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December 17, 2008

HAND DELIVERED

Ms. Ann Cole, Director
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Petition for Rate Increase by Tampa Electric Company
FPSC Docket No. 080317-EI

Dear Ms. Cole:

Enclosed for filing in the above docket, on behalf of Tampa Electric Company, are the original and twenty (20) copies of each of the following:

1. Rebuttal Testimony and Exhibit of Gordon L. Gillette
2. Rebuttal Testimony of Susan D. Abbott
3. Rebuttal Testimony and Exhibit of Donald A. Murry
4. Rebuttal Testimony and Exhibit of Mark J. Hornick
5. Rebuttal Testimony and Exhibit of Joann T. Wehle
6. Rebuttal Testimony and Exhibit of Regan Haines
7. Rebuttal Testimony and Exhibit of Dianne Merrill
8. Rebuttal Testimony and Exhibit of Steven P. Harris
9. Rebuttal Testimony of Alan Felsenthal
10. Rebuttal Testimony of Jeffrey S. Chronister
11. Rebuttal Testimony and Exhibit of William R. Ashburn

Please acknowledge receipt and filing of the above by stamping the duplicate copy of this letter and returning same to this writer.

Thank you for your assistance in connection with this matter.

Sincerely,

Lee L. Willis

COM 5+1
ECR
GCL 4
OPC
RCP 1
SSC 1
SGA 2
ADM
CLK

LLW/pp
Enclosures

cc: All Parties of Record (w/encls.)

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 080317-EI

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

TECO
TAMPA ELECTRIC

REBUTTAL TESTIMONY AND EXHIBIT
OF
GORDON L. GILLETTE

TECO
TAMPA ELECTRIC

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REBUTTAL TESTIMONY AND EXHIBIT

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BEFORE THE PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

GORDON L. GILLETTE

Q. Please state your name, business address, occupation and employer.

A. My name is Gordon L. Gillette. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Tampa Electric Company ("Tampa Electric" or "company") as Senior Vice President Finance and Chief Financial Officer.

Q. Are you the same Gordon L. Gillette who filed direct testimony in this proceeding?

A. Yes I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address issues in the prepared direct testimony of witnesses J. Randall Woolridge and Hugh Larkin, testifying on behalf of the Office of Public Counsel, Kevin O'Donnell, testifying on

behalf of the Florida Retail Federation, Thomas Herndon, testifying on behalf of the Florida Industrial Power Users Group, and Stephen Stewart, testifying on behalf of AARP.

Q. Have you prepared an exhibit supporting your rebuttal testimony?

A. Yes I have. My Rebuttal Exhibit No. __ (GLG-2) consists of two documents that were prepared under my direction and supervision. These consist of:

Document No. 1 Standard & Poor's Methodology for Imputing Debt for U.S. Utilities' Power Purchase Agreements

Document No. 2 New Issue Summary - 2008 Utility New Issuance

Q. Please summarize the key concerns and disagreements you have regarding the substance of the various witnesses' testimony.

A. My key concerns and disagreements are with the following matters:

- Dr. Woolridge challenges the level of support provided by Tampa Electric to justify its targeted single A bond

rating;

- Dr. Woolridge and Mr. O'Donnell suggest alternatives to the capital structure proposed by Tampa Electric. Dr. Woolridge also takes issue with the company's proposed power purchase agreement ("PPA") adjustment to the capital structure;
- Dr. Woolridge and Messrs. O'Donnell and Herndon suggest that utility bonds are cheaper in the current market than in the past and make assertions on the cost of short-term debt;
- Dr. Woolridge claims that Tampa Electric witness Susan Abbott did not compare the magnitude of Tampa Electric's construction program relative to those of other electric utilities;
- Messers. Larkin and Stewart argue that the company's recommended annual storm damage reserve accrual is inappropriate and, rather than changing it, it would be better to rely on surcharges and securitization to recover costs in the event of a storm;
- Mr. O'Donnell suggests that Tampa Electric's witness Abbott provides no substantive contribution to the case.

Because of the overlap of topics and issues, I have divided my testimony into six sections: 1) Single A Bond

Rating, 2) Capital Structure, 3) Recent Market Effects on Debt and Equity Costs, 4) Relative Capital Expenditures, 5) Storm Damage Cost Recovery, and 6) Testimony of Susan Abbott.

SINGLE A BOND RATING

Q. Dr. Woolridge challenges the level of support provided by Tampa Electric to justify its targeted single A bond rating. Do you take issue with this?

A. I do. On pages 86 and 87 of his direct testimony, Dr. Woolridge makes three points with which I disagree. He states that: 1) Ms. Abbott's ratings parameters exhibit shows that Tampa Electric is on the high end of the BBB range, even without rate relief, 2) neither Ms. Abbott nor I have performed a cost benefit analysis of Tampa Electric targeting a single A rating, and 3) the rating agencies have affirmed or enhanced their outlooks on Tampa Electric, with an important driver being the de-leveraging of the parent company, TECO Energy. I disagree with all three points.

Q. What is your comment on Dr. Woolridge's assertion that Ms. Abbott's ratings parameters exhibit shows that Tampa Electric is on the high end of the BBB range even without

rate relief?

A. Ms. Abbott and I had complementary exhibits in our direct testimonies showing projected coverage ratios. Her exhibit showed coverage ratios with Tampa Electric at the targeted 55.3 percent equity ratio, with and without the proposed rate increase. The exhibit in my testimony had an additional column showing the coverage ratios with the equity ratio at the 2007 level of about 46 percent and without the proposed rate increase. This column shows coverage ratios in the low BBB range. My exhibit illustrates that the company needs both rate relief and the proposed 55.3 percent jurisdictional financial equity ratio in order to be more certain of achieving credit rating parameters commensurate with its targeted single A debt rating.

