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**Subject:** Docket No. 080317-EI  
**Attachments:** FIPUG's Motion to Strike Prefiled Testimony 01.07.09.pdf

In accordance with the electronic filing procedures of the Florida Public Service Commission, the following filing is made:

- a. The name, address, telephone number and email for the person responsible for the filing is:

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- b. This filing is made in Docket No. 080317-EI, In re: Petition for rate increase by Tampa Electric Company.

- c. The document is filed on behalf of Florida Industrial Power Users Group (FIPUG).

- d. The total pages in the document are 61 pages.

e. The attached documents are Florida Industrial Power Users Group's Motion to Strike Prefiled Testimony and Exhibits of Susan D. Abbott and Gordon L. Gillette, Exhibit A (Index of Hearsay Items), and Exhibit B (Direct Testimony and Exhibit of Susan D. Abbott), Exhibit C (Rebuttal Testimony and Exhibit of Susan D. Abbott), Exhibit D (Direct Testimony and Exhibit of Gordon L. Gillette), and Exhibit E (Rebuttal Testimony and Exhibit of Gordon L. Gillette).

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DOCUMENT NUMBER-DATE

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1/7/2009

FPSC-COMMISSION CLERK

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

In re: Petition for rate increase by Tampa  
Electric Company.

DOCKET NO. 080317-EI

FILED: January 7, 2009

**FLORIDA INDUSTRIAL POWER USERS GROUP'S  
MOTION TO STRIKE PREFILED TESTIMONY AND EXHIBITS  
OF SUSAN D. ABBOTT AND GORDON L GILLETTE**

The Florida Industrial Power Users Group (FIPUG), pursuant to rule 28-106-204, Florida Administrative Code, by and through its undersigned attorneys, moves to strike portions of the prefiled direct and rebuttal testimony (and associated exhibits) of Susan D. Abbott and Gordon L. Gillette submitted by Tampa Electric Company's (TECO) in the above-captioned matter. Specifically, FIPUG moves to strike those portions of the testimony and exhibits that are hearsay and do not supplement or explain admissible evidence. Counsel has conferred with all other parties of record, pursuant to rule 28-106-204, Florida Administrative Code, and is authorized to represent that this motion is supported by the Florida Retail Federation, AARP, Public Counsel, and the Florida Attorney General. TECO opposes this motion.

**Introduction**

1. In this rate case, TECO, among other things, is seeking to increase its base rates by more than \$228 million to become effective May 1, 2009.
2. On August 11, 2008, TECO filed the direct testimony and exhibits of Susan D. Abbott and Gordon L. Gillette.

3. On December 17, 2008, TECO filed the rebuttal testimony of Susan D. Abbott and Gordon L. Gillette.

4. Portions of this testimony, as detailed below, contain impermissible hearsay, must be stricken, and must not be used as a basis for a finding.

#### Hearsay

5. Section 90.801(1)(c), Florida Statutes, defines hearsay evidence as a statement, other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted. In many portions of both their direct and rebuttal testimony, Ms. Abbott and Mr. Gillette make statements that meet this definition.

6. With certain exceptions not applicable here, hearsay is generally inadmissible. Section 90.802, Florida Statutes.

7. Section 120.57(1)(c), Florida Statutes, addresses the use of hearsay in administrative hearings. It provides that hearsay evidence may only be used "for the purpose of supplementing or explaining other evidence, but it shall not be sufficient in itself to support a finding unless it would be admissible over objections in civil actions." None of the hearsay exceptions applicable in civil actions as set out in sections 90.803 and 90.804, Florida Statutes, are applicable in this case. *See also*, rule 28-106.213(3), Florida Administrative Code. ("hearsay evidence ... may be used to supplement or explain other evidence, but shall not be sufficient in itself to support a finding unless the evidence falls within an exception to the hearsay rule as found in chapter 90, Florida Statutes."); *BAPCO v. Unemployment Appeals Commission*, 654 So.2d 292, 296 (Fla. 5th

DCA 1995) (until evidence exists in the record for hearsay to supplement or explain, hearsay evidence is “useless” and should be excluded.).

8. The portions of Ms. Abbott’s and Mr. Gillette’s testimony indicated in the attached Exhibits A – E do not supplement or explain other evidence. Rather, they are offered to singularly establish the truth of the matter asserted. As such, they are impermissible hearsay and should be stricken. Examples of inadmissible hearsay within Ms. Abbott’s and Mr. Gillette’s testimony are:

- Ms. Abbott’s assertion in her Direct Testimony, beginning on page 17, line 24, that “S&P calls “cash-flow analysis the single most critical aspect of all credit rating decisions.”” Ms. Abbott quotes from the 2006 Standard & Poor’s Corporate Ratings Criteria. The S&P publication is a declaration made out of court, not capable of being tested by cross examination, and is classic hearsay that is not admissible to establish the truth of the matter asserted.
- Ms. Abbott’s assertion in her Direct Testimony, beginning on page 18, line 1, that “[a]lthough they do not publish a ratings grid, Moody’s and Fitch use similar financial metrics and emphasize cash flow strongly.” Ms. Abbott provides no basis for this assertion, and her statement undoubtedly is information secured from an out of court declarant or source. As such, it is a declaration made out of court, not capable of being tested by cross examination, and is classic hearsay that is not admissible to establish the truth of the matter asserted.

- Mr. Gillette's assertions in his Direct Testimony beginning on page 17, line 4, that "[t]he processes used by the rating agencies to determine credit ratings are complex and consider many qualitative and quantitative factors." Further, beginning on page 18, line 16, he states that "[a]s part of their quantitative analyses, rating agencies focus on cash coverage ratios to determine a company's ability to meet its interest payments and debt obligations." Mr. Gillette provides no basis for these assertions, and his statements undoubtedly are information secured from an out of court declarant or source. As such, they are declarations made out of court, not capable of being tested by cross examination, and are classic hearsay statements that are not admissible to establish the truth of the matter asserted.

The above examples are illustrations of two types of hearsay statements that are being offered for the truth of the matter asserted and are not admissible under Florida law. Additional passages which must be stricken on this basis are included in Exhibits A – E.

### **Conclusion**

**WHEREFORE**, for the reasons explained above, the portions of Susan D. Abbott's and Gordon L. Gillette's prefiled direct and rebuttal testimony (and associated exhibits) as specifically identified in attached Exhibits A – E are inadmissible hearsay, should be stricken, and should not be used as a basis for a finding.

s/ Vicki Gordon Kaufman

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**CERTIFICATE OF SERVICE**

I **HEREBY CERTIFY** that a true and correct copy of the Florida Industrial Power User's Group's Motion to Strike Prefiled Testimony And Exhibits Of Susan D. Abbott and Gordon L. Gillette has been furnished by electronic mail and U.S. Mail this 7<sup>th</sup> day of January, 2009, to the following:

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**FLORIDA INDUSTRIAL POWER USERS GROUP'S**  
**MOTION TO STRIKE PREFILED TESTIMONY AND EXHIBITS**  
**OF SUSAN D. ABBOTT AND GORDON L. GILLETTE**

EXHIBIT A  
Index of Hearsay Items

Direct Testimony of Susan D. Abbott

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- Page 9, lines 16 – 24
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- Page 12, lines 10 – 13
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- Page 27, lines 5 – 9
- Page 32, entire exhibit
- Page 33, entire exhibit
- Page 34, entire exhibit
- Page 35, entire exhibit

