

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 130040-EI

IN RE: TAMPA ELECTRIC COMPANY'S
PETITION FOR AN INCREASE IN BASE RATES
AND MISCELLANEOUS SERVICE CHARGES



COM 5
AFD 1
APA 1
ECO 10
ENG 1
GCL 1
IDM
TEL
CLK 1

DIRECT TESTIMONY AND EXHIBIT
OF
SANDRA W. CALLAHAN

DOCUMENT NUMBER-DATE

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1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **PREPARED DIRECT TESTIMONY**

3 **OF**

4 **SANDRA W. CALLAHAN**

5
6 **Q.** Please state your name, business address, occupation and
7 employer.

8
9 **A.** My name is Sandra W. Callahan. My business address is
10 702 N. Franklin Street, Tampa, Florida 33602. I am Vice
11 President and Chief Financial Officer of Tampa Electric
12 Company ("Tampa Electric" or "company") and Senior Vice
13 President and Chief Financial Officer of TECO Energy,
14 Inc. ("TECO Energy" or "Parent Company").

15
16 **Q.** Please provide a brief outline of your educational
17 background and business experience.

18
19 **A.** I received a Bachelor of Science in Finance in 1976 from
20 the University of Baltimore. I have been a Certified
21 Public Accountant in Florida since 1983, and I was
22 engaged in the practice of public accounting with the
23 Tampa office of Coopers & Lybrand from 1982 to 1988.

24
25 I joined TECO Energy in 1988 as Director of Internal

1 Audit. I was promoted to Assistant Treasurer in 1991 and
2 Treasurer in 1995, responsible for capital raising, cash
3 management, investor relations, rating agency and banking
4 relationships, and funded benefit assets.

5
6 In July 2000, I was appointed Vice President-Treasury and
7 Risk Management and Treasurer, at which time my
8 responsibilities were expanded to include risk management
9 and insurance. In 2005, I also assumed responsibility
10 for energy risk management. In January 2007, the role of
11 Chief Accounting Officer was added to my previous
12 responsibilities, and I became responsible for the
13 Securities and Exchange Commission ("SEC") Reporting
14 section of the corporate accounting function of TECO
15 Energy.

16
17 In July 2009, I was appointed Vice President-Finance and
18 Accounting and Chief Financial Officer (Chief Accounting
19 Officer), responsible for treasury, risk and energy risk
20 management, corporate taxes, investor relations, and all
21 utility accounting and corporate accounting functions
22 including SEC reporting.

23
24 In February 2011, I was promoted to my current position
25 of Senior Vice President-Finance and Accounting and Chief

1 Financial Officer (Chief Accounting Officer). In
2 addition to the functions previously described, my
3 responsibilities currently include internal audit and
4 oversight of TECO Energy's foundation. I also serve as
5 the Vice President-Finance and Accounting, Chief
6 Financial Officer and Chief Accounting Officer of Tampa
7 Electric. As Chief Financial Officer, I am responsible
8 for financial planning and reporting, financing
9 strategies and activities and contact with the financial
10 community, including investors and rating agencies.

11
12 **Q.** What is the purpose of your direct testimony?

13
14 **A.** My testimony will discuss why it is important for Tampa
15 Electric to maintain its financial integrity. I will
16 describe Tampa Electric's credit ratings and the role of
17 strong credit ratings in providing unimpeded access to
18 capital at reasonable costs and on reasonable terms. I
19 will address the impact of the company's future
20 significant construction program on its need for capital
21 and the importance of the requested rate relief to
22 maintain Tampa Electric's financial integrity and credit
23 ratings. Finally, my testimony will support Tampa
24 Electric's capital structure.

25

1 Q. Have you prepared an exhibit for presentation in this
2 proceeding?

3
4 A. Yes. Exhibit No. ____ (SWC-1) entitled "Exhibit of Sandra
5 W. Callahan", was prepared under my direction and
6 supervision and consists of nine documents. These
7 documents include:

8 Document No. 1 List of Minimum Filing Requirement
9 Schedules Sponsored Or Co-Sponsored
10 By Sandra W. Callahan

11 Document No. 2 Tampa Electric Debt Activity and
12 Equity Contributions

13 Document No. 3 Tampa Electric 13-Month Average Long-
14 Term Debt Cost Rate

15 Document No. 4 Tampa Electric Credit Metrics

16 Document No. 5 Rating Agency Conventions and Scales-
17 Senior Unsecured Notes (Long-Term
18 Debt)

19 Document No. 6 Utility Senior Unsecured Credit
20 Ratings

21 Document No. 7 Standard & Poor's Corporate Ratings
22 Matrix

23 Document No. 8 Moody's Credit Rating Factors -
24 Regulated Utilities

25

4 **TAMPA ELECTRIC'S FINANCIAL POSITION**

5 **Q.** Why has Tampa Electric requested a base rate increase at
6 this time?

7
8 **A.** Tampa Electric last requested a base rate increase in
9 2008. Since then, the economy has gone through a
10 prolonged recessionary period. Utilities were not immune
11 to the downturn. Slower customer growth and lower
12 average per customer usage caused Tampa Electric to
13 experience a significant shortfall in revenues from the
14 levels expected after the company's prior base rate
15 proceeding. Despite the revenue shortfall, the company
16 continued to invest in order to maintain normal
17 operations and meet its obligation to reliably serve
18 existing and new customers. While the company has taken
19 numerous steps to control costs, there are simply not
20 enough cost cutting measures that can be implemented
21 without jeopardizing the company's ability to deliver
22 safe and reliable electric service while simultaneously
23 maintaining the company's financial integrity.

24
25 The company must continue to invest in its system to

1 replace infrastructure that is nearing the end of its
2 useful life and to ensure the continued availability of
3 its generating units for many more years. By 2014, Tampa
4 Electric will have increased plant in-service by over
5 \$1.1 billion since Tampa Electric's last base rate
6 proceeding. That will result in an increase to net
7 adjusted jurisdictional rate base of over \$770 million
8 necessary to provide reliable electric service to Tampa
9 Electric's customers not reflected in the company's
10 current base rates.

