BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Tampa Electric Company.	DOCKET NO. 080317-EI ORDER NO. PSC-09-0034-PCO-EI ISSUED: January 16, 2009

ORDER DENYING MOTION TO STRIKE AND CROSS MOTION TO STRIKE

On January 7, 2009, Florida Industrial Power Users Group (FIPUG), an intervenor in this rate proceeding, filed a Motion to Strike several portions of the prefiled testimony and exhibits of two Tampa Electric Company (TECO) witnesses. Witnesses Susan D. Abbott and Gordon L. Gillette proffer opinions on cost of capital issues that have been raised in this case. In their testimony, the witnesses propose a rate of return on investment for TECO that they believe will ensure that TECO will have reasonable access to capital markets. They support their opinions by relying upon information from a variety of sources of financial information, including rating agencies like Moody's Investors Service (Moody's) and Standard and Poors' (S&P). FIPUG objects to the inclusion of this information in the record on the grounds that it is hearsay evidence offered as the only evidence in the record to support a finding, and therefore inadmissible in this administrative proceeding.[1] Attachment A to this Order includes FIPUG's index of hearsay items, the direct testimony and exhibits of Susan D. Abbott, the rebuttal testimony and exhibits of Susan D. Abbott, with hearsay testimony underlined, and the direct testimony and exhibits of Gordon L. Gillette, with hearsay testimony underlined.

On January 14, 2009, TECO responded in opposition to FIPUG's motion to strike, contending that the rating agency information was admissible evidence because it supported the opinions of its expert witnesses on cost of capital issues, was based on personal knowledge, and was the type of information which experts in financial analysis reasonably rely upon in forming their opinions. In addition, TECO filed a Cross-Motion to Strike the prefiled testimony and exhibits of Office of Public Counsel (OPC) witness J. Randall Woolridge and Florida Retail Federation (FRF) witness Kevin W. O'Donnell. They also proffered opinions on the cost of capital issues identified in the case, and supported their opinions on the appropriate rate of return for TECO with information from S&P, Moody's, and other sources of financial information. TECO argued that their testimony should be stricken from the record if TECO's witnesses' testimony were stricken from the record. Attachment B to this Order includes TECO's index of hearsay in witness Woolridge's and witness O'Donnell's testimony and exhibits, the testimony and exhibits of Dr. J. Randell Woolridge, with hearsay testimony underlined, and the testimony and exhibits of Kevin W. O'Donnell, with hearsay testimony underlined.

[1] Section 90.801(c), F.S. defines hearsay as follows:

> 'Hearsay' is 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.

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Section 120.57(1) (c), Florida Statutes (F.S.) provides that in administrative hearings:

> Hearsay evidence may 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 objection in civil actions.

Rule 28-106.213(3), Florida Administrative Code, (F.A.C.) also provides that:

> Hearsay evidence, whether received in evidence over objection or not, 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, F.S.

The statute and the rule cited above provide two circumstances in which hearsay evidence is admissible in administrative proceedings. First, it is admissible if it is used to supplement or explain other evidence. Second, it is admissible if it falls within an exception to the hearsay rule in the Evidence Code. Upon consideration of the parties' legal arguments, and after careful review of the evidence in question, it is clear to me that the hearsay evidence satisfies both criteria for admissibility. It supplements and explains the witnesses' opinion testimony on TECO's cost of capital, access to capital markets, and appropriate return on equity, and it qualifies as an exception to the hearsay rule because it consists of facts or data that are of a type reasonably relied upon by experts in the subject matter to support the witnesses' opinion testimony.[2] Section 90.704, F.S. provides an exception to the hearsay rule for this type of evidence. Masters v. State, 958 So.2d 973, 975 (Fla. 5th DCA 2007). That statute states:

> The facts or data upon which an expert bases an opinion may be those perceived by, or made known to, the expert at or before trial. If the facts or data are of a type reasonably relied upon by experts in the subject to support the opinion expressed, the facts or data need not be admissible in evidence.

As these motions to strike indicate, TECO, OPC, and FRF's cost of capital witnesses relied on facts and data provided by ratings agencies and other financial reports to support their opinions, and thus it is clear that the information is of a type reasonably relied upon by experts to support their opinions. As TECO points out, the rating agency data is not the substantive evidence in this case. It is the witnesses' opinions and recommendations on TECO's financial needs, supported by the financial data, which is the substantive evidence here. Further, I agree with TECO that much of the evidence FIPUG highlights consists of the witnesses' personal knowledge of the financial industry, and is not hearsay at all.