Rebuttal Testimony of Susan D. Abbott

- Page 4, lines 6 – 9
- Page 6, lines 18 – 22
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- Page 8, lines 16 – 25
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- Page 18, lines 1 – 6
- Page 18, lines 17 – 21
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Direct Testimony of Gordon L. Gillette

- Page 13, lines 7 – 10
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- Page 18, lines 16 – 22
- Page 19, lines 15 – 18
- Page 21, lines 1 – 6
- Page 44, entire exhibit

Rebuttal Testimony of Gordon L. Gillette

- Page 12, lines 1 – 4
- Page 16, lines 13 – 18
- Page 16, lines 20 – 24
- Pages 28 – 32, entire exhibit

DOCKET NO. 080317-EI  
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**FLORIDA INDUSTRIAL POWER USERS GROUP'S**  
**MOTION TO STRIKE PREFILED TESTIMONY AND EXHIBITS**  
**OF SUSAN D. ABBOTT AND GORDON L. GILLETTE**

EXHIBIT B

Direct Testimony and Exhibit of Susan D. Abbott  
(with hearsay testimony underlined)

**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**

**DIRECT TESTIMONY AND EXHIBIT  
OF  
SUSAN D. ABBOTT  
ON BEHALF OF TAMPA ELECTRIC COMPANY**

DOCUMENT NUMBER-DATE

07053 AUG 11 8

FPSC-COMMISSION CLERK

1   **A.**   There are three principal U.S. rating agencies: Moody's  
2           Investors Service ("Moody's"), Fitch Ratings ("Fitch"),  
3           and Standard and Poor's ("S&P"). They have been in  
4           business since the turn of the 20<sup>th</sup> century or shortly  
5           thereafter, and they function as gatekeepers to  
6           financial marketplaces. Their primary function is to  
7           evaluate the creditworthiness of companies wishing to  
8           access capital in the public debt markets.

9  
10          Their ratings, expressed as a series of letters and  
11          numbers, are used to indicate to investors the  
12          likelihood that a company issuing debt will pay  
13          principal and interest on time, and in amounts expected.  
14          S&P, one of the largest rating agencies in the world,  
15          defines its ratings as an "evaluation of default risk  
16          over the life of a debt issue, incorporating an  
17          assessment of all future events to the extent they are  
18          known or can be anticipated"<sup>1</sup>.

19  
20          The "rating symbols" are English alphabet letters used  
21          by all three major U.S. rating agencies and are  
22          recognizable regardless of an investor's native  
23          language. The rating scales of each major U.S. rating  
24          agency are shown in Document No. 2 of my exhibit. Each  
25          rating level represents the probability of default. The

1 lower the rating, the higher the probability of default.  
2 When ratings fall from investment grade to non-  
3 investment grade, the probability of default rises  
4 rapidly to levels that are often double those of the  
5 lowest investment grade rating.

6  
7 From 1982 through 2006, the average cumulative credit  
8 loss as the result of a default was 13.4 percent by year  
9 20 in the life of a Baa bond, according to Moody's. In  
10 the same report, they calculated that 30.8 percent of  
11 Ba- rated issuers default, a rate more than twice as  
12 high as Baa-rated securities.<sup>ii</sup> Conversely, an investor  
13 in an A rated issuer will experience 6.4 percent loss  
14 over 20 years, less than half that of a Baa rated  
15 investment and a quarter of the loss that can be  
16 expected for a Ba rated investment.<sup>iii</sup> Any company that  
17 loses its investment grade status, in addition to paying  
18 more for the money it borrows to reflect the higher  
19 probability of default, has the added challenge of  
20 trying to regain its investment grade rating. According  
21 to Moody's, fewer than 35 percent of such companies  
22 regain their investment grade rating within five  
23 years.<sup>iv</sup>

24  
25 **Q.** How are ratings used?

1 completion of critical infrastructure construction in  
2 jeopardy and undermine reliability of service.

3  
4 **Q.** What has happened in the electric industry in the past  
5 few years?

6  
7 **A.** Two things of importance. Most utilities have gone  
8 "back to basics", meaning they have adjusted their  
9 business strategies to refocus on regulated electric and  
10 gas services. The other important issue is capital  
11 spending. The last construction cycle was completed  
12 almost 20 years ago. The infrastructure of the industry  
13 needs to be renewed, and growth has necessitated  
14 additional spending for new generation equipment as well  
15 as new distribution and transmission lines in addition  
16 to the extension of those already in place. A report  
17 published on March 24, 2008 by S&P reflects its current  
18 concerns, and is titled Credit Perspective: Regulatory  
19 Risk Remains for U.S. Utilities. In it, S&P states that  
20 for "utilities...entering a multiyear capital expansion  
21 phase for growth and to accommodate mandatory  
22 environmental standards and replace aging  
23 infrastructure, borrowing needs will rise." Therefore,  
24 "regulatory risk remains key to credit quality". I  
25 believe Tampa Electric's challenges mirror those of the

1    **A.**   Regulators should be concerned about the views held by  
2           rating agencies because electric utilities are capital  
3           intensive entities that must obtain capital from the  
4           markets to provide service.   The California Public  
5           Employee Retirement System estimates that \$20 trillion  
6           needs to be invested in the U.S. infrastructure over the  
7           next 25 years.   This includes investments in electric  
8           utility transmission and distribution equipment,  
9           generation, water facilities, bridges, tunnels, and toll  
10          roads among other things.   The need for capital in the  
11          electric utility industry alone will more than double  
12          from 2004 levels to approximately \$60 billion annually  
13          by 2010 according to Lehman Brothers' estimates.<sup>v</sup>

14  
15          Utilities throughout the U.S. are faced with large  
16          capital programs needed to upgrade aging equipment,  
17          provide for growth in their service territories, make  
18          environmentally conscious investments and maintain  
19          service quality.   Utilities must rely on either debt or  
20          equity capital provided from external sources and the  
21          funds a company can generate internally to finance these  
22          capital programs.   There are no other options.   A  
23          company's creditworthiness, as expressed through its  
24          ratings, will dictate its ability to attract capital in  
25          an increasingly competitive capital market.

1 Q. What impact does regulatory action have on a utility's  
2 ratings?

3  
4 A. Quite a lot. Capital-intensive companies like utilities  
5 need to maintain access to capital markets on reasonable  
6 and sustainable terms. Regulated utilities are unique,  
7 because they are not free to set their own prices for  
8 service. Their financial integrity is a function of the  
9 way the company is managed and the price levels set by  
10 regulators in a rate case. Rates are established by  
11 regulators to permit recovery of operating expenses and  
12 to provide a fair return on the capital invested. It  
13 follows that rate decisions by utility commissions have  
14 a major impact on the financial health of utilities.

15  
16 Indeed, it is fair to say that the investment community  
17 perceives that utility commissions have a significant  
18 impact on the financial health of the utilities they  
19 regulate. For example, Moody's states that "the  
20 supportiveness of the regulatory framework under which a  
21 utility operates is a critical rating factor"<sup>vi</sup>.  
22 Moody's states further, that "the most significant risk  
23 [for utilities] might be future disallowances of  
24 investments that were made with an understanding that  
25 those investments were prudent and necessary at the time

1 they were made<sup>vii</sup>. And, in its 2008 Industry Outlook,  
2 Moody's cites as a key risk, "an increasing likelihood  
3 that utility cash outflows could materially outpace  
4 authorized cash inflows - thereby potentially creating  
5 an acute deferral/recovery overhang risk<sup>viii</sup>. S&P  
6 expressed its view on the subject even more explicitly  
7 by naming an article written in 2004, "Utility  
8 Regulation Determines its Ratings". The article is a  
9 tutorial on how S&P analyzes regulation in light of the  
10 "renewed and increasing influence that regulators are  
11 asserting on the creditworthiness of utilities...".

