher gross margins for MidAmerican Energy's regulated electric business, partially offset by a growth in receivables net of payables, lower derivative collateral cash flows, higher payments for asset retirement obligation settlements, and the timing of DSM cost recovery cash flows. The increase in net cash flows from operating activities for 2015 compared to 2014 was primarily due to the timing of MidAmerican Energy's income tax cash flows with BHE, which totaled net cash receipts from BHE of $629 million and $149 million for 2015 and 2014, respectively. Income tax cash flows for 2015 reflect the receipt of $255 million of income tax benefits generated in 2014. The timing of MidAmerican Energy's income tax cash flows from period to period can be significantly affected by the estimated federal income tax payment methods and assumptions for each payment date. Additionally, cash flows from operations for 2015 improved due to higher gross margins for MidAmerican Energy's regulated electric business and lower derivative collateral requirements, partially offset by an increase in coal inventories and lower gross margins for the regulated gas business.

MidAmerican Energy's income tax cash flows benefited in 2015 and 2016 from bonus depreciation on qualifying assets placed in service and from production tax credits earned on qualifying projects as a result of the Tax Increase Prevention Act of 2014 (the "Act"), which was signed into law in December 2014. The Act extended to 2015 the 50% bonus depreciation for qualifying property purchased and placed in service before January 1, 2015 and before January 1, 2016 for certain longer-lived assets. Production tax credits were extended for wind power and other forms of non-solar renewable energy projects that began construction before the end of 2014.

In December 2015, the Protecting Americans from Tax Hikes Act of 2015 ("PATH") was signed into law, extending bonus depreciation for qualifying property acquired and placed in service before January 1, 2020 (bonus depreciation rates will be 50% for 2015-2017, 40% in 2018, and 30% in 2019), with an additional year for certain longer lived assets. Production tax credits were extended and phased out for wind power and other forms of non-solar renewable energy projects that begin construction before the end of 2019. Production tax credits are maintained at the following levels for projects for which construction begins before the end of the respective year as follows: at full value for 2016, at 80% of present value for 2017, at 60% of present value for 2018, and 40% of present value for 2019. As a result of PATH, MidAmerican Energy's cash flows from operations are expected to benefit due to bonus depreciation on qualifying assets placed in service through 2019 and production tax credits earned on qualifying wind projects through 2029.

Cash Flows From Investing Activities

MidAmerican Energy's net cash flows from investing activities were $(1.62) billion, $(1.45) billion and $(1.52) billion for 2016, 2015 and 2014, respectively. MidAmerican Funding's net cash flows from investing activities were $(1.61) billion, $(1.44) billion and $(1.52) billion for 2016, 2015 and 2014, respectively. Net cash flows from investing activities consist almost entirely of utility construction expenditures, which increased for 2016 compared to 2015 due to higher expenditures for wind-powered generation construction, including a project for the repowering of certain wind-powered generating facilities, partially offset by lower expenditures for MidAmerican Energy's transmission Multi-Value Projects ("MVP") investments. Utility construction expenditures decreased for 2015 compared to 2014 due to lower expenditures for environmental and other generation, partially offset by higher expenditures for wind-powered generation construction and MidAmerican Energy's transmission MVP investments. MidAmerican Energy placed in service 600 MW, 608 MW and 511 MW of wind-powered generating facilities during 2016, 2015 and 2014, respectively. Purchases and proceeds related to available-for-sale securities consist of activity within the Quad Cities Generating Station nuclear decommissioning trust and, in 2016, proceeds from the redemption of MidAmerican Energy's investments in auction rate securities. MidAmerican Funding received $13 million in 2015 related to the sale of an investment in a generating facility lease.

Cash Flows From Financing Activities

MidAmerican Energy's net cash flows from financing activities were $123 million, $173 million and $533 million for 2016, 2015 and 2014, respectively. MidAmerican Funding's net cash flows from financing activities were $133 million, $176 million and $535 million for 2016, 2015 and 2014, respectively. In December 2016, the Iowa Finance Authority issued $30 million of its variable-rate, tax-exempt Solid Waste Facilities Revenue Bonds due December 2046, the proceeds of which were loaned to MidAmerican Energy for the purpose of constructing solid waste facilities. In September 2016, the Iowa Finance Authority issued $33 million of variable-rate, tax-exempt Pollution Control Facilities Refunding Revenue Bonds due September 2036, the proceeds of which were loaned to MidAmerican Energy to refinance, in September 2016, variable-rate tax-exempt pollution control refunding revenue bonds totaling $29 million due September 2016 and $4 million due March 2017, which were optionally redeemed in full. In October 2015, MidAmerican Energy issued $200 million of 3.50% First Mortgage Bonds due October 2024 and $450 million of 4.25% First Mortgage Bonds due May 2046. The net proceeds were used for the payment of a $426 million turbine purchase obligation due December 2015 and for general corporate purposes. In April 2014, MidAmerican Energy issued $150 million of 2.40% First Mortgage Bonds due March 2019, $300 million of 3.50% First Mortgage Bonds due October 2024 and $400 million of 4.40% First Mortgage Bonds due October 2044. The net proceeds were used for the optional redemption in May 2014 of $350 million of MidAmerican Energy's 4.65% Senior Notes due October 2014 and for general corporate purposes. Through its commercial paper program, MidAmerican Energy received $99 million in 2016, made repayments totaling $50 million in 2015 and received $50 million in 2014. MidAmerican Funding received $9 million in 2016, paid $3 million in 2015 and received $1 million in 2014 through its note payable with BHE.