For the reasons outlined above, I deny FIPUG's Motion to Strike and TECO's Cross-Motion to Strike.

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[2] It should be noted that neither FIPUG nor TECO objected to these witnesses' expert qualifications in their prehearing statements as required by Order Establishing Procedure No. PSC-08-0557-PCO-EI, issued August 26, 2008, or at the prehearing conference held January 7, 2009. It appears that the witnesses are all well-qualified to provide opinion testimony in this proceeding.

By ORDER of Commissioner Nathan A. Skop, as Prehearing Officer, this 16th day of January, 2009.

NATHAN A. SKOP
Commissioner and Prehearing Officer

(SEAL)

MCB

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

Any party adversely affected by this order, which is preliminary, procedural or intermediate in nature, may request: (1) reconsideration within 10 days pursuant to Rule 25-22.0376, Florida Administrative Code; or (2) judicial review by the Florida Supreme Court, in the case of an electric, gas or telephone utility, or the First District Court of Appeal, in the case of a water or wastewater utility. A motion for reconsideration shall be filed with the Office of Commission Clerk, in the form prescribed by Rule 25-22.0376, Florida Administrative Code. Judicial review of a preliminary, procedural or intermediate ruling or order is available if review of the final action will not provide an adequate remedy. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.

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

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

Their ratings, expressed as a series of letters and numbers, are used to indicate to investors the likelihood that a company issuing debt will pay principal and interest on time, and in amounts expected. S&P, one of the largest rating agencies in the world, defines its ratings as an "evaluation of default risk over the life of a debt issue, incorporating an assessment of all future events to the extent they are known or can be anticipated"[1].

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

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

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

Q. How are ratings used?

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

Q. What has happened in the electric industry in the past few years?

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

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

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

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

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

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

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

Q. What are rating agencies looking for relative to regulation going forward?

A. Rating agencies are keenly aware of the capital spending cycle utilities have just entered. They have opined that while the "fundamental credit outlook for the U.S. electric utility sector currently remains stable, material negative bias appears to be developing over the intermediate and longer term due to rapidly rising business and operating risks"[ix]. The rising business and operating risks referred to are associated with the current building cycle. Therefore, rating agencies are looking to see whether regulators are taking sufficient

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

Q. How are ratings established?

A. Ratings analysis is a complex exercise that strives to balance financial results against qualitative risks. That result is then viewed in the context of the corporate structure and industry in which the company operates. While there are dozens of metrics calculated to determine a rating, S&P publishes a grid in which it overlays ranges of financial results for the three most important financial metrics with risk levels determined by examining a company's operating risks, political environment, and competitive position. S&P emphasizes, however, that "it is critical to realize that ratings analysis starts with the assessment of the business and competitive profile of the company. Two companies with identical financial metrics are rated very differently, to the extent that their business challenges and prospects differ"[x]. S&P describes its ratings grid as one that shows how "the company's business-risk profile determines the level of financial risk appropriate for any rating category"[xi]. The primary business risk the agencies focus on for utilities is regulation.

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

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

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

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

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

decisions"[xiii]. Although they do not publish a ratings grid, Moody's and Fitch use similar financial metrics and emphasize cash flow strongly.

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

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

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

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

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

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

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

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

spending period and potential hurricane damage.

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

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

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

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~~"[xiv].

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

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

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

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

Electric and TECO Energy, Fitch upgraded TECO Energy, Tampa Electric's parent company, to BBB- (investment grade) from BB+ (non-investment grade). Similarly, Moody's affirmed Tampa Electric's ratings in December of 2007 but upgraded TECO Energy's ratings. In its press release, Moody's stated that a "rating upgrade of the utility (Tampa Electric) could be considered if there is 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"[xv]. Finally, in June 2008, S&P changed its outlook on TECO Energy and Tampa Electric to positive from stable stating that the company "should be able to achieve better credit metrics as it focuses on achieving greater cash realization through the regulatory process". They go on to say that, "the company's ability to manage regulatory risk during the construction program will be an important factor in resolving the positive outlook"[xvi].

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

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

concern. Moody's stated, in its Credit Opinion on Tampa Electric published in December of 2007, that "the rating is constrained by expected high capital expenditure requirements for the system reliability and environmental compliance…".[xvii] All three rating agencies have clearly expressed their opinion that Tampa Electric's financial position results from the need to recover significant expenditures on its system and the uncertainty regarding future rate decisions. As a result, they are keeping Tampa Electric's ratings at the BBB/Baa level in anticipation of continued financial strain and uncertainty about regulatory outcomes.