12  
13 **Q.** What are rating agencies looking for relative to  
14 regulation going forward?

15  
16 **A.** Rating agencies are keenly aware of the capital spending  
17 cycle utilities have just entered. They have opined  
18 that while the "fundamental credit outlook for the U.S.  
19 electric utility sector currently remains stable,  
20 material negative bias appears to be developing over the  
21 intermediate and longer term due to rapidly rising  
22 business and operating risks<sup>ix</sup>. The rising business  
23 and operating risks referred to are associated with the  
24 current building cycle. Therefore, rating agencies are  
25 looking to see whether regulators are taking sufficient

1 action to preserve the financial integrity of the  
2 utilities they regulate.

3  
4 Q. How are ratings established?

5  
6 A. Ratings analysis is a complex exercise that strives to  
7 balance financial results against qualitative risks.  
8 That result is then viewed in the context of the  
9 corporate structure and industry in which the company  
10 operates. While there are dozens of metrics calculated  
11 to determine a rating, S&P publishes a grid in which it  
12 overlays ranges of financial results for the three most  
13 important financial metrics with risk levels determined  
14 by examining a company's operating risks, political  
15 environment, and competitive position. S&P emphasizes,  
16 however, that "it is critical to realize that ratings  
17 analysis starts with the assessment of the business and  
18 competitive profile of the company. Two companies with  
19 identical financial metrics are rated very differently,  
20 to the extent that their business challenges and  
21 prospects differ"<sup>x</sup>. S&P describes its ratings grid as  
22 one that shows how "the company's business-risk profile  
23 determines the level of financial risk appropriate for  
24 any rating category"<sup>x1</sup>. The primary business risk the  
25 agencies focus on for utilities is regulation.

1       The rating agencies have their own views of the  
2       regulatory climate in which a company operates, but also  
3       pay attention to knowledgeable Wall Street and other  
4       financial firms who express views on state regulatory  
5       climates. Florida is presently regarded by a number of  
6       equity analysts as having a constructive regulatory  
7       environment because of innovative and forward looking  
8       regulatory practices, including the timely recovery of  
9       storm restoration costs as a result of hurricanes in  
10       2004 and 2005, and timely recovery of changes in fuel,  
11       purchased power, conservation, and environmental  
12       compliance costs. Regulatory Research Associates  
13       ("RRA"), a firm that focuses entirely on regulation of  
14       utilities, ranks the FPSC as "Above Average 2"<sup>xii</sup> on a  
15       scale that runs from Above Average 1 (in which there are  
16       no entries currently) to Below Average 3. The entire  
17       RRA rankings are presented in Document No. 3 of my  
18       exhibit.

19  
20       Constructive regulatory policies and practices that  
21       support the creditworthiness of the utilities a  
22       regulatory body oversees is one of the most important  
23       issues rating agencies consider when deliberating  
24       ratings. Regulation in Florida is considered among the  
25       best in the country, and that has benefited customers by

1 allowing utilities to provide for their customers' needs  
2 at a lower cost than they might otherwise. This has  
3 been one of the factors that have helped Florida  
4 utilities maintain pace with the growth in the state,  
5 which is essential to economic development.

6  
7 Q. What does S&P emphasize in its ratings grid?

8  
9 A. S&P emphasizes three metrics: 1) funds from operations  
10 as a percentage of debt outstanding ("FFO/Debt"), 2)  
11 funds from operations coverage of interest ("FFO/Int"),  
12 and 3) debt to total capitalization ("Debt/Cap"). All  
13 three metrics measure cash flow or the obligations that  
14 need to be covered by that cash. The first two are cash  
15 measurements that describe how well a company's cash  
16 flow from operations supports its debt and interest  
17 burden. The third metric, Debt/Cap, describes how heavy  
18 that burden is. Numerous other financial metrics are  
19 calculated when a rating is assigned, but cash flow  
20 metrics are the most important. After all, cash  
21 obligations can only be paid by cash. Therefore, how  
22 well a company generates cash relative to its cash  
23 obligations is critical to an analysis of  
24 creditworthiness. S&P calls "cash-flow analysis the  
25 single most critical aspect of all credit rating

1 decisions"<sup>xiii</sup>. Although they do not publish a ratings  
2 grid, Moody's and Fitch use similar financial metrics  
3 and emphasize cash flow strongly.

4  
5 Q. Do the agencies overlay qualitative measures on the  
6 financial metrics in assigning ratings?

7  
8 A. Absolutely. There are a number of qualitative issues  
9 that affect a company's rating, but the single most  
10 important qualitative risk factor analyzed by the rating  
11 agencies for electric utilities is the quality of  
12 regulation. Strategy, capital programs, customer base,  
13 and basic business profile (i.e., whether a utility is a  
14 low risk transmission and distribution company or a  
15 higher risk vertically integrated one) are all  
16 important, but a company's financial integrity is  
17 significantly impacted by the rates regulators allow a  
18 company to charge. Regulators authorize the level of  
19 return on equity, the amount of equity on which a  
20 company is allowed to earn, and rate design, and these  
21 factors help determine cash flow. Since cash flow is of  
22 resounding importance, rating agencies are keenly  
23 focused on rates and whether they create cash flow that  
24 adequately covers fixed obligations.

25

1           S&P recently changed their descriptive ratings grid  
2           relative to utilities to normalize their expression with  
3           that used for all other corporate entities. They rank  
4           companies for business risk using the following  
5           appellations: "excellent", "strong", "satisfactory",  
6           "weak", and "vulnerable". Financial risk is described  
7           as "minimal", "modest", "intermediate", "aggressive", or  
8           "highly leveraged". All utilities have been judged to  
9           have "excellent" or "strong" business risk profiles.  
10           This reflects the quality of regulation and the  
11           continued need for supportive regulation to maintain  
12           credit ratings that allow free access to capital  
13           markets. The entire S&P grid is shown in Document No. 4  
14           of my exhibit.

15  
16   **Q.**   Once ratings analysts have all of this information, how  
17           is a rating determined?

18  
19   **A.**   Ratings are determined through an extensive process that  
20           involves a detailed examination of all the information  
21           available to the analyst, and the application of a  
22           significant amount of judgment based on experience. It  
23           is always difficult to accurately predict what a rating  
24           agency will do. However, rating agencies provide  
25           investors and rated companies some guidelines as to

1 their methodologies. S&P is the most transparent about  
2 their rating practices, although their matrix that  
3 compares business risk and financial risk is very broad,  
4 so understanding when they might move a rating is  
5 extremely difficult. Nevertheless, the process rating  
6 agencies use to determine a rating is fairly  
7 straightforward. Once the financial metrics are  
8 calculated and an analyst has determined the business  
9 risk level of a company, he or she compares the results  
10 to those of comparable companies in the industry as well  
11 as against internal standards that have been developed  
12 at each rating agency.

13  
14 **Q.** In your opinion, what should Tampa Electric be targeting  
15 as its credit rating?

16  
17 **A.** Tampa Electric needs to access the capital markets in  
18 order to make capital investments for the benefit of its  
19 customers. Because it is in competition for capital  
20 with other utilities and infrastructure entities, it is  
21 essential that Tampa Electric have credit quality  
22 sufficient to ensure access to capital under all market  
23 conditions. In my opinion, that desired rating level is  
24 in the A range. To achieve this rating, regulation must  
25 support the financial integrity of the company to a

1 spending period and potential hurricane damage.