11
12 The combined impact of these factors has eroded Tampa
13 Electric's projected earnings. Tampa Electric currently
14 projects that its earned return on common equity ("ROE")
15 will be 6.74 percent in 2014, without rate relief. This
16 level is not sufficient to allow the company to maintain
17 its financial integrity and attract the capital necessary
18 to continue to provide safe and reliable electric
19 service.

20
21 **Q.** What has Tampa Electric done to mitigate the need for a
22 base rate increase?

23
24 **A.** As described in the testimony of Tampa Electric witnesses
25 Gordon L. Gillette and Jeffrey S. Chronister, Tampa

1 Electric has taken actions to hold down operating costs
2 and capital spending, improve efficiencies and enhance
3 generating unit availability to mitigate the need for a
4 base rate increase. The details of these efforts are
5 also discussed in the direct testimony of Tampa Electric
6 witnesses Brad J. Register and Mark J. Hornick.

7
8 On the finance and accounting side, Tampa Electric has
9 also taken advantage of tax incentives and opportunities
10 to refinance approximately \$850 million of long-term
11 debt. The company effectively refinanced half of its
12 long-term debt balance from 2010 to 2012. The
13 refinancing activity and resulting improvement in
14 interest expense are outlined in Document Nos. 2 and 3 of
15 my exhibit, respectively. As witness Chronister
16 describes in his testimony, Tampa Electric's accounting
17 and tax teams completed extensive research to identify
18 retroactive tax repair deductions, which contributed to a
19 significant deferred tax benefit. He also describes the
20 beneficial impact of bonus depreciation deductions
21 through the 2014 test year. Both of these tax items and
22 the refinancing by Tampa Electric of half of its
23 long-term debt have substantially lowered the company's
24 13-month average cost of capital.

1 As a result of higher deferred taxes at a zero cost rate,
2 lower debt costs and the lower customer deposit interest
3 rate established by the Florida Public Service Commission
4 ("FPSC" or "Commission") in 2012, Tampa Electric's 13-
5 month average cost of capital has declined from the 8.29
6 percent approved in its 2008 base rate proceeding to 6.74
7 percent in its 2014 test year, an improvement of 155
8 basis points. Higher deferred taxes in the capital
9 structure at a zero cost rate accounts for 95 basis
10 points and the refinancing of long-term debt accounts for
11 49 basis points. The remaining 11 basis point reduction
12 is made up primarily by the lower customer deposit rate.
13

14 **Q.** What is the company's requested revenue requirement
15 increase and what are the key financial components of the
16 increase?
17

18 **A.** The company is requesting a base revenue increase of
19 \$134.8 million. The increase represents the amount
20 necessary to raise the company's projected 2014 net
21 operating income ("NOI") level to the required amount of
22 \$292.5 million. The required NOI is based on the
23 company's projected 2014 13-month average jurisdictional
24 adjusted rate base of \$4.3 billion and a weighted average
25 cost of capital of 6.74 percent. The 6.74 percent

1 weighted cost of capital assumes a jurisdictional
2 adjusted 13-month average capital structure consisting of
3 54.2 percent equity based on all investor sources of
4 capital. It also is based on an ROE of 11.25 percent, a
5 long-term debt rate of 5.40 percent, and a short-term
6 debt rate of 1.47 percent. On behalf of Tampa Electric,
7 witness Robert B. Hevert provides the support for the
8 company's requested ROE in his direct testimony. Tampa
9 Electric requests the Commission to follow its long-
10 standing policy of applying a 100 basis point range above
11 and below the mid-point ROE, a policy that has worked
12 well in the past and is understood and expected by the
13 investment community. Tampa Electric witness
14 Chronister's direct testimony explains the details of the
15 company's revenue requirement based on the 2014 projected
16 test year, as well as the budget process used to develop
17 sound and reliable projected test year financial
18 statements.

19
20 **Q.** Please describe Tampa Electric's overall construction
21 program.

22
23 **A.** Tampa Electric's construction program for 2013 through
24 2016 will total over \$2 billion. This very substantial
25 capital spending program compares to a 2012 per books

1 gross utility plant balance of \$6.6 billion (13-month
2 average). Included in the construction program is \$1.4
3 billion of expenditures associated with the normal
4 replacement and improvement of generation, transmission,
5 distribution and other facilities required to enable
6 Tampa Electric to continue providing efficient and
7 reliable service to its growing customer base. These
8 facilities must be added at today's higher costs as the
9 company's existing facilities age and wear out. The
10 construction program also includes \$600 million for the
11 company's major generation project involving the
12 conversion of Polk Units 2-5 from simple cycle combustion
13 turbines into a more efficient combined cycle facility,
14 scheduled to be placed in service in 2017. However, the
15 revenue requirement in the proposed base rate proceeding
16 does not include any increase related to the Polk
17 Conversion Project. The testimonies of witnesses
18 Chronister, Hornick, and S. Beth Young describe and
19 support the company's construction estimates.

20
21 **Q.** How will Tampa Electric fund its construction
22 requirements?

23
24 **A.** Because of the size of its construction requirements,
25 Tampa Electric cannot generate all of the required funds

1 from operations. Without an increase in base rates,
2 internal generation of funds averages only 60 percent of
3 construction capital expenditures for 2013 through 2016,
4 and in 2015, the year in which the company is at the peak
5 of construction spending for the Polk Conversion Project,
6 internal generation of funds falls to a low point of only
7 47 percent of the estimated construction expenditures.
8 Even with the increased rates requested in this
9 proceeding, internally generated funds for the period
10 2013 through 2016 will account for an average of only 73
11 percent of the estimated construction expenditures. The
12 balance of the needed funds must be obtained from
13 investors, primarily through the issuance of long-term
14 debt and equity infusions from the parent company.

15
16 **FINANCIAL INTEGRITY**

17 **Q.** What is financial integrity?

18
19 **A.** Financial integrity refers to a relatively stable
20 condition of liquidity and profitability in which the
21 company is able to meet its financial obligations to
22 investors while maintaining the ability to attract
23 investor capital as needed at reasonable costs and on
24 reasonable terms. If the company and its regulators act
25 in ways that maintain or enhance the company's financial

1 integrity, customers will ultimately benefit.

