

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for rate increase by Duke) DOCKET NO. 20240025-EI
Energy Florida, LLC)
)
Petition for rate increase by Tampa) DOCKET NO. 20240026-EI
Electric Company)
)
) FILED: August 23, 2024
)
_____)

VIA ELECTRONIC FILING

August 23, 2024

Enclosed for filing on behalf of the Federal Executive Agencies' ("FEA") is the errata to the Direct testimony of Mr. Christopher Walters making the corrections identified in FEA's data responses to Staff's 1st data request.

If you should have any question about this filing, please do not hesitate to contact me.

Respectfully submitted this 23rd day of August, 2024.

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**BEFORE THE
 FLORIDA PUBLIC SERVICE COMMISSION**

In re: Petition for rate increase by Tampa Electric Company.)	DOCKET NO. 20240026-EI
)	
In re: Petition for approval of 2023 Depreciation and Dismantlement Study, by Tampa Electric Company.)	DOCKET NO. 20230139-EI
)	
In re: Petition to implement 2024 Generation Base Rate Adjustment provisions in Paragraph 4 of the 2021 Stipulation and Settlement Agreement, by Tampa Electric Company.)	DOCKET NO. 20230090-EI
)	
)	
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Direct Testimony of Christopher C. Walters**

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1 **III.A. Tampa Electric's Investment Risk**

2 **Q PLEASE DESCRIBE THE MARKET'S ASSESSMENT OF TAMPA ELECTRIC'S**
3 **INVESTMENT RISK.**

4 A The market's assessment of a company's investment risk is generally described
5 by credit rating analysts' reports. The current credit ratings for Tampa Electric are
6 BBB+ and A3, from S&P and Moody's respectively.¹¹ The Company currently has
7 a "negative" outlook from S&P and a "stable" outlook from Moody's. In its **August**
8 **June** 2023 report covering Tampa Electric, S&P stated as follows:

9 *We expect Tampa Electric Co. (TEC) to maintain its financial*
10 *performance through our two-year outlook period. Our base-case*
11 *scenario assumes the implementation of the utility's most recent*
12 *rate-case proposals, annual capital spending averaging about \$1.2*
13 *billion, and dividend payments averaging about \$530 million over*
14 *the forecast period. TEC continues to have large capital*
15 *expenditures--nearly triple its depreciation expense. This will likely*
16 *strain financial measures for a least the next year or so during the*
17 *construction of renewable energy transition projects. Overall, we*
18 *forecast that TEC will maintain funds from operations (FFO) to debt*
19 *of about 20%-22% through the 2023-2025 outlook period.*

20 **Business Risk**

21 Our assessment of TEC's business risk reflects its lower-risk, rate-
22 regulated, and vertically integrated electric and gas utility
23 operations, as well as its management of regulatory risk, which we
24 view as consistent with that of its peers. TEC is regulated by the
25 FPSC, which, in our view, has been constructive for credit quality.
26 The FPSC tariff framework uses various cost-recovery riders to
27 allow timely recovery of capital investments. In addition, the FPSC
28 established equity returns that tend to exceed industry averages,
29 and the commission uses forecast test years and frequently
30 authorizes interim rate increases. Furthermore, TEC will likely
31 continue to benefit from above-average economic growth in
32 Florida. TEC's business risk is offset by the lack of regulatory or
33 geographical diversity because it operates only in Florida.
34 Additionally, TEC's generation capacity relies heavily on fossil-
35 based energy, with about 86% and 7% from gas and coal-fired
36 generation respectively, as of 2022. As a result, we view TEC's
37 business risk profile at the lower end of the category compared to
38 other utility peers

¹¹S&P Capital IQ, accessed on May 10, 2024.