2  
3 Q. How does S&P view Tampa Electric under its descriptive  
4 ratings grid?

5  
6 A. Tampa Electric is considered to have an "excellent"  
7 business risk profile in part because it is a regulated  
8 electric utility serving a growing customer population  
9 in Florida. However, it is considered to have an  
10 "aggressive" financial risk profile, indicating that the  
11 financial metrics are relatively modest.

12  
13 S&P's business risk level of "excellent", and financial  
14 risk profile of "aggressive", qualifies the company for  
15 a BBB rating, which is the rating Tampa Electric  
16 currently has. For Tampa Electric to achieve a better  
17 rating to carry it through its construction program,  
18 during which financial stress may degrade its metrics,  
19 the company should have stronger financial metrics.  
20 Document No. 5 of my exhibit contains a comparison of  
21 Tampa Electric's financial metrics to the range needed  
22 for both the current BBB rating, assuming an "excellent"  
23 business risk ranking, as well as what is necessary to  
24 move the financial risk indication to a more reasonable  
25 "intermediate" level, which would qualify for an A

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rating.

As can be seen, Tampa Electric's metrics, especially the important cash flow metrics of FFO/Debt and FFO/Interest, currently fall in, or near, the guidelines for the BBB rating category. More importantly, however, they are deteriorating. With a heavy capital program and persistent need to access the capital markets, Tampa Electric requires healthier financial metrics to ensure capital market access on a sustainable basis. As mentioned previously, Moody's is concerned about the overall industry's financial indicators, which "have been relatively stable over the past few years ... a credit negative since stronger metrics would be needed to offset the pace of rising business and operating risk"<sup>xiv</sup>.

**Q.** Document No. 5 of your exhibit shows that some of Tampa Electric's credit metrics in 2007 and in projected 2009 fall within the A range of the S&P matrix. Doesn't that indicate that Tampa Electric already has credit metrics that should qualify it for an A rating?

**A.** Clearly not. All three of the rating agencies affirmed Tampa Electric's ratings in the BBB category. The

1 rating reports state either that Tampa Electric's credit  
2 metrics are consistent with the current rating, or that  
3 improvements in the company's credit metrics could lead  
4 to ratings improvements. The S&P matrix that compares  
5 business risk and financial risk is, as I noted, very  
6 broad and does not represent the only factors affecting  
7 a rating. For example, a utility with the same credit  
8 metrics as Tampa Electric but with modest capital needs  
9 that are expected to be met entirely with internal cash  
10 flows might be rated A. But, it is very clear that  
11 Tampa Electric has significant capital spending  
12 requirements that will require external funding, and  
13 this is a continuation of a trend that has resulted in  
14 the deterioration of the company's credit metrics over  
15 time, as Document No. 5 of my exhibit illustrates.

16  
17 **Q.** What are the most recent pronouncements of the rating  
18 agencies that you believe are relevant to Tampa  
19 Electric's financial standing?

20  
21 **A.** Most recently, Fitch affirmed Tampa Electric's rating,  
22 citing credit concerns related to construction  
23 expenditures, environmental requirements, and the need  
24 for base rate relief to maintain current metrics. At  
25 the same time, recognizing the distinction between Tampa

1 Electric and TECO Energy, Fitch upgraded TECO Energy,  
2 Tampa Electric's parent company, to BBB- (investment  
3 grade) from BB+ (non-investment grade). Similarly,  
4 Moody's affirmed Tampa Electric's ratings in December of  
5 2007 but upgraded TECO Energy's ratings. In its press  
6 release, Moody's stated that a "rating upgrade of the  
7 utility (Tampa Electric) could be considered if there is  
8 additional clarity on the size and timing of its capital  
9 expenditure program and the magnitude and regulatory  
10 response to potential rate increases related to these  
11 capital expenditures"<sup>xv</sup>. Finally, in June 2008, S&P  
12 changed its outlook on TECO Energy and Tampa Electric to  
13 positive from stable stating that the company "should be  
14 able to achieve better credit metrics as it focuses on  
15 achieving greater cash realization through the  
16 regulatory process". They go on to say that, "the  
17 company's ability to manage regulatory risk during the  
18 construction program will be an important factor in  
19 resolving the positive outlook"<sup>xvi</sup>.

20  
21 **Q.** In your opinion, what are the implications of those  
22 pronouncements for Tampa Electric?

23  
24 **A.** First, all three of the rating agencies cite the same  
25 capital program and necessary rate relief as issues of

1 concern. Moody's stated, in its Credit Opinion on Tampa  
2 Electric published in December of 2007, that "the rating  
3 is constrained by expected high capital expenditure  
4 requirements for the system reliability and  
5 environmental compliance..."<sup>xvii</sup> All three rating  
6 agencies have clearly expressed their opinion that Tampa  
7 Electric's financial position results from the need to  
8 recover significant expenditures on its system and the  
9 uncertainty regarding future rate decisions. As a  
10 result, they are keeping Tampa Electric's ratings at the  
11 RBB/Baa level in anticipation of continued financial  
12 strain and uncertainty about regulatory outcomes.

13  
14 **Q.** If the Commission approves the rate increase as  
15 requested by Tampa Electric in this proceeding, will  
16 this be sufficient to improve its credit rating?

17  
18 **A.** Yes, it should be sufficient. Looking at the S&P grid  
19 for the 2009 test year and assuming the requested rate  
20 increase is approved, the credit metrics appear to be in  
21 the range of "intermediate", and should support credit  
22 ratings in the A range. More importantly, the credit  
23 metrics would improve measurably from their current  
24 levels and reverse the declining trend, something the  
25 rating agencies have cited as a catalyst for future

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upgrades of Tampa Electric's credit ratings.

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

**A.** My direct testimony supports the conclusion that Tampa Electric's current ratings are primarily the result of 1) changes in the risk level and general nature of the regulated electric utility sector since the company's last rate filing, and 2) an unrelenting need to fund capital expenditures in order to provide service to a constantly growing customer base. I also conclude that in order for Tampa Electric to access the capital markets to continue to fund a robust and necessary capital program at costs that limit rate impacts on customers, it needs to improve its ratings to the A level. Approval of the company's requested rate increase should improve its credit metrics and result in an A level profile.

**Q.** Does that conclude your direct testimony?

**A.** Yes it does.

Rating Agencies' Rating Symbols<sup>1</sup>

<u>Investment Grade</u>	<u>Non-Investment Grade</u>
<u>AAA/Aaa</u>	<u>BB+/Ba1</u>
<u>AA+/Aa1</u>	<u>BB/Ba2</u>
<u>AA/Aa2</u>	<u>BB-/Ba3</u>
<u>AA-/Aa3</u>	<u>B+/B1</u>
<u>A+/A1</u>	<u>B/B2</u>
<u>A/A2</u>	<u>B-/B3</u>
<u>A-/A3</u>	<u>CCC+/Caa1</u>
<u>BBB+/Baa1</u>	<u>CCC/Caa2</u>
<u>BBB/Baa2</u>	<u>CCC-/Caa3</u>
<u>BBB-/Baa3</u>	<u>CC/Ca</u>
	<u>C/C</u>
	<u>D/na</u>

The definition for the lowest investment grade category, BBB/Baa (including the +, -, 1, 2, and 3 gradations) means they are "subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics."<sup>2</sup>

BB/Ba rated, or non-investment grade companies, however, "are judged to have speculative elements and are subject to substantial credit risk" while B/B rated paper is "considered speculative and ... subject to high credit risk".<sup>3</sup>  
The differences between investment grade and non-investment grade can be quite stark in terms of access to, and cost of funds in the marketplace, and at times, even the difference between interest rates required for A and BBB rated issuers can be quite striking.