2

3 **Q.** How is financial integrity measured?

4

5 **A.** The primary indicators are the company's earned return on
6 common equity, cash coverage of interest expense and
7 fixed obligations, the amount and percentage of
8 internally generated cash flows in relation to
9 construction requirements, and maintenance of favorable
10 debt ratings.

11

12 **Q.** Why is financial integrity important to Tampa Electric
13 and its customers?

14

15 **A.** Financial integrity is essential to support capital
16 expenditure requirements - both planned and unplanned -
17 which are necessary to serve and in times of emergency,
18 to restore power to Tampa Electric's customers. Tampa
19 Electric competes in a global market for capital, and a
20 strong balance sheet with appropriate rates of return
21 attracts capital market investors. Financial strength
22 and flexibility enable Tampa Electric to have ready
23 access to capital on reasonable terms for the benefit of
24 its customers.

25

1 Customers benefit directly from the investments Tampa
2 Electric continues to make to improve its infrastructure.
3 For example, transmission and distribution system
4 investments enhance service reliability by mitigating
5 storm damage and facilitating efficient service
6 restoration, generating fleet modernization investments
7 improve fuel efficiency thus lowering fuel costs for
8 customers, and new technology projects improve the
9 efficiency of the company's operations. Maintaining a
10 strong financial position allows the company to finance
11 infrastructure investments at a lower cost than would
12 otherwise be possible.

13
14 Financial integrity is also important to ensure access to
15 capital at all times. As a regulated utility, Tampa
16 Electric has a statutory obligation to serve all
17 customers. This obligation requires the company to have
18 the flexibility to enter into the financial markets and
19 access capital when needed, even at times when it may not
20 be ideal from a market perspective. Tampa Electric's
21 balance sheet strength and financial flexibility are
22 important factors influencing its ability to finance
23 major infrastructure investments as well as manage
24 unexpected events.

25

1 **Q.** How will the company's proposed base rate increase affect
2 Tampa Electric's financial integrity?

3
4 **A.** The requested base rate increase will place Tampa
5 Electric in an appropriate financial position to fund its
6 significant capital program and continue providing a high
7 level of reliable service to its customers. In order to
8 raise the required capital, the company must be able to
9 provide fair returns to investors commensurate with the
10 risks they assume. A strong financial position ensures a
11 reliable stream of external capital and allows the
12 company's capital spending needs to be met in the most
13 cost-effective and timely manner.

14
15 **Q.** Please discuss the company's projected financial
16 integrity indicators.

17
18 **A.** Document No. 4 of my exhibit shows Tampa Electric's
19 credit parameters on a historical and projected basis. I
20 have provided the information both with and without the
21 impacts of bonus depreciation and one-time repair
22 deductions, for comparability between years. It is
23 important to recognize that the temporary tax benefits
24 have enhanced Tampa Electric's credit metrics in recent
25 years, but those benefits will probably not be available

1 in the future. As I described previously, Tampa
2 Electric's substantial construction program will result
3 in a significant decline in the proportion of capital
4 expenditures funded by internally generated funds. The
5 requested rate relief would maintain other key credit
6 metrics at levels similar to the recent levels that have
7 supported the company's current credit ratings. Without
8 rate relief, these metrics would deteriorate in 2014, as
9 the exhibit illustrates, and would continue to
10 deteriorate beyond 2014 as capital spending increases and
11 earned returns decline. Such deterioration would not
12 support Tampa Electric's current credit ratings and would
13 have negative implications for the company's credit
14 ratings, borrowing costs and access to capital.

15
16 **CREDIT RATINGS**

17 **Q.** What are Tampa Electric's current credit ratings?

18
19 **A.** Tampa Electric's senior unsecured debt is currently rated
20 A3 by Moody's Investor Service ("Moody's"), BBB+ by
21 Standard & Poor's ("S&P") and A- by Fitch Ratings
22 ("Fitch").

23
24 **Q.** When did the current ratings become effective?
25

1 **A.** The rating agencies responded positively to the
2 Commission's decisions in Tampa Electric's 2008 base rate
3 proceeding, in which the Commission approved a capital
4 structure, base rates and returns supportive of strong
5 credit metrics.

6
7 In March 2009, Moody's placed Tampa Electric's credit
8 ratings on review for upgrade and in May 2009, Moody's
9 upgraded the company's senior unsecured credit ratings to
10 Baal when the rates approved in the company's 2008 base
11 rate proceeding took effect. Moody's upgraded the
12 company's credit ratings again in May 2012 to their
13 current credit rating of A3, citing "a more certain and
14 predictable regulatory environment" and stating that "the
15 company's credit metrics are strong and stable and more
16 reflective of an A rated utility."

17
18 Fitch revised the rating outlook to Watch Positive in
19 October 2010 and upgraded the rating one notch in March
20 2011 to its current A- level, stating "results at Tampa
21 Electric are expected to continue to strengthen as a
22 result of higher base rates as well as continuing control
23 of O&M costs." Fitch also stated in March 2011 that it
24 "expects the utility to earn at or near its authorized
25 return on equity" and believes "the state political

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environment and FPSC have stabilized.”

S&P raised its ratings on Tampa Electric to BBB in May 2009 indicating that “improvement in credit metrics by 2010 tied to rate increases at Tampa Electric support the higher rating.” In March 2011, S&P revised the outlook to Positive, and in May 2011, upgraded Tampa Electric’s rating to its current level of BBB+ citing that “the utilities exhibit excellent credit characteristics, such as relatively healthy service territories, a supportive regulatory environment, and stable cash flows and earnings.”

Q. Why is it important that Tampa Electric continue to maintain its current ratings?

A. It is important for two reasons. First, Tampa Electric is facing significant capital spending requirements and strong debt ratings ensure Tampa Electric has adequate credit quality to raise the capital necessary to meet these requirements. Second, Tampa Electric’s current ratings provide a reasonable degree of assurance that ratings will not slip below investment grade in the event of a catastrophe, such as a hurricane or other unforeseen event.

1 **Q.** Why is it so important to protect against non-investment
2 grade ratings?