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

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

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.

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Rating Agencies' Rating Symbols[1]

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

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."[2]

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".[3] 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.

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

2 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.

3 IBID

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Public Utility Commission Rankings

Compiled by Regulatory Research Associates

As Of April 30, 2008

Jurisdiction	RRA Ranking
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

Jurisdiction	RRA Ranking
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

Attachment A

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EXHIBIT NO. ___ (SDA-1)
WITNESS: ABBOTT
DOCUMENT NO. 3
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Public Utility Commission Rankings

Compiled by Regulatory Research Associates

As Of April 30, 2008

Jurisdiction	RRA Ranking
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

Jurisdiction	RRA Ranking
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

Attachment A

Standard & Poor's Corporate Ratings Matrix

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

Utilities

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

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

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Attachment A

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

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

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

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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 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

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

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

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

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

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

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

Q. Why is Dr. Woolridge mistaken in his approach to this issue?

A. The inclusion of PPAs as debt equivalents has been incorporated as a core part of utility credit analysis by the rating agencies since the early 1990s. S&P has always taken a more systematic approach to the issue than has Moody's. S&P has published numerous articles on the topic, and clearly stated in its May 7, 2007 update on the topic, "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 percent." Florida has established such an adjustment mechanism, and therefore, Tampa Electric qualifies for S&P's 25 percent risk factor adjustment. In addition, as Tampa Electric witness Gordon Gillette discusses in his rebuttal testimony, S&P has told Tampa Electric that this is the risk factor they use when making adjustments to the company's balance sheet. Even though there is a purchased power cost pass-through mechanism in Florida, S&P apparently believes there is enough residual risk to reflect a 25 percent risk factor in its analysis, indicating that they do not believe the pass-through clause entirely mitigates the risk of the PPAs.

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

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

Q. Why is that?

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

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

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

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

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

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

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

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

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

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

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

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

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

Q. Please summarize your rebuttal testimony.

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

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

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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

TECO
TAMPA ELECTRIC

DIRECT TESTIMONY AND EXHIBIT

OF

GORDON L. GILLETTE

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

CREDIT RATING OBJECTIVE

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

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

Q. What credit rating is the company targeting in the future

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

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

CAPITAL STRUCTURE

Q. What capital structure is Tampa Electric proposing in its

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

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

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

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

A. Yes. Since the rating agencies consider portions of long-term fixed payments associated with purchased power agreements as debt and analyze company credit profiles with an adjustment to its credit parameters, the company's proposed capital structure reflects an adjustment for this imputation of additional debt.

Q. Using the S&P methodology, please describe the calculation for the additional debt that reflects the associated risk of long-term purchased power agreements in Tampa Electric's capital structure.

A. S&P discounts future capacity payments using a discount rate based on the cost of debt, and then applies a "risk factor" to determine the amount of imputed debt to include in the adjusted debt to total capital. For similarly situated electric utilities as Tampa Electric, S&P uses a risk factor of 25 percent. S&P also imputes an annual amount for interest expense in cash coverage ratios for the imputed debt.

Q. Using S&P's methodology, how much debt and interest expense has been imputed to recognize the impact of purchased power agreements on Tampa Electric's capital structure for 2009?

Attachment A

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Utility Credit Ratings*

Nationwide number of utilities at ratings level of:	S&P	%	Moody's	%	Fitch	%
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%

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
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OF

GORDON L. GILLETTE

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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

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.

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TAMPA ELECTRIC COMPANY
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STANDARD & POOR'S RatingsDirect

RESEARCH

Criteria | Corporates | Utilities:

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

Publication date: 07-May-2007
Primary Credit Analyst: David Bodek, New York (1) 212-438-7989; david_bodek@standardandpoors.com
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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 considered 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 include debt for that contract until the year that energy delivering 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 for [illegible] 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 mechanism s 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 in achieving the lowest risk factor.