Q. Please comment on Dr. Woolridge's assertion that no cost benefit analysis of Tampa Electric targeting a single A rating was preformed.

A. Dr. Woolridge seems to be implying that the company was remiss in not performing a cost benefit analysis of its targeted single A credit rating versus, I presume, staying at the current BBB rating or going lower in the

credit ratings spectrum. Whether or not the company targets an A rating is not simply a question of costs and benefits. It is a broader and more challenging question of risks, rewards, and access to capital. Within reasonable ranges, the cost of equity is higher than debt and, therefore, more equity in the capital structure costs more. However, a balance must be maintained. Carrying too much debt will cause lower credit ratings, higher debt costs and limit overall access to capital. Given the extensive construction program and need for access to maintain the capital spending planned by Tampa Electric over the next several years, the realization of significant risk of hurricanes, the unprecedented upheaval that is currently occurring in the financial markets, and the significant amount of fuel the company buys, Tampa Electric needs to have strong investment grade ratings in order to ensure that it will have access to the debt capital markets as needed to fund its construction program. I believe that targeting credit ratings in the A range is appropriate for these purposes.

Q. Please describe why an A rating is so important to maintain access to the credit markets.

A. The utility sector is very capital intensive and relies

heavily on the capital markets to provide funding for growth, system reliability and environmental compliance. While utilities have been able to meet their short-term funding needs during financial market disruptions by issuing highly-rated, short-dated commercial paper or tapping existing credit lines, access to longer-term financial markets is essential to fund long-term projects and maintain financial flexibility. The current financial crisis has impacted and disrupted all sectors of the capital markets, not only on the cost side but with regard to access to capital as well. As Ms. Abbott discusses in her rebuttal testimony, access to the credit markets has recently been especially challenging. During recent months, there have been periods of time when the debt capital markets were ostensibly closed for all new issuance, as was the case from September 10 through 22. When the debt capital markets eventually opened, providing small windows of opportunity for new issuances beginning in late September, only highly rated (strong single A or better) issuers were able to access the markets. It was several weeks later before a BBB rated utility was able to access the bond market, and the deals that were done by BBB issuers were mostly secured and at very high interest rates. This most recent period of financial market distress highlights the fact that highly

rated issuers have more efficient and consistent access to the capital markets than lower rated issuers. It further supports the company's conclusion that the single A rating is necessary and indeed critical during times of national and international financial distress in order to maintain access.

Further, as I describe in my direct testimony, a single A rating leaves a "safety net" in the event of a significant hurricane. With single A ratings, the company would be less likely to be downgraded to below investment grade, a close to catastrophic occurrence for a utility company, than if the company were maintaining a BBB rating before a major storm event occurred. I believe this is the reason more utilities in the southeast maintain debt ratings in the A range. On average, 58 percent of the electric utilities in the southeast have single A ratings or above. This compares to 28 percent across the U.S.

Q. Messrs. Woolridge, O'Donnell and Herndon question the benefits of being an A rated utility. Did they provide any evidence to suggest that a lower rating would provide adequate financial integrity and access to the capital markets?

A. No. None of these witnesses provide any evidence to suggest that a rating lower than single A would provide adequate financial integrity and appropriate and consistent access to the capital markets.

Q. Please describe the types of ratings that rating agencies use.

A. The rating agencies have two categories in which they provide information on a company. They provide an actual debt rating, which when changed up or down is termed a "ratings action". They also provide outlooks, typically either "positive", "stable", or "negative," to give institutional investors a sense of the direction that the rating might go in the future, pending certain future events such as key regulatory decisions.

Q. Dr. Woolridge states "the three major rating agencies have most recently affirmed or enhanced the outlook for the ratings of Tampa Electric," and that "an important factor in these decisions appears to be the deleveraging of the parent company, TECO Energy." How do you respond?

A. Dr. Woolridge is correct in his first statement where he indicates that "the three major rating agencies have most

recently affirmed or enhanced the outlook for the ratings of Tampa Electric." I disagree, however, with his second statement where he indicates that this is driven by the deleveraging of TECO Energy. While this may be partially the cause, the rating agencies are very focused on the outcome of this proceeding as well. They know that the company is moving aggressively to improve its equity ratio, capital structure, and overall financial integrity. I believe that an affirmation of the appropriateness of these actions by the Commission will potentially allow the agencies to take actions to upgrade Tampa Electric. By the same token, if the Commission were to accept the capital structure recommendations of the intervenors' witnesses in this case, I am very concerned that the rating agencies could downgrade Tampa Electric.

The most recent ratings changes by the rating agencies have been as follows:

- On November 27, 2007, S&P upgraded the unsecured debt of TECO Energy to BB+ and maintained the rating at Tampa Electric at BBB- (one notch above non-investment grade), citing TECO Energy's commitment to credit quality by shedding most of its unregulated businesses

and restoring its balance sheet;

- On December 5, 2007, Moody's upgraded the unsecured debt of TECO Energy to Baa3 (investment grade) reflecting the company's reduced business risk profile resulting from the sale of unregulated businesses and retirement of parent company debt. In the December 5, 2007 report, Moody's maintained the rating at Tampa Electric at Baa2, indicating that Tampa Electric's ratings could move up with additional clarity on the size and timing of its capital expenditure program and the magnitude and regulatory response to potential rate increases related to these capital expenditures; and
- On March 26, 2008, Fitch upgraded the unsecured debt of TECO Energy to BBB-, citing reduction in business risk and retirement of parent debt and affirmed the BBB+ unsecured debt rating of Tampa Electric, citing credit concerns for Tampa Electric, including an increasing reliance on gas-fired generation capacity, more stringent environmental regulations, lower sales growth and the need for base rate relief.