<sup>1</sup> S&P and Fitch, who use the same rating symbols, appear first, with Moody's symbols after the slash

<sup>2</sup> Moody's ratings definitions, Moody's Sourcebook, Power and Energy Company, October 2004; S&P's definitions, while using different words, are essentially the same in concept.

<sup>3</sup> IBID

**Public Utility Commission Rankings**

**Compiled by Regulatory Research Associates**

**As Of April 30, 2008**

<b><u>Jurisdiction</u></b>	<b><u>RRA Ranking</u></b>
Alabama	Above Average / 2
Arkansas	Below Average / 1
Arizona	Average / 3
California	Average / 1
Colorado	Average / 2
Connecticut	Average / 3
District of Columbia	Average / 2
Delaware	Average / 1
Florida	Above Average / 2
Georgia	Average / 1
Hawaii	Average / 2
Iowa	Above Average / 3
Idaho	Average / 3
Illinois	Below Average / 2
Indiana	Above Average / 2
Kansas	Average / 3
Kentucky	Average / 2
Louisiana	Average / 3
Massachusetts	Average / 1
Maryland	Average / 2
Maine	Average / 2
Michigan	Average / 2
Minnesota	Average / 2
Missouri	Average / 3
Mississippi	Above Average / 3
Montana	Below Average / 1
North Carolina	Above Average / 2
North Dakota	Average / 2
Nebraska	Average / 2

<b><u>Jurisdiction</u></b>	<b><u>RRA Ranking</u></b>
New Hampshire	Average / 3
New Jersey	Average / 2
New Mexico	Average / 3
Nevada	Average / 2
New York	Average / 2
Ohio	Average / 2
Oklahoma	Average / 2
Oregon	Average / 3
Pennsylvania	Average / 3
Rhode Island	Average / 2
South Carolina	Average / 1
South Dakota	Average / 2
Tennessee	Average / 1
Texas	Below Average / 1
Texas	Below Average / 1
Utah	Average / 3
Virginia	Above Average / 3
Vermont	Average / 3
Washington	Average / 1
Wisconsin	Above Average / 2
West Virginia	Below Average / 1
Wyoming	Average / 2

## Standard & Poor's Corporate Ratings Matrix

Business Risk/Financial Risk						
<u>Business Risk Profile</u>	<u>Financial Risk Profile</u>					
	<u>Minimal</u>	<u>Modest</u>	<u>Intermediate</u>	<u>Aggressive</u>	<u>Highly Leveraged</u>	
<u>Excellent</u>	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>BB</u>	
<u>Strong</u>	<u>AA</u>	<u>A</u>	<u>A-</u>	<u>BBB-</u>	<u>BB-</u>	
<u>Satisfactory</u>	<u>A</u>	<u>BBB+</u>	<u>BBB</u>	<u>BB+</u>	<u>B+</u>	
<u>Weak</u>	<u>BBB</u>	<u>BBB-</u>	<u>BB+</u>	<u>BB-</u>	<u>B</u>	
<u>Vulnerable</u>	<u>BB</u>	<u>B+</u>	<u>B+</u>	<u>B</u>	<u>B-</u>	

**Specialized, Non-Utility, Public U.S. Utilities**  
 (Fully adjusted, historically demonstrated, and expected to consistently continue)

	<u>Cash Flow</u>		<u>Debt Leverage</u>
	<u>(FFO/debt)(%)</u>	<u>(FFO/interest)(x)</u>	<u>(Tot debt/cap)(%)</u>
<u>Modest</u>	<u>40 - 60</u>	<u>4.0 - 6.0</u>	<u>25 - 40</u>
<u>Intermediate</u>	<u>25 - 45</u>	<u>3.0 - 4.5</u>	<u>35 - 50</u>
<u>Aggressive</u>	<u>10 - 30</u>	<u>2.0 - 3.5</u>	<u>45 - 60</u>
<u>Highly Leveraged</u>	<u>Below 15</u>	<u>2.5 or less</u>	<u>over 50</u>

3/4

DOCKET NO. 080317-EI  
 EXHIBIT NO. \_\_\_\_\_ (SDA-1)  
 WITNESS: ABBOTT  
 DOCUMENT NO. 4  
 PAGE 1 OF 1  
 FILED: 08/11/2008

**Tampa Electric's Credit Metrics**  
**versus**  
**Standard & Poor's Metrics Matrix**  
**2004 - 2009 Test Year**

	<u>S&amp;P Ratings Level</u> (Business Risk "Excellent")								<u>Proforma Adjusted</u>	
	<u>Financial Risk</u>		<u>Actual</u>						<u>Test Year</u>	
	<u>aggressive</u>	<u>intermediate</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2009</u>	<u>2009</u>	<u>w/rates</u>	<u>w/rates (1)</u>
	<u>BBB</u>	<u>A</u>								
<u>FFO/Debt</u>	<u>10%-30%</u>	<u>25%-45%</u>	<u>36%</u>	<u>34%</u>	<u>30%</u>	<u>30%</u>	<u>30%</u>	<u>39%</u>		
<u>FFO/Interest</u>	<u>2.0x-3.5x</u>	<u>3.0x-4.5x</u>	<u>4.8x</u>	<u>4.3x</u>	<u>3.8x</u>	<u>3.7x</u>	<u>3.4x</u>	<u>4.5x</u>		
<u>Debt/Capital</u>	<u>45%-60%</u>	<u>35%-50%</u>	<u>51%</u>	<u>51%</u>	<u>54%</u>	<u>54%</u>	<u>45%</u>	<u>45%</u>		

1) Reflects full year of requested revenue increase of \$228,167,000.

DOCKET NO. 080317-EI  
EXHIBIT NO. \_\_\_\_\_ (SDA-1)  
WITNESS: ABBOTT  
DOCUMENT NO. 5  
PAGE 1 OF 1  
FILED: 08/11/2008

DOCKET NO. 080317-EI

FILED: January 7, 2009

**FLORIDA INDUSTRIAL POWER USERS GROUP'S**  
**MOTION TO STRIKE PREFILED TESTIMONY AND EXHIBITS**  
**OF SUSAN D. ABBOTT AND GORDON L. GILLETTE**

EXHIBIT C

Rebuttal Testimony and Exhibit of Susan D. Abbott  
(with hearsay testimony underlined)

**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**

**REBUTTAL TESTIMONY  
OF  
SUSAN D. ABBOTT  
ON BEHALF OF TAMPA ELECTRIC COMPANY**

DOCUMENT NUMBER - DATE

11641 DEC 17 9

FPSC - COMMISSION CLERK

1 construction program and the need to purchase large  
2 amounts of fuel and purchased power on a regular basis.  
3 Solid creditworthiness is essential for both access to  
4 the financial markets, and to make capital expenditures  
5 and to purchase fuel, materials, and supplies necessary  
6 to produce electricity for ratepayers. My testimony is  
7 meant to help the Commissioners make a fully informed  
8 decision by providing insight into 1) how financial  
9 integrity is regarded by the rating agencies, 2) how  
10 rating agency actions affect a company's access to  
11 capital, and 3) what the financial metrics would be with  
12 and without the rates requested, both cases assuming a  
13 55 percent equity level, as a way to gauge the effect on  
14 Tampa Electric's financial integrity of any decision the  
15 Commission makes. Dr. Woolridge, Mr. O'Donnell, and Mr.  
16 Herndon make no attempt whatsoever to provide  
17 information on what their recommendations would do to  
18 the financial integrity of Tampa Electric.