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	1,000,000					
Funds from operations	1,500,000					
Interest expense	400,000					
Adjustable imputed debt						

Attachment A

TAMPA ELECTRIC COMPANY
DOCKET NO. 080317-EI
REBUTTAL EXHIBIT NO. ____ (GLG-2)
WITNESS: GILLETTE
DOCUMENT NO. 1
PAGE 3 OF 5
FILED: 12/17/08

TAMPA ELECTRIC COMPANY
DOCKET NO. 080317-EI
OPC'S THIRD REQUEST FOR PODS
FILED: SEPTEMBER 29, 2008

Short-term debt	600,000						
Long-term due within one year	300,000						
Long-term debt	6,582,000						
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							
EBITDA interest (x)	5.4						
FFO to total Debt (%)	20.0						
Debt to capitalization (%)	55.0						
Ratios adjusted for debt imputation							
FFO to interest (x)‡	4.8						
FFO to total debt (%)**	18.0						
Debt to capitalization (%)††	59.0						

*Thereafter escalating years; §, ¶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 reasonably correspond to long-term load service 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 development new available 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 a utility's [illegible]. 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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Attachment A

TAMPA ELECTRIC COMPANY
DOCKET NO. 080317-EI
REBUTTAL EXHIBIT NO. ___ (GLG-2)
WITNESS: GILLETTE
DOCUMENT NO. 1
PAGE 5 OF 5
FILED: 12/17/08

TAMPA ELECTRIC COMPANY
DOCKET NO. 080317-EI
OPC'S THIRD REQUEST FOR PODS
FILED: SEPTEMBER 29, 2008

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Attachment B

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State of Florida

Before the

Florida Public Service Commission

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

Prepared Direct Testimony

of

Kevin W. O'Donnell, CFA

On Behalf of the

Florida Retail Federation

November 26, 2008

COM ___
ECR 5
GCL 1
OPC ___
RCP 1
SSC 1
SGA 1
ADM ___
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structure, and other regulatory issues in general rate cases, fuel cost proceedings, and other proceedings before the North Carolina Utilities Commission and the South Carolina Public Service Commission. In 1996, I testified before the U.S. House of Representatives, Committee on Commerce and Subcommittee on Energy and Power, concerning competition within the electric utility industry. Additional details regarding my education and work experience are set forth in Appendix A to my direct testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purposes of my testimony are to recommend a reasonable rate of return on common equity that Tampa Electric should be allowed in this proceeding, to provide analysis and recommendations regarding the correct capital structure to be used in setting Tampa Electric's rates, and to comment on the testimony of Tampa Electric's witnesses Murry and Abbott. In particular, I believe that Ms. Abbott's testimony provides no value to Tampa Electric's customers and accordingly, Tampa Electric should not be allowed to recover any of the $290,000 in proposed fees and costs for her testimony. I also recommend that the $116,000 in rate case expenses for the services of JM Cannell be denied as Ms. Cannell offers no testimony at all in this proceeding.

Q. WHAT IS YOUR OPINION OF THE COMPANY'S REQUESTED REVENUE INCREASE IN THIS CASE?

A. I believe that Tampa Electric's requested revenue increase in this case is excessive and cannot be supported by the evidence put forward by the Company in its application or by the realities of relevant capital markets. To be specific, the Company's requested after-tax return on equity, which is a measure of its profitability, of 12.00% is excessive and not at all representative of current market conditions This conclusion is strongly confirmed by the fact that Tampa Electric faces very low risk as a regulated

monopoly company providing a product that is truly a necessity, with the very great degree of revenue certainty that Tampa Electric enjoys. Similarly, the Company's requested capital structure is not representative of the manner in which Tampa Electric finances its rate base investment and is therefore improper for use in this proceeding.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS CASE.

A. My recommendations in this case are as follows:

1. the return on equity that Tampa Electric should be granted in this case is in the range of 9.25% to 10.25% with a specific recommendation of 9.75%;

2. the capital structure that best reflects Tampa Electric's actual rate base investment is the Company's 13-month average capital structure adjusted for the proportionate use of the parent company's debt as equity in the subsidiary's capital structure;

3. Tampa Electric's request to recover the rate case expenses associated with Susan Abbott's testimony should be denied because Ms. Abbott's testimony provides no value whatsoever to Tampa Electric's customers.

4. the requested rate case expenses of $116,000 for JM Cannell should also be denied as Ms. Cannell provides no recommendations in this case nor even provides basic testimony.