So while all three agencies upgraded TECO Energy, all three left Tampa Electric's ratings where they had been. This indicates that, as one would expect, deleveraging TECO Energy is driving TECO Energy's ratings more than it

is Tampa Electric's. Additionally, recent discussions with the rating agencies suggest that Tampa Electric's current credit parameters, including its equity ratio, are not sufficient to justify a single A rating. Hence, the more important factors for Tampa Electric to obtain stronger debt ratings are for the company to receive the rate relief requested, including the proposed equity ratio and return on equity.

CAPITAL STRUCTURE

Q. Messrs. Woolridge and O'Donnell suggest alternatives to the 55.32 percent equity ratio proposed by Tampa Electric. Why should the Commission reject their recommendations and use the company's proposed equity ratio?

A. In the interest of lowering the revenue requirement, the intervenor witnesses have recommended much lower equity ratios than the company has proposed. Although they derived their recommended equity ratios using different arguments or justifications which I will discuss later in my testimony, their recommendations were similar (48.9 percent and 49.6 percent) compared to the company's proposed 55.32 percent. While Mr. O'Donnell's 49.6 percent recommendation was not stated directly in his

testimony, I calculated it using his proposed overall capital structure, which used all regulatory sources of capital. If the Commission were to adopt these significantly lower equity ratios, the company would not be able to achieve its goal of having credit parameters in the single A range. As discussed in both Ms. Abbott's and my direct testimony, the 55.32 percent equity ratio the company has proposed should result in credit parameters that best enable the company to achieve a single A rating.

Q. How do the equity ratio recommendations of Messrs. Woolridge and O'Donnell of 48.9 percent and 49.6 percent, respectively, compare to the allowed capital structures of other investor-owned utilities in Florida?

A. The recommended equity ratios are substantially lower than the most recently approved capital structures for Progress Energy Florida, Inc. ("PEF") and Florida Power & Light Company ("FP&L"). In their recent rate case proceedings, the Commission approved PEF and FPL's equity ratios at 57.83 percent and 55.83 percent, respectively. Furthermore, in Tampa Electric's 1996 earnings review, the Commission capped the company's equity ratio at 58.7 percent. These equity ratio decisions demonstrate the

long history of this Commission's support for utility financial integrity and the reasonableness of the company's requested 55.32 percent equity ratio.

Q. Dr. Woolridge states that the 48.89 percent equity ratio more accurately reflects how the company has been financed in the past. Is he correct?

A. No. He used an outdated time period that is not reflective of how the company is currently financed and will be financed in the future. By using the 2007 and 2008 13-month average capital structures to derive his proposed ratio, Dr. Woolridge did not account for the full effect of the equity infusions TECO Energy has already made and plans to make to Tampa Electric. The difference can be better understood by comparing the year-end equity ratio in the company's September 2008 Surveillance Report to the 48.89 percent recommended equity ratio by Dr. Woolridge. The company's equity ratio as of September 2008 is 51.9 percent. While this ratio only reflects equity infusions made through September, it will continue to increase as TECO Energy makes additional equity infusions.

As I stated earlier in my testimony, given what we know

about the current situation in the financial markets, the risk of hurricanes and the extensive capital expenditure needs of Tampa Electric going forward, it would be a mistake to leave the capital structure and resulting debt ratings where they were in 2007 and early 2008.

Q. Dr. Woolridge also states that the 48.89 percent equity ratio more accurately reflects the capitalization of other electric utility companies. Is he correct?

A. No. Dr. Murry's rebuttal testimony addresses the problems associated with Dr. Woolridge's proposed proxy group; however, I would like to address one of the particular proxy companies selected by Dr. Woolridge. Progress Energy, Inc. (the holding company) is listed in his proposed proxy group exhibit and it is shown to have an equity ratio of only 43 percent. It evidently does not reflect PEF's most recent Commission approved 57.83 percent equity ratio, which is more comparable to and supportive of the 55.32 percent equity ratio requested by Tampa Electric in this proceeding.

Q. Dr. Woolridge takes issue with the company's proposed PPA adjustment to the capital structure. What is your response?

A. Dr. Woolridge makes three basic points in support of his position that a PPA adjustment is not warranted; 1) the risk factor is not defined, 2) the adjustment is not in accordance with GAAP accounting, and 3) the PPA payments are unlike debt. While Ms. Abbott addresses some of these issues in her rebuttal testimony, I have a few additional comments regarding his first and third points.

In his first point, Dr. Woolridge questions the use of the 25 percent risk factor in calculating the imputed debt amount and he states that the "S&P risk factor for imputing debt is not well defined and cannot be assessed in this situation." To the contrary, through direct discussions with S&P, the company is aware that S&P has been and continues to impute debt for PPAs in its credit rating analysis of Tampa Electric by applying a 25 percent factor to the present value of the PPA capacity payments. This is exactly what Tampa Electric has done in preparing the projected adjustment in this proceeding. This is further supported by Document No. 1 of my Rebuttal Exhibit No. __ (GLG-2) which is an article that suggests that S&P would use a 25 percent factor for companies with recovery clause mechanisms similar to Tampa Electric's.