3
4 **A.** Given the capital-intensive nature of the utility
5 industry, it is critical that utilities maintain credit
6 ratings sufficiently above the investment grade threshold
7 to retain uninterrupted access to capital. The
8 breakpoint between investment grade and non-investment
9 grade is shown on Document No. 5 of my exhibit, which
10 describes the three rating agency conventions and scales
11 for senior unsecured notes (long-term debt). A company
12 raising debt that has non-investment grade ("speculative
13 grade") credit ratings is subject to occasional lapses in
14 availability of debt capital, onerous debt covenants and
15 higher borrowing costs. In addition, companies with non-
16 investment grade ratings are generally unable to obtain
17 unsecured commercial credit and must provide collateral,
18 prepayment or letters of credit for contractual
19 agreements such as long-term gas transportation
20 agreements, fuel purchase and fuel hedging agreements.

21
22 Given the high capital needs, obligation to serve
23 existing and new customers, and significant requirements
24 for unsecured commercial credit that electric utilities
25 have, non-investment grade ratings are unacceptable.

1 Tampa Electric's current ratings should provide
2 sufficient room if an unanticipated event occurs for the
3 ratings to slip before becoming non-investment grade.

4
5 The importance of this is well-recognized in the electric
6 utility industry, as illustrated in Document No. 6 of my
7 exhibit, which shows the distribution of ratings for the
8 overall industry along with the ratings of the
9 southeastern U.S. utilities. The importance is
10 particularly evident in the preponderance of A ratings
11 among utilities in the southeast, where companies have
12 experienced the higher capital requirements associated
13 with integrated utilities, higher than average customer
14 growth, and a long-recognized exposure to the potential
15 impacts of tropical windstorm events.

16
17 **Q.** Why are strong ratings important in light of the
18 company's future capital needs?

19
20 **A.** In order to reliably serve its customers, Tampa Electric
21 will invest over \$2 billion from 2013 through 2016 for
22 its substantial construction program as I have previously
23 described. Tampa Electric will need to access the
24 capital markets to support this program.

25

1 A strong credit rating is important because it affects a
2 company's cost of capital and access to the capital
3 markets. Credit ratings indicate the relative riskiness
4 of the company's debt securities. Therefore, credit
5 ratings are reflected in the cost of borrowed funds. All
6 other factors being equal, i.e., timing, markets, size
7 and terms of an offering, the higher the credit rating,
8 the lower the cost of funds.

9
10 Secondly, companies with lower credit ratings have
11 greater difficulty raising funds in any market, but
12 especially in times of economic uncertainty, credit
13 crunches, or during periods when large volumes of
14 government and higher grade corporate debt are being
15 sold.

16
17 As a result of the positive ratings actions following the
18 Commission's decisions in the 2008 base rate proceeding,
19 Tampa Electric was able to access the debt capital
20 markets in a very difficult economic period, and the
21 company has been able to achieve very attractive pricing
22 on its debt that will benefit the company's customers
23 over many years. Specifically, the company has reduced
24 its embedded cost of long-term debt from 6.78 percent in
25 2009 to 5.40 percent in the 2014 test year.

1 **Q.** Can the financial credit market be foreclosed by
2 unforeseen events extraneous to the utility industry?

3
4 **A.** Yes. Market instability resulting from the sub-prime
5 mortgage problems affected liquidity in the entire
6 financial sector, and there were periods of time in 2008
7 and 2009 when the debt markets were effectively closed to
8 all but the highest rated borrowers. This is a good
9 example of how access to the marketplace can be shut off
10 for even creditworthy borrowers by extraneous, unforeseen
11 events, and it emphasizes why a strong credit rating is
12 essential to ongoing, unimpeded access to the capital
13 markets.

14
15 Maintaining unimpeded access to the capital markets is
16 particularly important for a utility like Tampa Electric
17 with an obligation to its customers to finance very
18 significant infrastructure investments and manage
19 unforeseen events. Being unable to access funds could
20 place the completion of critical infrastructure
21 construction in jeopardy and undermine reliability of
22 service.

23
24 **Q.** How are credit ratings determined?

25

1 **A.** The process the rating agencies follow to determine
2 ratings involves an assessment of both business risk and
3 financial risk. Moody's and S&P each publish information
4 on their ratings criteria. S&P's Corporate Ratings
5 Matrix is shown in Document No. 7 of my exhibit. Moody's
6 Rating Factors for Regulated Utilities are shown in
7 Document No. 8 of my exhibit.

8
9 **Q.** How does regulation affect ratings?

10

11 **A.** The primary business risk the rating agencies focus on
12 for utilities is regulation, and each of the rating
13 agencies have their own views of the regulatory climate
14 in which a utility operates. Regulatory Research
15 Associates ("RRA"), a firm that focuses primarily on
16 regulation of utilities, ranks the FPSC as "Above Average
17 3" on a scale that runs from Above Average 1 to Below
18 Average 3. The RRA rankings are presented in Document
19 No. 9 of my exhibit. The maintenance of constructive
20 regulatory policies and practices that support the
21 creditworthiness of the utilities is one of the most
22 important issues rating agencies consider when
23 deliberating ratings.

24

25 A key test of regulatory quality is the ability of

1 companies to earn a reasonable rate of return over time,
2 including through economic and construction cycles, and
3 to maintain satisfactory financial ratios supported by
4 good quality of earnings. The fact is, regulated
5 utilities cannot materially improve or even maintain
6 their financial condition without regulatory support.
7 Thus, regulators have a very dramatic impact on the
8 company, its customers and its investors.

9
10 Regulation in Florida has historically been supportive of
11 maintaining the credit quality of the state's utilities,
12 and that has benefited customers by allowing utilities to
13 provide for their customers' needs consistently and at a
14 reasonable cost. This has been one of the factors that
15 has helped Florida utilities maintain pace with the
16 growth in the state, which has been essential to economic
17 development.

18
19 **Q.** What are recent concerns expressed by the rating agencies
20 for the industry?

21
22 **A.** All of the rating agencies currently characterize the
23 electric utility industry outlook as stable, reflecting a
24 general expectation that major challenges facing the
25 industry, including slow sales growth, significant

1 capital spending requirements, and reduced cash flows
2 when tax incentives expire, will be mitigated by a
3 continuation of low gas commodity prices and regulatory
4 support. The stable outlooks are not without risk,
5 however, as illustrated by recent comments from Moody's.