19

20 **Q.** How do Dr. Woolridge, Mr. O'Donnell, and Mr. Herndon  
21 reflect their interpretation of your testimony?

22

23 **A.** In his direct testimony, Dr. Woolridge states on pages  
24 85, lines 19 through 21 and 86, lines 1 and 2, that I do  
25 "not perform any studies to evaluate the adequacy of Dr.

1 Q. But shouldn't Dr. Woolridge, Mr. O'Donnell, and Mr.  
2 Herndon expect ratings analysis to include consideration  
3 of allowed returns on equity?  
4

5 A. Yes. Any credit analysis includes an examination of  
6 allowed returns on equity. However, more important to  
7 creditworthiness than the level of returns allowed is  
8 how ROE, capital structure and rate design work together  
9 in light of the level of a company's business risk to  
10 generate cash flow that is adequate to support a  
11 company's credit ratings. Mr. Herndon fatuously states  
12 that I suggest that the company's ratings would  
13 "automatically" improve if it were granted its requested  
14 return on equity. After 20 years of working at a rating  
15 agency, and more than ten years working with them from  
16 the outside, I know that nothing is "automatic" about  
17 what they do, and the return on equity is far from the  
18 only thing the rating agencies look at. What I did  
19 suggest was that approval of the requested rate increase  
20 and capital structure would improve the company's  
21 financial profile to the point where A ratings by the  
22 rating agencies would be warranted.  
23

24 Q. Why have you concluded that none of the three intervenor  
25 witnesses demonstrates an understanding of the rating

1 Q. Why is Dr. Woolridge mistaken in his approach to this  
2 issue?  
3  
4 A. The inclusion of PPAs as debt equivalents has been  
5 incorporated as a core part of utility credit analysis  
6 by the rating agencies since the early 1990s. S&P has  
7 always taken a more systematic approach to the issue  
8 than has Moody's. S&P has published numerous articles  
9 on the topic, and clearly stated in its May 7, 2007  
10 update on the topic, "in cases where a regulator has  
11 established a power cost adjustment mechanism that  
12 recovers all prudent PPA costs, we employ a risk factor  
13 of 25 percent..." Florida has established such an  
14 adjustment mechanism, and therefore, Tampa Electric  
15 qualifies for S&P's 25 percent risk factor adjustment.  
16 In addition, as Tampa Electric witness Gordon Gillette  
17 discusses in his rebuttal testimony, S&P has told Tampa  
18 Electric that this is the risk factor they use when  
19 making adjustments to the company's balance sheet. Even  
20 though there is a purchased power cost pass-through  
21 mechanism in Florida, S&P apparently believes there is  
22 enough residual risk to reflect a 25 percent risk factor  
23 in its analysis, indicating that they do not believe the  
24 pass-through clause entirely mitigates the risk of the  
25 PPAs.

1 Q. How do you respond to the claim that Moody's does not  
2 adjust for PPAs, and, therefore, those adjustments  
3 should be ignored?

4  
5 A. The truth is that Moody's does calculate a debt  
6 equivalent for PPAs. They just do not put as much  
7 weight on them as does S&P, and may not, under certain  
8 circumstances, reflect the adjustment in their metrics.  
9 Nevertheless, the concept that if rating agencies make  
10 different adjustments, those adjustments should somehow  
11 be negated makes no sense. That approach shows a lack  
12 of understanding of how investors view ratings and risk.

13  
14 Q. Why is that?

15  
16 A. If the inclusion of PPA obligations as debt equivalents  
17 results in pressure on either a rating that becomes  
18 visible to investors in the form of a negative outlook,  
19 or a lower rating than another agency has for that same  
20 company, the investors will default or give more weight  
21 to the lower outlook or rating. That negatively affects  
22 a company's ability to access the market and affects the  
23 interest rates for new debt.

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25 Q. You cited two issues Dr. Woolridge is mistaken about.

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What is the second?

A. Dr. Woolridge emphasizes that debt imputed by S&P relative to PPAs is not GAAP accounting, and therefore investors will not see the liability on the company's financial statements.

The rating agencies use GAAP statements as a starting point in their analyses. However, since they are interested only in cash flow measures of creditworthiness, they make routine adjustments to financial statements to include or exclude items. The rating agency believes those items represent a fixed obligation or change the level of cash flow. They make these adjustments regardless of what the GAAP treatment of those items may be. In addition, the rating agencies routinely publish reports on the adjustments they make, so investors are well aware of what they are. Investors do not blindly accept GAAP statements as the whole truth of a company's creditworthiness. If Dr. Woolridge understood that, he would never have made the odd statement that investors would never see the adjustments the rating agencies make.

Q. What statements did Mr. O'Donnell make that indicates he

1 A. Mr. O'Donnell is being provocative rather than helpful  
2 in his critique of my testimony. The "conflict of  
3 interest" that he refers to on page 42, lines 6 and 7,  
4 is grossly misunderstood by most and irrelevant to this  
5 case. It involves the erroneous assumption on the part  
6 of some that the rating agencies cannot be objective  
7 because they are paid by the issuers they rate. It is  
8 hard to see why, even if the assertion were true, it is  
9 relevant here. In addition, he suggests that I believe  
10 rates for electric service should be set by the rating  
11 agencies and that I do not understand the regulatory  
12 process. Further, the idea that a management concerned  
13 with its ratings is going to take risks it otherwise  
14 would not demonstrates a complete lack of understanding  
15 of rating agencies. Rating agencies do not like risk,  
16 and would, therefore downgrade or otherwise maintain a  
17 low rating on a company that increased its risk.  
18 Therefore, where is the incentive provided by a rating  
19 agency for company management to take risk? There  
20 simply is no incentive. Mr. O'Donnell's statements have  
21 nothing to do with the substance of my testimony, or  
22 Tampa Electric's financial integrity. He seems to have  
23 been unable to formulate a cogent argument as to why  
24 Tampa Electric's financial integrity is not important to  
25 the Commission, and has chosen instead to attack the

1 recovery clauses the FPSC allows which do diminish risk  
2 to a certain degree, they have not demonstrated that  
3 they understand that the utility industry suffers from  
4 high levels of financial risk.

5  
6 Q. What do you mean by "financial risk"?

7  
8 A. Rating agencies construct ratings by examining both  
9 business risk and financial risk. Business risk  
10 includes such issues as regulatory practices, the growth  
11 rates for electric service in the service territory,  
12 fuel use, customer mix, etc. Financial risk relates to  
13 how much leverage a company has and how well its cash  
14 flow covers its obligations. As I explained in my  
15 direct testimony, S&P evaluates all companies for  
16 business risk on a scale of "Excellent" to "Vulnerable",  
17 and for financial risk on a scale of "Modest" to "Highly  
18 Leveraged". Although 133 of the 180 utilities S&P rates  
19 have "Excellent" business risk profiles, meaning their  
20 business risk is low, 106 are deemed to have  
21 "Aggressive", or high financial risk, while 65 have  
22 "Intermediate" financial risk. Only one is deemed to  
23 have "Modest" financial risk. As a result, even their  
24 "Excellent" business risk positions only generate an  
25 average industry rating of BBB. In today's markets, BBB

1 utilities can not access the markets at all at times, or  
2 can do so, but only at very high cost.

3  
4 Q. What indicates that Dr. Woolridge, Mr. O'Donnell, and  
5 Mr. Herndon are out of touch with market conditions?