With regard to Dr. Woolridge's third argument, I believe he ignores this Commission's history of recognizing the S&P imputation of off-balance sheet debt for PPAs in its prior rulings. As I mention in my direct testimony, Rule 25-22.081(7), Florida Administrative Code, Contents of Petition, requires utilities to include a discussion of the potential for increases and decreases in its cost of capital associated with purchased power in a petition for determination of need for new generation. Also, in both FP&L's and PEF's recent base rate proceedings, the Commission approved off-balance sheet obligations for PPAs to be incorporated into the capital structure and weighted average cost of capital.

Q. Do you agree with Mr. O'Donnell's statement that his adjustment in the proposed capital structure for this issue is "in keeping with Commission Rule 25-14.004"?

A. No. Mr. O'Donnell's proposed adjustment to the capital structure is not consistent with the Commission's parent company debt rule. Furthermore, Mr. O'Donnell's recommended adjustment to the equity in the capital structure is neither supportable nor appropriate.

RECENT MARKET EFFECTS ON DEBT AND EQUITY COSTS

Q. Messrs. Woolridge, O'Donnell and Herndon suggest that interest rates and equity risk premiums are currently at historically low levels and therefore, the return on equity set in this case should be lower. Do you agree with these assertions?

A. No, I do not. While it is true that current interest rates on Treasury securities have been bid down to historically low levels, credit spreads, which are the amounts added to the Treasury rate to derive the "all-in" price of corporate debt, are at historically wide levels resulting in yields for bonds, including utility bonds, at significantly higher than historical levels. Recent trading yields of 10-year utility debt are higher than any period since 2000 and since 1992 before that. In addition, recent new utility debt issues have been priced with significant new issue premiums over and above current trading yields. The cost of capital for debt and equity issuers has increased in response to the current financial market crisis and investors' quest for quality. In Document No. 2 of my rebuttal exhibit GLG-2, I provide a list of the various utility bond deals that have been recently executed along with the respective company's credit rating. This list clearly demonstrates the higher rates associated with debt in this current financial

market.

Q. Please address the difference between Dr. Woolridge's proposed cost of short-term debt compared to the company's.

A. Because of the volatility and uncertainty surrounding short-term interest rates, the company utilized average historical LIBOR rates in developing its proposed short-term interest rate of 4.5 percent based on a LIBOR rate of 4.37 percent. Dr. Woolridge indicates that the more appropriate LIBOR rate should be based off of the November 13, 2008 rate of 2.15 percent which happens to be near the absolute lowest rate seen in the last four years. Dr. Woolridge's Exhibit JRW-4, page 5 of 6, shows LIBOR rates from January 2, 2004 to November 2, 2008. The average rate over this selected time period is 3.8 percent. However, over the last three years, LIBOR rates have averaged 4.5 percent. Current LIBOR rates have been driven down by the billions of dollars of liquidity the Federal Reserve, Treasury Department, and U.S. Government have flooded into the market to entice banks to begin lending to each other in the current financial crisis. As evidenced by the significant spike in LIBOR rates in September to 4.75 percent, these rates have been

extremely volatile and presumably will continue to be volatile for the foreseeable future. It is therefore prudent to use a historical average LIBOR rate as the company proposed rather than a rate at a particular point in time as Dr. Woolridge has done to determine future short-term funding costs.

RELATIVE CAPITAL EXPENDITURES

Q. Dr. Woolridge alleges that Ms. Abbott made no comparison of the magnitude of Tampa Electric's construction program to those of other electric utilities and/or to the electric utilities included in Dr. Murry's proxy group. How do you respond?

A. While Ms. Abbott may not have discussed the company's capital expenditure program in relation to the requirements of the industry, I did. In my direct testimony, I discuss the significant capital expenditures since Tampa Electric's last base rate case in 1992 along with the more recent capital spending trends that have affected the electric industry and, specifically, the company's levels of capital spending. I discuss the significant recent increase in Tampa Electric's rate base and the significant needs over the next several years for capital spending. I describe that only about half of

Tampa Electric's projected construction expenditures over the next five years will be made with internally generated funds and the remainder must be made with external funding.

For 2008 through 2010, Tampa Electric's projected capital expenditures are estimated at $1.8 billion, and more than 60 percent of this amount will need to be sourced externally. According to a recent report prepared by an investment bank, the electric utility industry's capital expenditures for 2008 through 2010 are estimated at $276 billion which represents about 41 percent of the industry's market value. This same report cites Tampa Electric's 2008 through 2010 capital expenditures representing about 44 percent of market value. This clearly illustrates that the company's capital expenditure needs are significant relative to the industry's significant needs and it underscores the importance of maintaining a high level of financial integrity and a strong credit rating going forward.

STORM DAMAGE COST RECOVERY

Q. Messrs. Larkin and Stewart argue that the level of Tampa Electric's proposed storm damage accrual and reserve is inappropriate and they support surcharges and

securitization for future needs. Do you agree?

A. No. Since Florida's 2004 hurricane season experience, three storm cost recovery mechanisms have been used: an annual reserve accrual included in base rates, a storm surcharge or pass-through added to base rates for two to three years, and securitization, which is a financing mechanism that effectively spreads a surcharge over a longer period of time. Both witnesses state that the company's existing annual accrual and reserve target are appropriate and recommend, in the event that the reserve is not adequate following a significant storm, the company can simply rely on a surcharge and securitization. In his rebuttal testimony, Tampa Electric witness Jeffrey Chronister addresses why their recommendation is not appropriate nor is it in the best interest of customers. However, I would like to address the limitations of securitization as a financing mechanism for storm costs.