Q. HOW IS YOUR TESTIMONY STRUCTURED?

A. The remainder of my testimony is divided into nine sections as follows:

I. Economic and Legal Guidelines for Fair Rate of Return

II. Cost of Common Equity

- A. DCF Analysis
- B. Comparable Earnings Analysis
- C. Return on Equity Recommendation

III. Capital Structure and Overall Rate of Return

I. ECONOMIC AND REGULATORY POLICY GUIDELINES FOR A FAIR RATE OF RETURN

Q. PLEASE BRIEFLY DESCRIBE THE ECONOMIC AND REGULATORY POLICY CONSIDERATIONS YOU HAVE TAKEN INTO ACCOUNT IN DEVELOPING YOUR RECOMMENDATION CONCERNING THE FAIR RATE OF RETURN THAT TAMPA ELECTRIC SHOULD BE ALLOWED THE OPPORTUNITY TO EARN.

A. The theory of utility regulation assumes that public utilities are natural monopolies. Historically, it was believed or assumed that it was more efficient for a single firm to provide a particular utility service than multiple firms. Even though deregulation for the procurement of natural gas and electric utility supplies is rapidly spreading, the delivery of these products to end-use customers will continue to be considered a natural monopoly for the foreseeable future. When it is deemed that a perceived natural monopoly does in fact exist, regulatory authorities regulate the service areas in which regulated utilities provide service, e.g. by assigning exclusive franchised territories to public utilities or by determining territorial boundaries where disputes arise (as in Florida), in order for these utilities to provide services more efficiently and at the lowest possible cost. In exchange for the protection of its monopoly service area, the utility is obligated to provide adequate service at a fair, regulated price.

This naturally raises the question - what constitutes a fair price? The generally accepted answer is that a prudently managed utility should be allowed to charge prices that allow the utility the opportunity to recover the reasonable and prudent costs of providing utility service and the opportunity to earn a fair rate of return on invested capital. This fair rate of return on

capital should allow the utility, under prudent management, to provide adequate service and attract capital to meet future expansion needs in its service area. Obviously, since public utilities are capital-intensive businesses, the cost of capital is a crucial issue for utility companies, their customers, and regulators. If the allowed rate of return is set too high, then consumers are burdened with excessive costs, current investors receive a windfall, and the utility has an incentive to overinvest. If the return is set too low, adequate service is jeopardized because the utility will not be able to raise new capital on reasonable terms.

Since every equity investor faces a risk-return tradeoff, the issue of risk is an important element in determining the fair rate of return for a utility.

Regulatory law and policy recognize that utilities compete with other forms in the market for investor capital. In the case of Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944), the U.S. Supreme Court recognized that utilities compete with other firms in the market for investor capital. Historically, this case has provided legal and policy guidance concerning the return which public utilities should be allowed to earn:

In that case, the U.S. Supreme Court specifically stated that:

> "...the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain credit and attract capital." (320 U.S. at 603)

II. COST OF COMMON EQUITY

Q. PLEASE EXPLAIN HOW THE ISSUE OF DETERMINING AN APPROPRIATE RETURN ON A UTILITY'S COMMON EQUITY INVESTMENT FITS INTO A REGULATORY AUTHORITY'S DETERMINATION OF FAIR, JUST, AND REASONABLE RATES FOR THE UTILITY.

A. In Florida and in all regulatory jurisdictions, a utility's rates must be "fair, just, and reasonable." As noted above, regulation recognizes that utilities are entitled to an opportunity to recover the reasonable and prudent costs of providing service, and the opportunity to earn a fair rate of return on the capital invested in the utility's facilities, such as power plants, transmission lines, distribution lines, buildings, vehicles, and similar long-lived capital assets. Utilities obtain capital funding through a combination of borrowing (debt financing) and issuing stock. The allowed return on equity (ROE) is the amount that is appropriate for the utility's common stockholders to earn a fair return on the capital that they contribute to the utility when they buy its stock. If the regulatory authority sets the ROE too low, the stockholders will not have the opportunity to earn a fair return; if the regulatory authority sets the ROE too high, the customers will pay too much, and the resulting rates will be unfair and unreasonable

Q. HOW DO REGULATORY AUTHORITIES GO ABOUT DETERMINING WHAT IS A FAIR RATE OF RETURN ON EQUITY?

A. Regulatory commissions and boards, as well as financial industry analysts, institutional investors, and individual investors, use different analytical models and methodologies to estimate/calculate reasonable rates of return on equity. Among the measures used are "Discounted Cash Flow" or "DCF" analysis and "Comparable Earnings Analysis." Sometimes a technique called

the "Capital Asset Pricing Model" or "CAPM" method is used. I believe that the two most useful methodologies are DCF Analysis and the Comparable Earnings Analysis.