1 **Financial Risk**

2 We assess TEC's financial risk profile using our medial volatility
3 financial benchmark tables rather than the financial benchmarks
4 we use for a typical corporate issuer, which reflects its lower-risk
5 regulated utility operations and effective management of regulatory
6 risk. TEC has a very large capital program, about triple that of
7 depreciation expense, that will likely result in negative discretionary
8 cash flow, indicative of the company's external funding needs. TEC
9 has recently received approval for increases in base rates of about
10 \$191 million, \$90 million, and \$21 million, for 2022, 2023, and
11 2024, respectively. The outcome of the rate case was helpful for
12 TEC to maintain its financial measures. Furthermore, our analysis
13 of TEC's financial measures also incorporates recent regulatory
14 outcomes.¹²

15
16 The "negative" outlook is clearly being driven by the outlook of Tampa
17 Electric's ultimate parent company, Emera Inc., rather than by cash flow or other
18 credit concerns at Tampa Electric. In fact, Tampa Electric's Stand-Alone-Credit-
19 Profile ("SACP") rating from S&P, the rating that would otherwise be assigned to
20 Tampa Electric if not for its affiliation with Emera Inc., is 'a' compared to its
21 published rating of BBB+. In other words, Tampa Electric's credit rating is being
22 hindered by two notches directly as a result of its affiliation with Emera Inc.

23
24 **III.B. Tampa Electric's Proposed Capital Structure**

25 **Q WHAT IS TAMPA ELECTRIC'S PROPOSED CAPITAL STRUCTURE?**

26 A Tampa Electric's proposed capital structure is summarized in Table CCW-6 below:

27
28
29
30
31

¹²S&P Global Ratings, RatingsDirect, ~~Oklahoma Gas & Electric~~ Tampa Electric Co, July
June 2415, 2023.

1 based on regulatory commission-authorized returns for utility companies.
2 Authorized returns are typically based on expert witnesses' estimates of the
3 investor-required return at the time of the proceeding.

4 The second equity risk premium estimate is based on the difference
5 between regulatory commission-authorized returns on common equity and
6 contemporary "A" rated utility bond yields by Moody's. I selected the period 1986
7 through 2023 because public utility stocks consistently traded at a premium to book
8 value during that period. This is illustrated in Exhibit CCW-9, which shows the
9 market-to-book ratio since 1986 for the utility industry was consistently above a
10 multiple of 1.0x. Over this period, an analyst can infer that authorized ROEs were
11 sufficient to support market prices that at least exceeded book value. This is an
12 indication that commission-authorized returns on common equity supported a
13 utility's ability to issue additional common stock without diluting existing shares. It
14 further demonstrates that utilities were able to access equity markets without a
15 detrimental impact on current shareholders.

16 Based on this analysis, as shown in Exhibit CCW-10, the average indicated
17 equity risk premium over U.S. Treasury bond yields has been 5.635.70%. Since
18 the risk premium can vary depending upon market conditions and changing
19 investor risk perceptions, I believe using an estimated range of risk premiums
20 provides the best method to measure the current return on common equity for a
21 risk premium methodology.

22 I assessed the five-year and ten-year rolling average risk premiums over
23 the study period to gauge the variability over time of risk premiums. These rolling
24 average risk premiums mitigate the impact of anomalous market conditions and
25 skewed risk premiums over an entire business cycle. As shown on my Exhibit

1 CCW-10, the five-year rolling average risk premium over Treasury bonds ranged
2 from ~~4.25% to 7.09%~~~~4.17% to 7.17%~~, while the ten-year rolling average risk
3 premium ranged from 4.30% to 6.~~92~~91%.

4 As shown on my Exhibit CCW-11, the average indicated equity risk
5 premium over contemporary "A" rated Moody's utility bond yields was ~~4.274~~4.34%.
6 The five-year and ten-year rolling average risk premiums ranged from 2.~~80~~88% to
7 5.~~97~~90% and 3.~~44~~20% to 5.~~75~~73%, respectively.