While securitization can be a very effective financing mechanism, it may not be economic or feasible for amounts less than $150 to $200 million. The fixed costs of the securitized debt issuance and the ongoing cost of administration, which are higher than for unstructured

financings, would make a small issue size very expensive. More importantly, it is difficult to attract investors to small issue sizes, primarily because investors desire the liquidity of a large transaction. Because of the size considerations, securitization represents a realistic solution for only the large and low probability events, such as Category 3 or higher storms. At the current accrual and reserve level, this would leave a fairly large gap that would fall to a short-term surcharge. As Tampa Electric witness Stephen Harris states in his rebuttal testimony, at the current annual accrual of $4 million, there is a greater than 50 percent chance of a negative reserve balance within the next five years. The company's recommended increase to the storm damage accrual is necessary and appropriate.

TESTIMONY OF SUSAN ABBOTT

Q. Mr. O'Donnell suggests that Tampa Electric's witness Abbott provides no return on equity or capital structure recommendation and makes no substantive contribution to the case. Do you agree?

A. No, I do not. Ms. Abbott's role is not to testify in support of the company's requested return on equity and its requested capital structure. Dr. Murry and I provide

complete testimony in these areas. Ms. Abbott was hired because of her background and expertise on rating agencies and her understanding of how regulatory commissions' base rate decisions can impact a company's ratings. She has provided insight into rating agencies' processes and perspectives, analyzed the company's current creditworthiness, helped determine a necessary rating to ensure access to the debt and equity markets, and provided direct and rebuttal testimony. The Commission has a long history of considering the testimony of financial integrity witnesses similar to that provided by Ms. Abbott.

Q. Do you agree with Mr. O'Donnell's recommendation that Ms. Abbott's fees should be excluded from rate case expense because she makes no substantive contribution to the case and they are too high?

A. No, I do not. She is an integral part to the company's comprehensive case and her fees are competitive and appropriate. Mr. Chronister addresses overall rate case expense in his rebuttal testimony and, while he does not specifically address Ms. Abbott's fee, he addresses the appropriateness of the company's proposed rate case expense.

SUMMARY OF REBUTTAL TESTIMONY

Q. Please summarize your rebuttal testimony.

A. My rebuttal testimony has addressed the primary concerns and disagreements I have regarding the testimonies of the intervenors' witnesses Woolridge, Larkin, O'Donnell, Herndon, and Stewart. They all make assertions that are not accurate, not appropriate or not applicable to the issues in this proceeding. While they raise a variety of issues including the company's proposed capital structure, its targeted credit rating, the recent market effects on the cost of debt and equity, and other various projected costs such as storm damage accrual and rate case expense, none of them present sufficient evidence to support any adjustments to the company's proposed revenue requirement. The company has presented facts and information that support its petition and the appropriateness of the revenue requirement contained in its filing.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

TAMPA ELECTRIC COMPANY
DOCKET NO. 080317-EI
WITNESS: GILLETTE
REBUTTAL EXHIBIT NO.__ (GLG-2)

REBUTTAL EXHIBIT

OF

GORDON L. GILLETTE

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RESEARCH

Criteria | Corporates | Utilities:

Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements

Publication date: 07-May-2007
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For many years, Standard & Poor's Ratings Services has viewed power supply agreements (PPA) in the U.S. utility sector as creating fixed, debt-like, financial obligations that represent substitutes for debt-financed capital investments in generation capacity. In a sense, a utility that has entered into a PPA has contracted with a supplier to make the financial investment on its behalf. Consequently, PPA fixed obligations, in the form of capacity payments, merit inclusion in a utility's financial metrics as though they are part of a utility's permanent capital structure and are incorporated in our assessment of a utility's creditworthiness.

We adjust utilities' financial metrics, incorporating PPA fixed obligations, so that we can compare companies that finance and build generation capacity and those that purchase capacity to satisfy customer needs. The analytical goal of our financial adjustments for PPAs is to reflect fixed obligations in a way that depicts the credit exposure that is added by PPAs. That said, PPAs also benefit utilities that enter into contracts with suppliers because PPAs will typically shift various risks to the suppliers, such as construction risk and most of the operating risk. PPAs can also provide utilities with asset diversity that might not have been achievable through self-build. The principal risk borne by a utility that relies on PPAs is the recovery of the financial obligation in rates.

The Mechanics Of PPA Debt Imputation

A starting point for calculating the debt to be imputed for PPA-related fixed obligations can be found among the "commitments and contingencies" in the notes to a utility's financial statements. We calculate a net present value (NPV) of the stream of the outstanding contracts' capacity payments reported in the financial statements as the foundation of our financial adjustments.

The notes to the financial statements enumerate capacity payments for the five years succeeding the annual report and a "thereafter" period. While we have access to proprietary forecasts that show the detail underlying the costs that are amalgamated beyond the five-year horizon, others, for purposes of calculating an NPV, can divide the amount reported as "thereafter" by the average of the capacity payments in the preceding five years to derive an approximate tenor of the amounts combined as the sum of the obligations beyond the fifth year.

In calculating debt equivalents, we also include new contracts that will commence during the forecast period. Such contracts aren't reflected in the notes to the financial statements, but relevant information regarding these contracts are provided to us on a confidential basis. If a contract has been executed but the energy will not flow until some later period, we won't impute debt for that contract until the year that energy deliveries begin under the contract if the contract represents incremental capacity. However, to the extent that the contract will simply replace an expiring contract, we will impute debt as though the future contract is a continuation of the existing contract.