6  
7 A. Several things. First, Mr. Herndon illogically claims  
8 that a 7.5 percent return on equity would be attractive  
9 to investors. In the current market environment, if BBB  
10 utilities even have access to the markets, they are  
11 paying 9 percent and 10 percent for 10-year debt. No  
12 equity investor will accept an equity return that is  
13 less than the company's cost of debt, simply because the  
14 equity holder's risk is higher than the debt holder's.  
15 In fact, that subordinate position leads equity  
16 investors to demand a reasonable spread between the cost  
17 of debt and the return on equity. Mr. Herndon also  
18 compares his recommended return on equity to the risk  
19 free rate, which is quite low. In fact, the Treasury  
20 rate has been pushed down to stimulate economic growth,  
21 while the credit markets, when they are open, are  
22 requiring higher and higher spreads to that Treasury  
23 rate. The new issue bond market was closed entirely for  
24 two weeks in September. When it reopened, it opened to  
25 A and AA rated utilities and AAA corporations. Spreads,

1 which had been in the 175 to 300 basis points range for  
2 A rated utilities at the low end, and split rated  
3 utilities in the BBB range at the high end, prior to the  
4 market closing increased to 350, then 400, and were  
5 recently at almost 700 basis points for unsecured 10  
6 year debt of investment grade split rated companies.  
7 Dr. Woolridge claims that capital costs are at historic  
8 lows. This is the same misinformation provided by Mr.  
9 Herndon. Treasury rates may be at historic lows, but  
10 utilities do not borrow at Treasury rates. The evidence  
11 is clear that interest rates required by investors to  
12 lend money to utilities are higher than they have been  
13 since the recovery from the economic slump of the early  
14 1990's. In addition, the difference in cost from one  
15 rating category to the next is higher than it has been  
16 in at least 20 years. More importantly, access is  
17 limited. Despite most utilities having aggressive  
18 construction spending needs, issuance of utility debt in  
19 the U.S. dropped in the third quarter of this year by  
20 half, from \$20.1 billion to \$9.7 billion, according to  
21 Dealogic.

22  
23 Q. The absence of a study of the cost of an increase in  
24 Tampa Electric's ratings, assuming the requested return  
25 on equity is granted, has been criticized by both Mr.

1 the targeted 55.3 percent equity ratio, with and without  
2 the requested rate increase. However, Tampa Electric's  
3 witness Mr. Gillette provided a complementary exhibit to  
4 mine which included what the financial metrics would be  
5 without the proposed rate increase at Tampa Electric's  
6 2007 equity ratio of 46 percent. The resulting  
7 financial metrics indicate the company needs both rate  
8 relief and the proposed equity ratio to be more assured  
9 of achieving credit rating parameters within its  
10 targeted single A debt rating.

11  
12 **Q.** Please summarize your rebuttal testimony.

13  
14 **A.** My rebuttal testimony explains my view that Dr.  
15 Woolridge, Mr. O'Donnell and Mr. Herndon either did not  
16 understand, or will not acknowledge that my direct  
17 testimony was in support of Tampa Electric's need for  
18 improved financial integrity in order to access the  
19 capital markets to successfully pursue an ambitious  
20 construction program undertaken for the benefit of  
21 ratepayers. None of them explored what their own  
22 recommendations meant to the financial integrity of the  
23 company, and they seem to have failed to understand the  
24 benefits to both consumers and financial partners of a  
25 financially healthy utility. I have demonstrated that,

1 contrary to Dr. Woolridge, Mr. O'Donnell and Mr.  
2 Herndon's claims, the financial markets are both  
3 difficult to access and are demanding higher rates of  
4 interest, even for what would be considered  
5 "creditworthy" entities. I have also injected some  
6 balance into their views of how much risk the utility  
7 industry endures. My direct and rebuttal testimonies  
8 were written to illuminate the issue of financial  
9 integrity and how important it is to a company that  
10 needs to access the capital markets on a regular basis.  
11 Not one of the witnesses acknowledges my focus on cash  
12 flow and how a regulatory decision affects credit  
13 metrics. The Commissioners, while taking into  
14 consideration all of the relevant testimony provided  
15 them in this case, must understand that their decision,  
16 which is theirs alone to make, will have a profound  
17 impact on Tampa Electric's ability to access the capital  
18 markets, and at what price. Credit metrics combined  
19 with business risk factors dictate the level of a  
20 company's creditworthiness. Creditworthiness defines  
21 the ability of a company to access the capital markets.  
22 With a \$3.5 billion construction program in progress,  
23 Tampa Electric needs to improve and then maintain its  
24 financial integrity in order to access the markets at  
25 will. This message was lost on Dr. Woolridge, Mr.

DOCKET NO. 080317-EI

FILED: January 7, 2009

**FLORIDA INDUSTRIAL POWER USERS GROUP'S**  
**MOTION TO STRIKE PREFILED TESTIMONY AND EXHIBITS**  
**OF SUSAN D. ABBOTT AND GORDON L. GILLETTE**

EXHIBIT D

Direct Testimony and Exhibit of Gordon L. Gillette  
(with hearsay testimony underlined)

**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**



**DIRECT TESTIMONY AND EXHIBIT  
OF  
GORDON L. GILLETTE**

DOCUMENT NUMBER-DATE

07052 AUG 11 8

FPSC-COMMISSION CLERK

1 Financial strength is often referred to in regulatory  
2 circles as "financial integrity". If the company and its  
3 regulators act in ways that maintain or enhance the  
4 company's financial integrity, customers will ultimately  
5 benefit. The Commission has a history of performing the  
6 delicate balancing act between rate increases and  
7 maintaining financial integrity very well. The rating  
8 agencies and Wall Street alike have long recognized the  
9 Commission for its constructive regulatory decision  
10 making. The Commission is viewed by Wall Street and the  
11 public as being tough but fair in reaching an appropriate  
12 balance between the interests of customers and investors.

13  
14 **CREDIT RATING OBJECTIVE**

15 **Q.** What is Tampa Electric's current credit rating?

16  
17 **A.** Tampa Electric is currently rated in the BBB range by the  
18 three major rating agencies: Standard & Poor's ("S&P"),  
19 Moody's Investor Service ("Moody's") and Fitch Ratings  
20 ("Fitch"). In her direct testimony, witness Abbott  
21 explains in more detail how the rating agencies currently  
22 view Tampa Electric and how they have derived their  
23 ratings for the company.

24  
25 **Q.** What credit rating is the company targeting in the future

1 Q. Do the credit rating agencies publicly announce or  
2 publish what it takes to achieve certain credit ratings?

3  
4 A. No. The processes used by the rating agencies to  
5 determine credit ratings are complex and consider many  
6 qualitative and quantitative factors. The ratings  
7 process typically provides little transparency, and the  
8 rating agencies publish no precise guidelines regarding  
9 how to achieve a certain rating. S&P is the only rating  
10 agency that has even attempted to provide some level of  
11 quantitative guidance. Some years ago, S&P published a  
12 matrix that identified ranges of credit parameters, such  
13 as coverage ratios, necessary to achieve certain credit  
14 ratings. However, S&P has recently modified this matrix,  
15 broadening the ranges for the ratings and leaving more  
16 room for judgment on their part, but creating greater  
17 uncertainty on the part of debt issuers, like Tampa  
18 Electric, on the exact quantitative targets needed to  
19 achieve certain credit ratings. In addition, since the  
20 rating agencies consider qualitative factors as well,  
21 achieving the quantitative parameters does not ensure  
22 that a particular rating will actually be achieved.