8
9 **Q WHY ARE THE TIME PERIODS USED TO DERIVE THESE EQUITY RISK**
10 **PREMIUM ESTIMATES APPROPRIATE TO FORM ACCURATE**
11 **CONCLUSIONS ABOUT CONTEMPORARY MARKET CONDITIONS?**

12 A Contemporary market conditions can change dramatically during the period that
13 rates determined in this proceeding will be in effect. A relatively long period of time
14 where stock valuations reflect premiums to book value indicates that the
15 authorized ROEs and the corresponding equity risk premiums were supportive of
16 investors' return expectations and provided utilities access to the equity markets
17 under reasonable terms and conditions. Further, this time period is long enough
18 to smooth abnormal market movement that might distort equity risk premiums.
19 While market conditions and risk premiums do vary over time, this historical time
20 period is a reasonable period to estimate contemporary risk premiums.

21
22 **Q PLEASE EXPLAIN OTHER MARKET EVIDENCE YOU RELIED ON IN**
23 **DETERMINING AN APPROPRIATE EQUITY RISK PREMIUM.**

24 A The equity risk premium should reflect the market's perception of risk in the utility
25 industry today. I have gauged investor perceptions in utility risk today in Exhibit

1 CCW-12, where I show the yield-spread between utility bonds and Treasury bonds
2 since 1980. As shown in this schedule, the average utility bond yield-spreads over
3 Treasury bonds for “A” and “Baa” rated utility bonds for this historical period are
4 1.48% and 1.90%, respectively.

5 A current 13-week average “A” rated utility bond yield of 5.66% when
6 compared to the current Treasury bond yield of 4.50%, as shown in Exhibit CCW-
7 13, page 1, implies a yield-spread of 1.16%. This current utility bond yield-spread
8 is lower than the long-term average-spread for “A” rated utility bonds of 1.48%.
9 The 13-week average yield on “Baa” rated utility bonds is 5.89%. This indicates a
10 current spread for the “Baa” rated utility bond yield of 1.39%, which is lower than
11 the long-term average of 1.90%.

12

13 **Q WHAT ARE THE RESULTS BASED ON YOUR RISK PREMIUM ANALYSES?**

14 **A** I give primary consideration to the Risk Premium results using Treasury bonds and
15 A-rated utility bonds. My recommendation also takes the results of adding the
16 Baa-rated utility bond yield to the equity risk premium over A-rated utility bonds
17 into consideration.

18 Considering the current and projected economic environment, current yield
19 spreads and equity risk premiums, as well as current levels of interest rates and
20 interest rate projections, a more normalized equity risk premium is warranted. As
21 such, I believe an average equity risk premium over Treasury yields of 5.6370% is
22 appropriate. Adding this risk premium to the projected Treasury yield of 4.20%
23 produces an ROE of 9.6390%.

24 Applying a similar methodology as described above, the average ~~of the~~
25 ~~rolling five-year average~~ risk premiums over A-rated utility bonds is 4.2734%. The

1 A-rated utility bond yield has averaged 5.66% over the 13-week period ending May
2 10, 2024 while the Baa-rated utility bond yield has averaged 5.89% over the same
3 period. Adding this risk premium to the 13-week A-rated utility bond yield of 5.66%
4 produces an estimated cost of equity of ~~9.93~~10.00%. Adding this risk premium to
5 the 13-week Baa-rated utility bond yield of 5.89% produces an estimated cost of
6 equity of ~~10.46~~23%.

7 The A-rated utility bond yield has averaged 5.60% over the 26-week period
8 ending May 10, 2024 while the Baa-rated utility bond yield has averaged 5.84%
9 over the same period. Adding the equity risk premium of ~~4.27~~34% to the 26-week
10 A-rated utility bond yield of 5.60% produces an estimated cost of equity of
11 ~~9.87~~94%. Adding the equity risk premium of ~~4.34~~27% to the 26-week Baa-rated
12 utility bond yield of 5.84% produces an estimated cost of equity of ~~10.44~~18%.