We calculate the NPV of capacity payments using a discount rate equivalent to the company's average cost of debt, net of securitization debt. Once we arrive at the NPV, we apply a risk factor, as is discussed below, to reflect the benefits of regulatory or legislative cost recovery mechanisms.

Balance sheet debt is increased by the risk-factor-adjusted NPV of the stream of capacity payments. We derive an adjusted

debt-to-capitalization ratio by adding the adjusted NPV to both the numerator and the denominator of that ratio.

We calculate an implied interest expense for the imputed debt by multiplying the same utility average cost of debt used as the discount rate in the NPV calculation by the amount of imputed debt. The adjusted FFO-to-interest expense ratio is calculated by adding the implied interest expense to both the numerator and denominator of the equation. We also add implied depreciation to the equation's numerator. We calculate the adjusted FFO-to-total-debt ratio by adding imputed debt to the equation's denominator and an implied depreciation expense to its numerator.

Our adjusted cash flow credit metrics include a depreciation expense adjustment to FFO. This adjustment represents a vehicle for capturing the ownership-like attributes of the contracted asset and tempers the effects of imputation on the cash flow ratios. We derive the depreciation expense adjustment by multiplying the relevant year's capacity payment obligation by the risk factor and then subtracting the implied PPA-related interest expense for that year from the product of the risk factor times the scheduled capacity payment.

Risk Factors

The NPVs that Standard & Poor's calculates to adjust reported financial metrics to capture PPA capacity payments are multiplied by risk factors. These risk factors typically range between 0% to 50%, but can be as high as 100%. Risk factors are inversely related to the strength and availability of regulatory or legislative vehicles for the recovery of the capacity costs associated with power supply arrangements. The strongest recovery mechanisms translate into the smallest risk factors. A 100% risk factor would signify that all risk related to contractual obligations rests on the company with no mitigating regulatory or legislative support.

For example, an unregulated energy company that has entered into a tolling arrangement with a third-party supplier would be assigned a 100% risk factor. Conversely, a 0% risk factor indicates that the burden of the contractual payments rests solely with ratepayers. This type of arrangement is frequently found among regulated utilities that act as conduits for the delivery of a third party's electricity and essentially deliver power, collect charges, and remit revenues to the suppliers. These utilities have typically been directed to sell all their generation assets, are barred from developing new generation assets, and the power supplied to their customers is sourced through a state auction or third parties, leaving the utilities to act as intermediaries between retail customers and the electricity suppliers.

Intermediate degrees of recovery risk are presented by a number of regulatory and legislative mechanisms. For example, some regulators use a utility's rate case to establish base rates that provide for the recovery of the fixed costs created by PPAs. Although we see this type of mechanism as generally supportive of credit quality, the fact remains that the utility will need to litigate the right to recover costs and the prudence of PPA capacity payments in successive rate cases to ensure ongoing recovery of its fixed costs. For such a PPA, we employ a 50% risk factor. In cases where a regulator has established a power cost adjustment mechanism that recovers all prudent PPA costs, we employ a risk factor of 25% because the recovery hurdle is lower than it is for a utility that must litigate time and again its right to recover costs.

We recognize that there are certain jurisdictions that have true-up mechanisms that are more favorable and frequent than the review of base rates, but still don't amount to pure pass-through mechanisms. Some of these mechanisms are triggered when certain financial thresholds are met or after prescribed periods of time have passed. In these instances, in calculating adjusted ratios, we will employ a risk factor between the revised 25% risk factors for utilities with power cost adjustment mechanisms and 50%.

Finally, we view legislatively created cost recovery mechanisms as longer lasting and more resilient to change than regulatory cost recovery vehicles. Consequently, such mechanisms lead to risk factors between 0% and 15%, depending on the legislative provisions for cost recovery and the supply function borne by the utility. Legislative guarantees of complete and timely recovery of costs are particularly important to achieving the lowest risk factors.

Illustration Of The PPA Adjustment Methodology

The calculations of the debt equivalents, implied interest expense, depreciation expense, and adjusted financial metrics, using risk factors, are illustrated in the following example:

Example Of Power-Purchase Agreement Adjustment

($000s)	Assumption	Year 1	Year 2	Year 3	Year 4	Year 5	Thereafter
Cash from operations	2,000,000						
Funds from operations	1,500,000						
Interest expense	444,000						
Directly issued debt							

Short-term debt	600,000						
Long-term due within one year	300,000						
Long-term debt	6,500,000						
Shareholder's Equity	6,000,000						
Fixed capacity commitments	600,000	600,000	600,000	600,000	600,000	600,000	4,200,000*
NPV of fixed capacity commitments							
Using a 6.0% discount rate	5,030,306						
Application of an assumed 25% risk factor	1,257,577						
Implied interest expense¶	75,455						
Implied depreciation expense	74,545						
Unadjusted ratios							
FFO to interest (x)	4.4						
FFO to total Debt (%)	20.0						
Debt to capitalization (%)	55.0						
Ratios adjusted for debt imputation							
FFO to interest (x)§	4.0						
FFO to total debt (%)**	18.0						
Debt to capitalization (%)¶¶	59.0						

*Thereafter approximate years: 7. ¶The current year's implied interest is subtracted from the product of the risk factor multiplied by the current year's capacity payment. §Adds implied interest to the numerator and denominator and adds implied depreciation to FFO. **Adds implied depreciation expense to FFO and implied debt to reported debt. ¶¶Adds implied debt to both the numerator and the denominator. FFO--Funds from operations. NPV--Net present value.