6
7 Moody's, in its February 2013 Industry Outlook report for
8 the U.S. Regulated Utilities, expressed concern about
9 "the industry's ability to pass through base rate
10 increases (aided by low commodity costs) without the
11 benefit of robust organic growth in customers or usage
12 per customer. Flat to declining demand growth represents
13 yet another risk to the stability of our outlook, as it
14 places the full amount of rising cost pressure on a
15 static amount of customer use."

16
17 In the same report, Moody's notes that "utilities have
18 elected to take advantage of favorable tax policies which
19 boost near term cash flow in exchange for reduced rate
20 base growth in the future." The report further states,
21 "this inflation due to one-time benefits is a risk, as
22 utilities will likely have lower cash flow when bonus
23 depreciation ends, all else being equal."

24
25 Tampa Electric faces the same challenges cited by the

1 agencies as risks to ratings stability, and this
2 underscores the importance of maintaining strong and
3 stable credit metrics during the years ahead.
4

5 **CAPITAL STRUCTURE**

6 **Q.** What capital structure is Tampa Electric proposing in its
7 request for increased base rates?
8

9 **A.** Tampa Electric is projecting, for the 2014 test year, a
10 jurisdictional adjusted 13-month average financial
11 capital structure consisting of 45.8 percent debt and
12 54.2 percent common equity. This test year equity ratio
13 of 54.2 percent based on investor sources (equivalent to
14 42.3 percent based on all sources) is appropriate. It is
15 consistent with the equity ratio deemed appropriate by
16 the Commission in 2009 and was a key factor in the
17 ratings upgrades that occurred following the Commission
18 decision. Tampa Electric's requirements for financial
19 strength continue, and therefore the maintenance of the
20 equity ratio is of key importance. If coupled with an
21 adequate ROE and base rates that properly reflect the
22 true cost of service, the combination of this capital
23 structure and the resulting coverage ratios should
24 provide adequate financial strength and credit parameters
25 to maintain the company's credit ratings and assure

1 continued access to capital.

2

3 **Q.** What is Tampa Electric's current equity ratio?

4

5 **A.** Tampa Electric's equity ratio at December 31, 2012 was
6 54.6 percent.

7

8 **Q.** How has Tampa Electric's capital structure been impacted
9 since its last base rate proceeding?

10

11 **A.** Since its last base rate proceeding, Tampa Electric and
12 its customers have benefited from significant new tax
13 incentives, primarily bonus depreciation and additional
14 tax deductions for repairs. As witness Chronister
15 describes in his direct testimony, Tampa Electric has
16 taken full advantage of these tax incentives, which as he
17 describes, will have added a total of \$575 million to its
18 deferred tax balance through the 2014 test year. This
19 additional accumulation of zero cost capital is, of
20 course, very beneficial for the company and its customers
21 as I described previously in my direct testimony. Since
22 the last base rate proceeding through the end of 2012,
23 these tax benefits provided Tampa Electric with
24 approximately \$350 million of cash it had not
25 anticipated. As a result, during this period, equity

1 infusions to Tampa Electric totaled \$148 million while
2 debt balances decreased by \$121 million as shown in
3 Document No. 2 of my exhibit. Because of the additional
4 cash provided by these tax benefits, Tampa Electric
5 needed only limited additional equity capital until 2012
6 when debt maturities increased the need for equity
7 infusions.

8
9 **Q.** What are the expectations of the rating agencies with
10 respect to Tampa Electric's equity ratio?

11
12 **A.** The rating agencies are well aware of the impacts of
13 bonus depreciation and other tax incentives on the
14 utility industry. Increased cash flow resulting from
15 lower current taxes has helped to significantly offset
16 capital needs for many utilities, including Tampa
17 Electric. While acknowledging the positive impact of the
18 tax benefits, the rating agencies recognize that the
19 benefits are temporary and have incorporated into their
20 credit assessments an expectation that Tampa Electric
21 would achieve an equity ratio in line with the authorized
22 54 percent through equity contributions from its parent.

23
24 In May 2012, Moody's stated, "We believe Tampa Electric
25 will continue to maintain a very high payout ratio but we

1 also expect that the company will maintain its regulatory
2 equity ratio of approximately 54-55 percent via equity
3 infusions from TECO Energy." Similarly, in April 2012,
4 Fitch stated, "The Company's authorized equity ratio for
5 ratemaking purposes is 54 percent. Fitch would expect
6 distributions from Tampa Electric to its parent to be
7 balanced with capital contributions as needed to maintain
8 the capital structure as capex ramps up in the next
9 several years."

10
11 **SUMMARY**

12 **Q.** Please summarize your direct testimony.

13
14 **A.** Maintaining a strong financial position, or financial
15 integrity, is critical to allow Tampa Electric to attract
16 capital on reasonable terms and continue to provide a
17 safe and reliable electric system for its customers.
18 Financial integrity helps ensure uninterrupted access to
19 capital markets to finance required capital spending as
20 well as to manage unforeseen events.

21
22 Tampa Electric's capital spending requirements over the
23 next several years will be significant, including \$1.4
24 billion for normal replacement and improvement of its
25 facilities and \$600 million for the Polk 2-5 Conversion

1 Project. The company cannot fund all of this internally
2 and must access external capital to support its
3 construction program.

4
5 The requested capital structure of 54.2 percent equity
6 and the return on equity of 11.25 percent recommended by
7 witness Hevert will provide the financial strength and
8 credit parameters needed to maintain the company's credit
9 ratings and assure continued unimpeded access to capital.
10 The proposed equity ratio is consistent with Tampa
11 Electric's actual sources of capital, with its actual
12 equity ratio of 54.6 percent at year-end 2012, and with
13 the 54 percent equity ratio approved in 2009.

14
15 Tampa Electric's rate request, which includes the
16 continued appropriate levels of ROE and equity ratio,
17 will maintain the company's financial integrity and place
18 Tampa Electric in an appropriate financial position to
19 fund its significant capital program and continue
20 providing the high level of reliable service to its
21 customers.