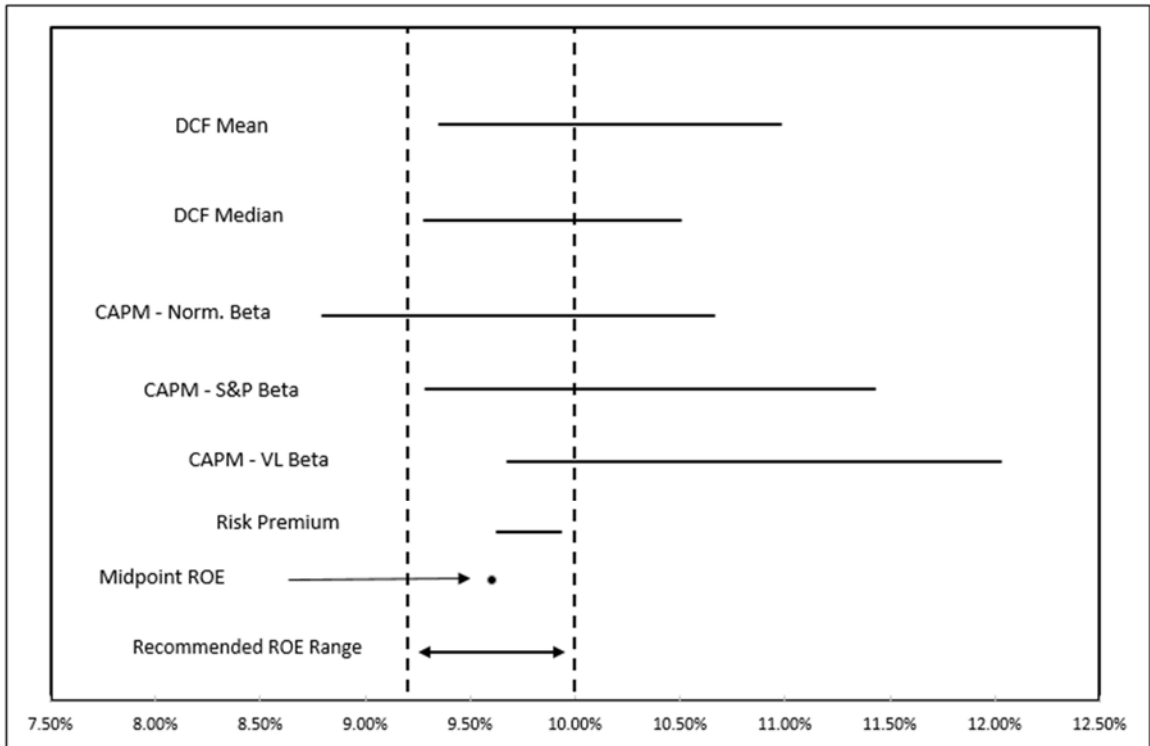
13 The results of my risk premium analyses are summarized in Table CCW-
14 9.

Table CCW-9	
<u>Summary of Risk Premium Results</u>	
<u>Description</u>	
Projected Treasury Yield	9.63 <u>90</u> %
<u>13-Week Yields</u>	
A-Rated Utility Bond	9.93 <u>10.00</u> %
Baa-Rated Utility Bond	10.23 <u>46</u> %
<u>26-Week Yields</u>	
A-Rated Utility Bond	9.87 <u>94</u> %
Baa-Rated Utility Bond	10.44 <u>18</u> %