Short-Term Contracts

Standard & Poor's has abandoned its historical practice of not imputing debt for contracts with terms of three years or less. However, we understand that there are some utilities that use short-term PPAs of approximately one year or less as gap fillers pending the construction of new capacity. To the extent that such short-term supply arrangements represent a nominal percentage of demand and serve the purposes described above, we will neither impute debt for such contracts nor provide evergreen treatment to such contracts.

Evergreen Treatment

The NPV of the fixed obligations associated with a portfolio of short-term or intermediate-term contracts can lead to distortions in a utility's financial profile relative to the NPV of the fixed obligations of a utility with a portfolio of PPAs that is made up of longer-term commitments. Where there is the potential for such distortions, rating committees will consider evergreen treatment of existing PPA obligations as a scenario for inclusion in the rating analysis. Evergreen treatment extends the tenor of short- and intermediate-term contracts to reflect the long-term obligation of electric utilities to meet their customers' demand for electricity.

While we have concluded that there is a limited pool of utilities whose portfolios of existing and projected PPAs don't meaningfully correspond to long-term load serving obligations, we will nevertheless apply evergreen treatment in those cases where the portfolio of existing and projected PPAs is inconsistent with long-term load-serving obligations. A blanket application of evergreen treatment is not warranted.

To provide evergreen treatment, Standard & Poor's starts by looking at the tenor of outstanding PPAs. Others can look to the "commitments and contingencies" in the notes to a utility's financial statements to derive an approximate tenor of the contracts. If we conclude that the duration of PPAs is short relative to our targeted tenor, we would then add capacity payments until the targeted tenor is achieved. Based on our analysis of several companies, we have determined that the evergreen extension of the tenor of existing contracts and anticipated contracts should extend contracts to a common length of about 12 years.

The price for the capacity that we add will be derived from new peaker entry economics. We use empirical data to establish the cost of developing new peaking capacity and reflect regional differences in our analysis. The cost of new capacity is translated into a dollars per kilowatt-year (kW-year) figure using a weighted average cost of capital for the utility and a proxy capital recovery period.

Analytical Treatment Of Contracts With All-In Energy Prices

The pricing for some PPA contracts is stated as a single, all-in energy price. Standard & Poor's considers an implied capacity price that funds the recovery of the supplier's capital investment to be subsumed within the all-in energy price. Consequently, we use a proxy capacity charge, stated in $/kW, to calculate an implied capacity payment associated with the PPA. The $/kW figure is multiplied by the number of kilowatts under contract. In cases of resources such as wind power that exhibit very low capacity factors, we will adjust the kilowatts under contract to reflect the anticipated capacity factor that the resource is expected to achieve.

We derive the proxy cost of capacity using empirical data evidencing the cost of developing new peaking capacity. We will reflect regional differences in our analysis. The cost of new capacity is translated into a $/kW figure using a weighted average cost of capital and a proxy capital recovery period. This number will be updated from time to time to reflect prevailing costs for the development and financing of the marginal unit, a combustion turbine.

Transmission Arrangements

In recent years, some utilities have entered into long-term transmission contracts in lieu of building generation. In some cases, these contracts provide access to specific power plants, while other transmission arrangements provide access to competitive wholesale electricity markets. We have concluded that these types of transmission arrangements represent extensions of the power plants to which they are connected or the markets that they serve. Irrespective of whether these transmission lines are integral to the delivery of power from a specific plant or are conduits to wholesale markets, we view these arrangements as exhibiting very strong parallels to PPAs as a substitute for investment in power plants. Consequently, we will impute debt for the fixed costs associated with long-term transmission contracts.

PPAs Treated As Leases

Several utilities have reported that their accountants dictate that certain PPAs need to be treated as leases for accounting purposes due to the tenor of the PPA or the residual value of the asset upon the PPA's expiration. We have consistently taken the position that companies should identify those capacity charges that are subject to operating lease treatment in the financial statements so that we can accord PPA treatment to those obligations, in lieu of lease treatment. That is, PPAs that receive operating lease treatment for accounting purposes won't be subject to a 100% risk factor for analytical purposes as though they were leases. Rather, the NPV of the stream of capacity payments associated with these PPAs will be reduced by the risk factor that is applied to the utility's other PPA commitments. PPAs that are treated as capital leases for accounting purposes will not receive PPA treatment because capital lease treatment indicates that the plant under contract economically "belongs" to the utility.

Evaluating The Effect Of PPAs

Though history is on the side of full cost recovery, PPAs nevertheless add financial obligations that heighten financial risk. Yet, we apply risk factors that reduce debt imputation to recognize that utilities that rely on PPAs transfer significant risks to ratepayers and suppliers.