22
23 **Q.** Does this conclude your direct testimony?

24
25 **A.** Yes.

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OF

SANDRA W. CALLAHAN

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LIST OF MINIMUM FILING REQUIREMENT SCHEDULES
SPONSORED OR CO-SPONSORED BY SANDRA W. CALLAHAN

MFR Schedule	Title
B-14	Earnings Test
C-24	Parent(S) Debt Information
D-1a	Cost Of Capital - 13-Month Average
D-1b	Cost Of Capital - Adjustments
D-2	Cost Of Capital - 5-Year History
D-3	Short-Term Debt
D-4a	Long-Term Debt Outstanding
D-4b	Reacquired Bonds
D-5	Preferred Stock Outstanding
D-6	Customer Deposits
D-7	Common Stock Data
D-8	Financial Plans - Stock And Bond Issues
D-9	Financial Indicators - Summary
F-1	Annual And Quarterly Reports To Shareholders
F-2	SEC Reports
F-8	Assumptions

Tampa Electric
Debt Activity and Equity Contributions
(\$ millions)

Date	Activity	Interest Rate %				Change 2010-2012
			2010	2011	2012	
12/10	Exchanged existing notes for new 10-year notes	6.875	(110.4)			(110.4)
12/10	Exchanged existing notes for new 10-year notes	6.375	(121.3)			(121.3)
12/10	Exchanged existing notes for new 10-year notes	5.4	231.7			231.7
11/10	Issued notes in term rate mode	1.5	75.0			75.0
3/11	Purchased in lieu of redemption	1.5		(75.0)		(75.0)
3/12	Purchased in lieu of redemption	5			(86.0)	(86.0)
6/12	Issued 30-year notes	4.1			250.0	250.0
6/12	Notes matured	6.875			(99.6)	(99.6)
8/12	Notes matured	6.375			(208.7)	(208.7)
9/12	Issued 10-year notes	2.6			225.0	225.0
10/12	Called bonds at par	5.1			(60.7)	(60.7)
10/12	Called bonds at par	5.5			(86.4)	(86.4)
Change in Long-Term Debt			75.0	(75.0)	(66.4)	(66.4)
Change in Short-Term Debt			(55.0)	-	-	(55.0)
Change in Total Debt			20.0	(75.0)	(66.4)	(121.4)
Equity Contributions			40.0	-	108.0	148.0

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Tampa Electric
13-Month Average Long-Term Debt Cost Rate

Year	13-Month Average Long-Term Debt Cost Rate*
2009 Actual	6.78%
2010 Actual	6.68%
2011 Actual	6.55%
2012 Actual	6.18%
2013 Proj.	5.58%
2014 Proj.	5.40%

* Includes amortization of discount/(premium) and issue costs

**Tampa Electric Credit Metrics
2009 - 2014 Test Year**

	Actual					Projected		Proforma Adjusted Test Year	
	2009	2010	2011	2012	2013	w/o rates	w/ rates ⁽¹⁾		
						2014	2014	2014	2014
FFO / Debt ⁽³⁾	22%	25%	27%	28%	27%			21%	25%
without bonus and one-time repairs deduction ⁽²⁾⁽³⁾	17%	21%	23%	24%	24%			21%	25%
FFO / Interest ⁽³⁾	4.4x	4.9x	5.2x	5.7x	6.3x			5.2x	5.9x
without bonus and one-time repairs deduction ⁽²⁾⁽³⁾	3.6x	4.2x	4.6x	5.0x	5.5x			5.2x	5.9x
Debt / EBITDA ⁽³⁾	3.6x	3.0x	2.9x	2.9x	3.0x			3.4x	2.8x
without bonus and one-time repairs deduction ⁽²⁾⁽³⁾	3.7x	3.1x	3.0x	2.9x	3.1x			3.4x	2.8x
Debt / Capital - Regulatory Adjusted 13-month avg.	48%	48%	48%	47%	45%			46%	46%

(1) Reflects full year of requested revenue increase of \$134.8 million.

(2) Removes impact of bonus depreciation and retroactive tax repair deductions due to the temporary and/ or one- time nature of those tax incentives.

(3) Includes S&P adjustments.

**Rating Agency Conventions and Scales
Senior Unsecured Notes (Long-Term Debt)**

S&P ⁽¹⁾		Moody's ⁽²⁾		Fitch ⁽³⁾		
Extremely Strong	AAA	Highest Quality	Aaa	Highest Quality	AAA	Investment
Very Strong	AA+	High Quality	Aa1	Very High Quality	AA+	
	AA		Aa2		AA	
	AA-		Aa3		AA-	
Strong	A+	Upper-Medium Quality	A1	High Quality	A+	
	A		A2		A	
	A-		A3		A-	
Adequate	BBB+	Medium-Grade Quality	Baa1	Good Quality	BBB+	
	BBB		Baa2		BBB	
	BBB-		Baa3		BBB-	
Less Vulnerable	BB+	Substantial Risk	Ba1	Speculative	BB+	Speculative Grade
	BB		Ba2		BB	
	BB-		Ba3		BB-	
More Vulnerable	B+	High Risk	B1	Highly Speculative	B+	
	B		B2		B	
	B-		B3		B-	
Currently Vulnerable	CCC+	Very High Risk	Caa1	Substantial Risk	CCC+	
	CCC		Caa2		CCC	
	CCC-		Caa3		CCC-	
Highly Vulnerable	CC	Highly Speculative	Ca	Very High Levels of Risk	CC	
Bankruptcy petition filed or similar action taken	C	Default	C	Exceptionally High Levels of Risk	C	
Default	D					

(1) Standard & Poor's Guide to Credit Rating Essentials - 2011
 (2) Moody's Investors Service: Rating Symbols and Definitions - January 2013
 (3) Fitch Ratings - Definitions of Ratings and Other Forms of Opinion - November 2012

Utility Senior Unsecured Credit Ratings*
as of 3/14/13

	Fitch	%	Moody's	%	S&P	%
Nationwide number of utilities at ratings level of:						
AA	0	0%	0	0%	1	2%
A	39	53%	27	35%	17	26%
BBB	32	44%	50	64%	46	70%
BB	2	3%	1	1%	2	3%
B	0	0%	0	0%	0	0%
	<u>73</u>	<u>100%</u>	<u>78</u>	<u>100%</u>	<u>66</u>	<u>100%</u>

	Fitch	%	Moody's	%	S&P	%
Southeast number of utilities at ratings level of:						
AA	0	0%	0	0%	0	0%
A	10	83%	7	70%	5	56%
BBB	2	17%	3	30%	4	44%
BB	0	0%	0	0%	0	0%
B	0	0%	0	0%	0	0%
	<u>12</u>	<u>100%</u>	<u>10</u>	<u>100%</u>	<u>9</u>	<u>100%</u>

*Derived from SNL report on Utilities credit ratings as of 3/14/13. Excludes Tampa Electric.