23

24 **CAPITAL STRUCTURE**

25 Q. What capital structure is Tampa Electric proposing in its

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test year?

A. Tampa Electric is projecting, for the 2009 test year, a jurisdictional adjusted 13-month average financial capital structure consisting of 44.7 percent debt, including off-balance sheet purchased power obligations, and 55.3 percent common equity. This 55.3 percent equity ratio is necessary since the company believes the combination of this capital structure and the resulting coverage ratios should enable the achievement of credit parameters commensurate with debt ratings in the single A range.

Q. What coverage ratios are important to rating agencies?

A. As part of their quantitative analyses, rating agencies focus on cash coverage ratios to determine a company's ability to meet its interest payments and debt obligations. Typical coverage ratios reviewed by the agencies are Funds from Operations to Interest (FFO/Interest) and Funds from Operations to Total Debt (FFO/Debt). Document No. 5 of my exhibit shows Tampa Electric's credit parameters on a historical and projected basis. It shows that there has been a significant deterioration in Tampa Electric's credit

1 metrics as used by the credit rating agencies. If Tampa  
2 Electric's requested rate increase was not granted and  
3 the capital structure remained at the 2007 level, there  
4 would be another significant decline in the credit  
5 parameters. For Tampa Electric to improve its credit  
6 metrics, equity infusions from TECO Energy and base rate  
7 relief are needed. In her direct testimony, witness  
8 Abbott further addresses these credit parameters and the  
9 effect these factors have on Tampa Electric's credit  
10 ratings.

11  
12 **Q.** Did you consider other credit parameters when targeting  
13 ratings in the single A range?

14  
15 **A.** Yes. Although the rating agencies tend to focus on cash  
16 coverage ratios, another commonly used parameter in the  
17 utility industry is an Earnings Before Interest and Taxes  
18 to Interest (EBIT/Interest) coverage ratio. This  
19 coverage ratio is included in the company's MFR Schedule  
20 D-9 and is reported in Schedule 5 of the company's  
21 monthly Surveillance Report filings. Tampa Electric's  
22 coverage ratio for EBIT/Interest has been declining and  
23 is projected to be 2.1 times in 2009. This same coverage  
24 ratio averaged 4.6 times in 1992 through 2000 and 3.5  
25 times in 2001 through 2007. The 2.1 times represents an

- 1 **A.** Yes. Since the rating agencies consider portions of  
2 long-term fixed payments associated with purchased power  
3 agreements as debt and analyze company credit profiles  
4 with an adjustment to its credit parameters, the  
5 company's proposed capital structure reflects an  
6 adjustment for this imputation of additional debt.  
7
- 8 **Q.** Using the S&P methodology, please describe the  
9 calculation for the additional debt that reflects the  
10 associated risk of long-term purchased power agreements  
11 in Tampa Electric's capital structure.  
12
- 13 **A.** S&P discounts future capacity payments using a discount  
14 rate based on the cost of debt, and then applies a "risk  
15 factor" to determine the amount of imputed debt to  
16 include in the adjusted debt to total capital. For  
17 similarly situated electric utilities as Tampa Electric,  
18 S&P uses a risk factor of 25 percent. S&P also imputes  
19 an annual amount for interest expense in cash coverage  
20 ratios for the imputed debt.  
21
- 22 **Q.** Using S&P's methodology, how much debt and interest  
23 expense has been imputed to recognize the impact of  
24 purchased power agreements on Tampa Electric's capital  
25 structure for 2009?

Utility Credit Ratings\*

	<u>S&amp;P</u>	<u>%</u>	<u>Moody's</u>	<u>%</u>	<u>Fitch</u>	<u>%</u>
Nationwide number of utilities at ratings level						
of:						
AA	0	0.0%	0	0.0%	0	0.0%
A	24	25.0%	29	33.8%	19	24.0%
BBB	60	62.5%	50	58.1%	47	59.5%
BB	12	12.5%	7	8.1%	13	16.5%
B	0	0.0%	0	0.0%	0	0.0%
	96	100.0%	86	100.0%	79	100.0%

	<u>S&amp;P</u>	<u>%</u>	<u>Moody's</u>	<u>%</u>	<u>Fitch</u>	<u>%</u>
Southeast number of utilities at ratings level						
of:						
AA	0	0.0%	0	0.0%	0	0.0%
A	8	53.3%	9	60.0%	8	61.5%
BBB	7	46.7%	5	33.3%	4	30.8%
BB	0	0.0%	1	6.7%	1	7.7%
B	0	0.0%	0	0.0%	0	0.0%
	15	100.0%	15	100.0%	13	100.0%

\*Derived from the Regulatory Research Associates Credit Rating Report as of May 30, 2008. Excludes Tampa Electric.

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**FLORIDA INDUSTRIAL POWER USERS GROUP'S**  
**MOTION TO STRIKE PREFILED TESTIMONY AND EXHIBITS**  
**OF SUSAN D. ABBOTT AND GORDON L. GILLETTE**

EXHIBIT E

Rebuttal Testimony and Exhibit of Gordon L. Gillette  
(with hearsay testimony underlined)

**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**



**REBUTTAL TESTIMONY AND EXHIBIT  
OF  
GORDON L. GILLETTE**

DOCUMENT NUMBER - DATE

11-6-10 080317-EI

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

9  
10 **CAPITAL STRUCTURE**

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

16  
17 **A.** In the interest of lowering the revenue requirement, the  
18 intervenor witnesses have recommended much lower equity  
19 ratios than the company has proposed. Although they  
20 derived their recommended equity ratios using different  
21 arguments or justifications which I will discuss later in  
22 my testimony, their recommendations were similar (48.9  
23 percent and 49.6 percent) compared to the company's  
24 proposed 55.32 percent. While Mr. O'Donnell's 49.6  
25 percent recommendation was not stated directly in his

1 A. Dr. Woolridge makes three basic points in support of his  
2 position that a PPA adjustment is not warranted; 1) the  
3 risk factor is not defined, 2) the adjustment is not in  
4 accordance with GAAP accounting, and 3) the PPA payments  
5 are unlike debt. While Ms. Abbott addresses some of  
6 these issues in her rebuttal testimony, I have a few  
7 additional comments regarding his first and third points.  
8

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



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

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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 burden 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						

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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	600,000	4,200,000**
<b>NPV of fixed capacity commitments</b>								
Using a 6.0% discount rate	5,030,306							
Application of an assumed 25% risk factor	1,257,577							
Implied interest expense <sup>1</sup>	75,455							
Implied depreciation expense	74,545							
<b>Unadjusted ratios</b>								
FFO to interest (%)	5.9							
FFO to total Debt (%)	20.0							
Debt to capitalization (%)	55.0							
<b>Ratios adjusted for debt imputation</b>								
FFO to interest (%) <sup>1</sup>	4.0							
FFO to total debt (%)**	18.0							
Debt to capitalization (%) <sup>1</sup> **	59.0							

<sup>1</sup>Thereafter, approximately years: 2. <sup>2</sup>The current year's implied interest is subtracted from the product of the risk factor multiplied by the current year's capacity payment. <sup>3</sup>Adds implied interest to the numerator and denominator and adds implied depreciation to FFO. <sup>4</sup>Adds implied depreciation expense to FFO and implied debt to reported debt. <sup>5</sup>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 protected 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 protected 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**

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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. In spite 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.

#### **Additional Contacts:**

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TAMPA ELECTRIC COMPANY  
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DOCUMENT NO. 1  
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TAMPA ELECTRIC COMPANY  
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