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PAGE 1 OF 1
FILED: 12/17/08

New Issue Summary

2008 Utility New Issuance

Issue Date	Issuer	Security Type	Ticker	Amount ($mm)	Coupon (%)	Maturity Date	Rating	Spread
12/10/08	Monongahela Power Co	Secured	AYE	300	7.950	12/15/13	Baa2/BBB	+639
12/09/08	FPL Group Capital, Inc.	Unsecured	FPL	450	7.875	12/15/15	A2/A-	+596.7
12/08/08	Oklahoma Gas & Electric Company	Unsecured	OGE	250	8.250	01/15/19	A2/BBB+	+549.2
12/08/08	Wisconsin Electric Power Company	Unsecured	WEC	250	6.250	12/01/15	A1/A-	+425
12/04/08	Central Illinois Light Company	Secured	AEE	150	8.875	12/15/13	Baa2/BBB	+734.9
12/04/08	Potomac Electric Power	Secured	POM	250	7.900	12/15/38	Baa1/BBB	+462.7
12/02/08	Consolidated Edison Co of NY	Unsecured	ED	600	7.125	12/01/18	A1/A-	+450
12/01/08	Wisconsin Public Service	Secured	TEG	125	6.375	12/01/15	Aa3/A+	+434.5
11/25/08	Dominion Resources	Unsecured	D	600	8.875	01/15/19	Baa2/A-	+678.9
11/24/08	Public Service Electric & Gas	Secured	PEG	275	6.330	11/01/13	A3/A-	+412.5
11/18/08	Westar Energy	Secured	WR	300	8.625	12/01/18	Baa2/BBB	+521.3
11/18/08	Southern California Gas Company	Secured	SRE	250	5.500	03/15/14	A1/A+	+332.0
11/18/08	Delmarva Power & Light	Secured	POM	250	6.400	12/01/13	Baa1/A-	+420.0
11/17/08	Sempra Energy	Unsecured	SRE	500	9.800	02/15/19	Baa1/BBB	+618.9
11/17/08	Sempra Energy	Unsecured	SRE	250	8.900	11/15/13	Baa1/BBB	+670
11/14/08	Southwestern Public Service Co	Unsecured	XEL	250	8.750	12/01/18	Baa1/BBB	+515.5
11/14/08	Alabama Power Company	Unsecured	SO	250	5.800	11/15/13	A2/A	+355
11/13/08	Central Hudson Gas & Electric	Unsecured	CHG	30	6.854	11/01/13	A2/A	+450
11/13/08	Mississippi Power Company	Unsecured	SO	50	6.000	11/15/13	A1/A	+375
11/13/08	Cleveland Electric Illuminating	Secured	FE	300	8.875	11/15/18	Baa2/BBB	+513.6
11/13/08	Pacific Gas & Electric	Unsecured	PCG	400	6.250	12/01/13	A3/BBB+	+410
11/13/08	Pacific Gas & Electric	Unsecured	PCG	200	6.250	10/15/18	A3/BBB+	+395
11/12/08	Georgia Power	Unsecured	SO	100	8.200	11/01/48	A2/A	NA
11/12/08	Duke Energy	Secured	DUK	400	5.750	11/15/13	A2/A	+345
11/12/08	Duke Energy	Secured	DUK	500	7.000	11/15/18	A2/A	+340
11/12/08	Georgia Power	Unsecured	SO	400	6.000	11/01/13	A2/A	+360
11/06/08	Atlantic City Electric Co	Secured	POM	250	7.750	11/15/18	A3/A-	+412.5
11/03/08	Virginia Electric and Power	Unsecured	D	700	8.875	11/15/38	Baa1/A-	+456
10/20/08	Illinois Power	Secured	AEE	400	9.750	11/15/18	Baa3/BBB	+609.3
10/16/08	Pacific Gas & Electric	Unsecured	PCG	600	8.250	10/15/18	Aa3/BBB+	+455.7
10/15/08	Ohio Edison	Secured	FE	250	8.125	10/15/38	Baa1/BBB	+427.3
10/14/08	PPL Electric Utilities	Secured	PPL	400	7.125	11/30/13	A3/A-	+412.5
10/07/08	Detroit Edison	Secured	DTE	250	6.400	10/01/13	A3/A-	+400
10/07/08	Southern California Edison	Secured	EIX	500	5.750	03/15/14	A2/A	+340
10/01/08	Interstate Power & Light	Unsecured	LNT	250	7.250	10/01/18	A3/BBB+	+358
10/01/08	Wisconsin Power *Light	Unsecured	LNT	250	7.600	10/01/38	A2/A-	+350
09/25/08	South Carolina Electric & Gas	Secured	SCG	300	6.500	11/01/18	A2/A-	+265
09/25/08	Peco Energy	Secured	EXC	300	5.600	10/15/13	A2/A	+262.5
09/25/08	Wisconsin Electric Power Co	Unsecured	WEC	300	6.000	04/01/14	A1/A-	+300
09/08/08	Consumers Energy	Secured	CMS	350	6.125	03/15/19	Baa1/BBB	+245
09/04/08	Oklahoma Gas & Electric	Unsecured	OGE	250	6.350	09/01/18	A3/BBB	+275
09/04/08	Ohio Power Company	Unsecured	AEP	250	5.750	09/01/13	A2/BBB+	+290
09/03/08	Oncor Electric Delivery Co	Secured	TXU	650	5.950	09/01/13	Baa3/BBB	+305
09/03/08	Oncor Electric Delivery Co	Secured	TXU	550	6.800	09/01/18	Baa3/BBB	+312.5
09/03/08	Oncor Electric Delivery Co	Secured	TXU	300	7.500	09/01/38	Baa3/BBB	+320
09/03/08	Northern State Power - Wisconsin	Secured	XEL	200	6.375	09/01/38	A2/A	+210
08/27/08	Sierra Pacific Company	Secured	SRP	250	5.450	09/01/13	Baa3/BBB	+247
08/18/08	Duke Energy Indiana	Secured	DUK	500	6.350	08/15/38	A3/A	+193
08/13/08	Southern Company	Unsecured	SO	600	FRN	08/20/10	A2/A-	3mL+ 70
	2008YTD Total			**44,537**				
	2007 Comp Total			**34,346**				

*re-opening