Standard & Poor's Corporate Ratings Matrix

Business Risk and Financial Risk Profile matrix

Financial Risk Profile

Business Risk Profile	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	CCC+

Financial Risk Indicative Ratios - Corporates

(Fully adjusted, historically demonstrated, and expected to consistently continue)

	FFO/Debt (%)	Debt/EBITDA (x)	Debt/Capital (%)
Minimal	greater than 60	less than 1.5	less than 25
Modest	45-60	1.5-2	25-35
Intermediate	30-45	2-3	35-45
Significant	20-30	3-4	45-50
Aggressive	12-20	4-5	50-60
Highly Leveraged	less than 12	greater than 5	greater than 60

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Moody's Credit Rating Factors - Regulated Utilities

Broad Rating Factors	Broad Rating Factor Weighting	Rating Sub-Factors	Sub-Factor Weighting
Regulatory Framework	25%		25%
Ability to Recover Costs and Earn Returns	25%		25%
Diversification	10%	Market Position	5% *
		Generation and Fuel Diversity	5% **
Financial Strength, Liquidity and Key Financial Metrics	40%	Liquidity	10%
		Cash from Operations Pre-Working Capital + Interest / Interest	7.5%
		Cash from Operations Pre-Working Capital / Debt	7.5%
		Cash from Operations Pre-Working Capital - Dividends / Debt	7.5%
		Debt / Capitalization or Debt / Regulated Asset Value	7.5%
Total	100%		100%

* 10% weight for issuers that lack generation; **0% weight for issuers that lack generation.

Moody's Key Financial Metrics

	Aaa	Aa	A	Baa	Ba	B
Cash from Operations Pre-Working Capital + Interest / Interest	> 8.0x	6.0x - 8.0x	4.5x - 6.0x	2.7x - 4.5x	1.5x - 2.7x	< 1.5x
Cash from Operations Pre-Working Capital / Debt	> 40%	30% - 40%	22% - 30%	13% - 22%	5% - 13%	< 5%
Cash from Operations Pre-Working Capital - Dividends / Debt	> 35%	25% - 35%	17% - 25%	9% - 17%	0% - 9%	< 0%
Debt / Capitalization	< 25%	25% - 35%	35% - 45%	45% - 55%	55% - 65%	> 65%
Debt / Regulated Asset Value	< 30%	30% - 45%	45% - 60%	60% - 75%	75% - 90%	> 90%

Regulated Electric and Gas Utilities

Appendix A: Regulated Electric and Gas Utilities Methodology Factor Grid

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Factor 1: Regulatory Framework							
Weighting: 25%	Aaa	Aa	A	Baa	Ba	B	Sub-Factor Weighting
	Regulatory framework is fully developed, has a long-track record of being predictable and stable, and is highly supportive of utilities. Utility regulatory body is a highly rated sovereign or strong independent regulator with unquestioned authority over utility regulation that is national in scope.	Regulatory framework is fully developed, has been mostly predictable and stable in recent years, and is mostly supportive of utilities. Utility regulatory body is a sovereign, sovereign agency, provincial, or independent regulator with authority over most utility regulation that is national in scope.	Regulatory framework is fully developed, has above average predictability and reliability, although is sometimes less supportive of utilities. Utility regulatory body may be a state commission or national, state, provincial or independent regulator.	Regulatory framework is a) well-developed, with evidence of some inconsistency or unpredictability in the way framework has been applied, or framework is new and untested, but based on well-developed and established precedents, or b) jurisdiction has history of independent and transparent regulation in other sectors. Regulatory environment may sometimes be challenging and politically charged.	Regulatory framework is developed, but there is a high degree of inconsistency or unpredictability in the way the framework has been applied. Regulatory environment is consistently challenging and politically charged. There has been a history of difficult or less supportive regulatory decisions, or regulatory authority has been or may be challenged or eroded by political or legislative action.	Regulatory framework is less developed, is unclear, is undergoing substantial change or has a history of being unpredictable or adverse to utilities. Utility regulatory body lacks a consistent track record or appears unsupportive, uncertain, or highly unpredictable. May be high risk of nationalization or other significant government intervention in utility operations or markets.	25%
Factor 2: Ability to Recover Costs and Earn Returns							
Weighting: 25%	Aaa	Aa	A	Baa	Ba	B	Sub-Factor Weighting
	Rate/tariff formula allows unquestioned full and timely cost recovery, with statutory provisions in place to preclude any possibility of challenges to rate increases or cost recovery mechanisms.	Rate/tariff formula generally allows full and timely cost recovery. Fair return on all investments. Minimal challenges by regulators to companies' cost assumptions; consistent track record of meeting efficiency tests.	Rate/tariff reviews and cost recovery outcomes are fairly predictable (with automatic fuel and purchased power recovery provisions in place where applicable), with a generally fair return on investments. Limited instances of regulatory challenges; although efficiency tests may be more challenging; limited delays to rate or tariff increases or cost recovery.	Rate/tariff reviews and cost recovery outcomes are usually predictable, although application of tariff formula may be relatively unclear or untested. Potentially greater tendency for regulatory intervention, or greater disallowance (e.g. challenging efficiency assumptions) or delaying of some costs (even where automatic fuel and purchased power recovery provisions are applicable).	Rate/tariff reviews and cost recovery outcomes are inconsistent, with some history of unfavorable regulatory decisions or unwillingness by regulators to make timely rate changes to address market volatility or higher fuel or purchased power costs. AND/OR Tariff formula may not take into account all cost components; investment are not clearly or fairly remunerated.	Difficult or highly uncertain rate and cost recovery outcomes. Regulators may engage in second-guessing of spending decisions or deny rate increases or cost recovery needed by utilities to fund ongoing operations, or high likelihood of politically motivated interference in the rate/tariff review process. AND/OR Tariff formula may not cover return on investments, only cash operating costs may be remunerated.	25%