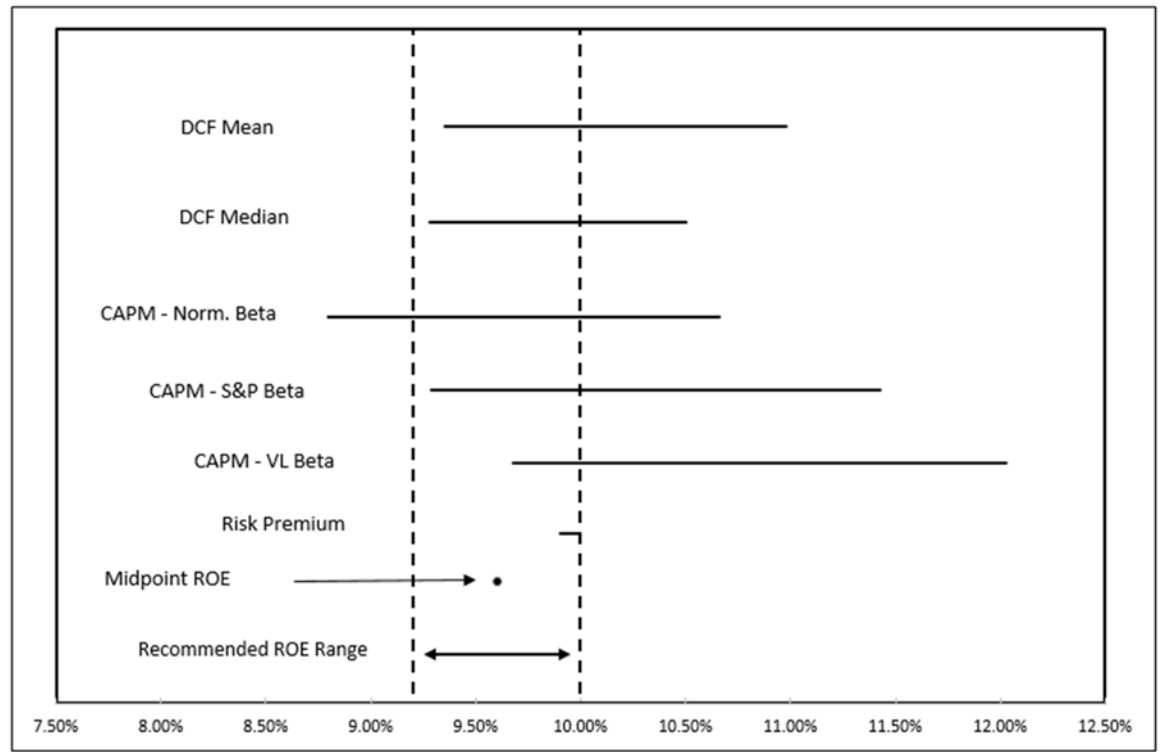
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16

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FIGURE CCW-5



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1 Finally, this Commission has ~~routinely~~ rejected the ECAPM with an
2 adjusted beta. As such, Mr. D'Ascendis' use of an adjusted beta in the ECAPM
3 should be rejected.

4
5 **IV.H. D'Ascendis Non-Regulated Company Analysis**

6 **Q PLEASE DESCRIBE MR. D'ASCENDIS' NON-PRICE REGULATED**
7 **COMPANIES' EARNED ROE METHODOLOGY.**

8 A Mr. D'Ascendis' non-price regulated ROE estimate is based on the results from the
9 same cost of equity studies described above using a proxy group of non-price
10 regulated companies that he chose based solely on whether they had betas within
11 two standard deviations of the beta of his utility proxy group. His DCF, Risk
12 Premium, and CAPM model results for the non-price regulated firms are 10.26%,
13 12.57%, and 11.75%, respectively. For his spot data analysis on the same non-
14 price regulated companies, the financial models produce results of 10.32%,
15 12.70%, and 12.06%.⁵¹

16
17 **Q IS IT REASONABLE FOR MR. D'ASCENDIS TO USE HIS NON-PRICE**
18 **REGULATED RISK PROXY GROUP TO ESTIMATE THE REQUIRED ROE FOR**
19 **TAMPA ELECTRIC?**

20 A No. Mr. D'Ascendis has not proven that these companies are risk-comparable to
21 Tampa Electric. For example, Mr. D'Ascendis' non-price regulated proxy group
22 includes large technology firms such as Cisco Systems and Oracle Corp. It is
23 simply not credible to believe that these firms are comparable in business and
24 operating risk to regulated utilities. To draw a valid comparison between Tampa

⁵¹Exhibit 8.

CERTIFICATE OF SERVICE
Docket Nos. 20240026-EI

I **HEREBY CERTIFY** that a true and correct copy of the foregoing has been furnished by electronic mail this 23rd day of August, 2024, to the following:

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