*Debt Authorizations and Related Matters*

MidAmerican Energy has authority from the FERC to issue commercial paper and bank notes aggregating $605 million through February 28, 2017, and $905 million from March 1, 2017, through February 28, 2019, at interest rates not to exceed the applicable London Interbank Offered Rate ("LIBOR") plus a spread of 400 basis points. MidAmerican Energy has a $600 million unsecured credit facility expiring in March 2018. MidAmerican Energy may request that the banks extend the credit facility up to two years. The credit facility, which supports MidAmerican Energy's commercial paper program and its variable-rate tax-exempt bond obligations and provides for the issuance of letters of credit, has a variable interest rate based on LIBOR or a base rate, at MidAmerican Energy's option, plus a spread that varies based on MidAmerican Energy's credit ratings for senior unsecured long-term debt securities. Additionally, MidAmerican Energy has a $5 million unsecured credit facility for general corporate purposes.

MidAmerican Energy currently has an effective registration statement with the SEC to issue an indeterminate amount of long-term debt securities through September 16, 2018. Additionally, following the February 2017 issuance of $850 million of first mortgage bonds, MidAmerican Energy has authorization from the FERC to issue through March 31, 2017, long-term securities totaling up to $137 million at interest rates not to exceed the applicable United States Treasury rate plus a spread of 175 basis points and from the ICC to issue up to an aggregate of $500 million of additional long-term debt securities, of which $350 million expires March 15, 2018, and $150 million expires September 22, 2018.

In conjunction with the March 1999 merger, MidAmerican Energy committed to the IUB to use commercially reasonable efforts to maintain an investment grade rating on its long-term debt and to maintain its common equity level above 42% of total capitalization unless circumstances beyond its control result in the common equity level decreasing to below 39% of total capitalization. MidAmerican Energy must seek the approval of the IUB of a reasonable utility capital structure if MidAmerican Energy's common equity level decreases below 42% of total capitalization, unless the decrease is beyond the control of MidAmerican Energy. MidAmerican Energy is also required to seek the approval of the IUB if MidAmerican Energy's equity level decreases to below 39%, even if the decrease is due to circumstances beyond the control of MidAmerican Energy. If MidAmerican Energy's common equity level were to drop below the required thresholds, MidAmerican Energy's ability to issue debt could be restricted. As of December 31, 2016, MidAmerican Energy's common equity ratio was 53% computed on a basis consistent with its commitment. As a result of MidAmerican Energy's regulatory commitment to maintain its common equity above certain thresholds, MidAmerican Energy could dividend $2.0 billion as of December 31, 2016, without falling below 42%, and MidAmerican Funding had restricted net assets of $3.1 billion.

MidAmerican Funding or one of its subsidiaries, including MidAmerican Energy, may from time to time seek to acquire its outstanding debt securities through cash purchases in the open market, privately negotiated transactions or otherwise. Any debt securities repurchased by MidAmerican Funding or one of its subsidiaries may be reissued or resold by MidAmerican Funding or one of its subsidiaries from time to time and will depend on prevailing market conditions, the issuing company's liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

Future Uses of Cash

MidAmerican Energy and MidAmerican Funding have available a variety of sources of liquidity and capital resources, both internal and external, including net cash flows from operating activities, public and private debt offerings, the issuance of commercial paper, the use of unsecured revolving credit facilities, and other sources. These sources are expected to provide funds required for current operations, capital expenditures, debt retirements and other capital requirements. The availability and terms under which MidAmerican Energy and MidAmerican Funding have access to external financing depends on a variety of factors, including their credit ratings, investors' judgment of risk and conditions in the overall capital markets, including the condition of the utility industry.

*Capital Expenditures*

MidAmerican Energy's primary need for capital is utility construction expenditures. Capital expenditure needs are reviewed regularly by management and may change significantly as a result of these reviews, which may consider, among other factors, changes in environmental and other rules and regulations; impacts to customers' rates; outcomes of regulatory proceedings; changes in income tax laws; general business conditions; load projections; system reliability standards; the cost and efficiency of construction labor, equipment and materials; commodity prices; and the cost and availability of capital.

MidAmerican Energy's historical and forecast capital expenditures, each of which exclude amounts for non-cash equity AFUDC and other non-cash items, for the years ended December 31 are as follows (in millions):

| | Historical | | | Forecast | | |
|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| Wind-powered generation development | $ 767 | $ 931 | $ 943 | $ 843 | $ 880 | $ 1,438 |
| Wind-powered generation repowering | — | — | 67 | 292 | 132 | — |
| Transmission Multi-Value Projects | 144 | 156 | 119 | 38 | 37 | — |
| Other | 615 | 359 | 507 | 678 | 475 | 341 |
| Total | $ 1,526 | $ 1,446 | $ 1,636 | $ 1,851 | $ 1,524 | $ 1,779 |