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Regulated Electric and Gas Utilities

Factor 3: Diversification

Weighting: 10%	Aaa	Aa	A	Baa	Ba	B	Sub-Factor Weighting
Market Position	A high degree of multinational/regional diversification in terms of market and/or regulatory regime.	Material operations in more than three nations or geographic regions providing diversification of market and/or regulatory regime.	Material operations in two or three states, nations, or geographic regions and exhibits some diversification of market and/or regulatory regime.	Operates in a single state, nation, or economic region with low volatility with some concentration of market and/or regulatory regime.	Operates in a limited market area with material concentration in market and/or regulatory regime.	Operates in a single market which may be an emerging market or riskier environment, with high concentration risk.	5% *
	For LDCs, extremely low reliance on industrial customers and/or exceptionally large residential and commercial customer base and well above average growth.	For LDCs, very low reliance on industrial customers and/or very large residential and commercial customer base with very high growth.	For LDCs, low reliance on industrial customers and/or high residential and commercial customer base with high growth.	For LDCs, moderate reliance on industrial customers in defensive sectors, moderate residential and customer base.	For LDCs, high reliance on industrial customers in somewhat cyclical sectors, small residential and commercial customer base.	For LDCs, very high reliance on industrial customers in cyclical sectors, very small residential and commercial customer base.	
Generation and Fuel Diversity	A high degree of diversification in terms of generation and/or fuel source, well insulated from commodity price changes, no generation concentration, or 0-20% of generation from carbon fuels.	Some diversification in terms of generation and/or fuel source, affected only minimally by commodity price changes, little generation concentration, or 20-40% of generation from carbon fuels.	May have some concentration in one particular type of generation or fuel source, although mostly diversified, modest exposure to commodity price changes, or 40-55% of generation from carbon fuels.	Some reliance on a single type of generation or fuel source, limited diversification, moderate exposure to commodity prices, or 55-70% of generation from carbon fuels.	Operates with little diversification in terms of generation and/or fuel source, high exposure to commodity price changes, or 70-85% of generation from carbon fuels.	High concentration in a single type of generation or highly reliant on a single fuel source, little diversification, may be exposed to commodity price shocks, or 85-100% of generation from carbon fuels.	5% **

*10% weight for issuers that lack generation **0% weight for issuers that lack generation

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Regulated Electric and Gas Utilities

Factor 4: Financial Strength, Liquidity and Key Financial Metrics

Weighting: 40%	Aaa	Aa	A	Baa	Ba	B	Sub-Factor Weighting
Liquidity	Financially robust under all scenarios with no need for external funding, unquestioned access to the capital markets, and excellent liquidity.	Financially robust under virtually all scenarios with little to no need for external funding, superior access to the capital markets, and very strong liquidity.	Financially strong under most scenarios with some reliance on external funding, solid access to the capital markets, and strong liquidity.	Some reliance on external funding and liquidity is more likely to be affected by external events, good access to the capital markets, and adequate liquidity under most scenarios.	Weak liquidity with more susceptibility to external shocks or unexpected events. Significant reliance on debt funding. Bank financing may be secured and there may be limited headroom under covenants.	Very weak liquidity with limited ability to withstand external shocks or unexpected events. Must use debt to finance investments. Bank financing is normally secured and there may be a high likelihood of breaching one or more covenants.	10%
CFO pre-WC + Interest/ Interest	> 8.0x	6.0x - 8.0x	4.5x - 6.0x	2.7x - 4.5x	1.5x - 2.7x	< 1.5x	7.5%
CFO pre-WC/ Debt	> 40%	30% - 40%	22% - 30%	13% - 22%	5% - 13%	< 5%	7.5%
CFO pre-WC - Dividends/ Debt	> 35%	25% - 35%	17% - 25%	9% - 17%	0% - 9%	< 0%	7.5%
Debt/ Capitalization	< 25%	25% - 35%	35% - 45%	45% - 55%	55% - 65%	> 65%	7.5%
Debt/RAV	< 30%	30% - 45%	45% - 60%	60% - 75%	75% - 90%	> 90%	7.5%

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Public Utility Commission Rankings
Compiled by Regulatory Research Associates
As of January 16, 2013

Jurisdiction	RRA Ranking
Alabama	Above Average / 2
Alaska	Average / 2
Arizona	Average / 3
Arkansas	Average / 3
California	Average / 1
Colorado	Average / 1
Connecticut	Below Average / 3
Delaware	Average / 2
District of Columbia	Average / 2
Florida	Above Average / 3
Georgia	Average / 1
Hawaii	Average / 1
Idaho	Average / 2
Illinois	Below Average / 2
Indiana	Above Average / 3
Iowa	Above Average / 3
Kansas	Average / 2
Kentucky	Average / 1
Louisiana	Average / 1
Maine	Average / 2
Maryland	Below Average / 2
Massachusetts	Average / 2
Michigan	Average / 1
Minnesota	Average / 2
Mississippi	Above Average / 3
Missouri	Average / 2
Montana	Below Average / 1
Nebraska	Average / 2
Nevada	Average / 2
New Hampshire	Average / 3
New Jersey	Average / 3
New Mexico	Below Average / 1
New York	Average / 3
North Carolina	Above Average / 3
North Dakota	Average / 1
Ohio	Average / 2
Oklahoma	Average / 2
Oregon	Average / 3
Pennsylvania	Average / 3
Rhode Island	Average / 3
South Carolina	Average / 1
South Dakota	Average / 3
Tennessee	Average / 1
Texas	Below Average / 1
Utah	Average / 2
Vermont	Average / 3
Virginia	Above Average / 2
Washington	Average / 3
West Virginia	Below Average / 1
Wisconsin	Above Average / 2
Wyoming	Average / 2