A. Discounted Cash Flow (DCF) Analysis

Q. CAN YOU PLEASE EXPLAIN THE DISCOUNTED CASH FLOW METHOD?

A. Yes. The DCF method is a widely used method for estimating an investor's required return on a firm's common equity. In my twenty-four years of experience with the Public Staff of the North Carolina Utilities Commission and as a consultant, I have seen the DCF method used much more often than any other method for estimating the appropriate return on common equity. Consumer advocate witnesses, utility witnesses and other intervenor witnesses have used the DCF method, either by itself or in conjunction with other methods such as the Comparable Earnings Method or the Capital Asset Pricing Model (CAPM), in their analyses.

The DCF method is based on the concept that the price which the investor is willing to pay for a stock is the discounted present value or present worth of what the investor expects to receive as a result of purchasing that stock. This return to the investor is in the form of future dividends and price appreciation. However, price appreciation can be ignored since appreciation in price is only realized when the investor sells the stock. Therefore, the only income that the investor will receive from the company in which it invests is the dividend stream. Mathematically, the relationship is:

Let D = dividends per share in the initial future period
g = expected growth rate in dividends
k = cost of equity capital

P = price of asset (or present value of a future stream of dividends)

$$\text{then } P = \frac{D}{(1+k)} + \frac{D(1+g)}{1+k)^2} + \frac{D(1+g)}{(1+k)^3} + \frac{D(1+g)}{(1+k)^t}$$

This equation represents the amount (P) an investor will be willing to pay for a share of common equity with a given dividend stream over (t) periods.

Reducing the formula to an infinite geometric series, we have:

$$P = \frac{D}{k-g}$$

Solving for k yields:

$$k = \frac{D}{P+g}$$

Q. MR. O'DONNELL, DO INVESTORS IN UTILITY COMMON STOCKS REALLY USE THE DCF MODEL IN MAKING INVESTMENT TAMPA ELECTRIC DECISIONS?

A. Absolutely. Utility investors tend to be individuals or institutions interested in current income. The average stock investor interested in income will use the DCF to calculate how much funds he/she will receive relative to the initial investment, which is defined as the current dividend yield and the amount of funds that the investor can expect in the future from the growth in the dividend. Both of these components are central to the basic tenet of the DCF model that combines a dividend yield and a growth rate for dividends to derive the overall rate of return.

Q. HAVE YOU USED THE DCF MODEL IN ANALYZING COMMON STOCKS FOR INVESTMENT PURPOSES?

A. Yes. I have used and continue to use the DCF method extensively in analyzing common stocks for potential personal purchases as well as for purchases contemplated for money management clients.

Although the DCF formula stated above may appear complicated, the DCF method is intuitively a very simple model to understand. To determine the total rate of return one expects from investing in a particular equity security, the investor adds the dividend yield which he or she expects to receive in the future to the expected growth in dividends over time. If the regulatory authority sets the rate at a fair level, the utility will be able to attract capital at a reasonable cost, without forcing the utility's customers to pay more than necessary to attract needed capital.

Unlike models such as the Capital Asset Pricing Model (CAPM) that are more theoretical and academic in nature, the DCF is grounded in solid practicality that is used by money managers and individual investors throughout the world on a daily basis.

Q. CAN YOU GIVE AN EXAMPLE?

A. Of course. If investors expect a current dividend yield of 6%, and also expect that dividends will grow at 4%, then the DCF model indicates that investors would buy the utility's common stock if it provided a return on equity of 10%.

Q. HAVE YOU PREPARED ANY ANALYSES USING THE DCF METHOD TO EVALUATE A FAIR RATE OF RETURN FOR TAMPA ELECTRIC COMPANY?

A. Yes, I have. First, I identified a group of 24 comparable companies and then proceeded to evaluate their current and projected dividend yields and growth. The following discussion explains how I selected this population of

comparable companies and how I calculated what I believe to be the appropriate rate of return on equity for the Florida PSC to use in determining allowed revenues (revenue requirements) and consumer rates for Tampa Electric.

I developed this group of comparable companies to ensure that the return on equity for Tampa Electric developed in this analysis is consistent with the returns which can be obtained from similar equity investments in the open market.

I was not able to perform a DCF analysis directly on Tampa Electric Company since it is a subsidiary of TECO Energy, Inc. However, since TECO Energy is publicly traded, I was able to perform a rate of return analysis on the parent company.

Q. PLEASE EXPLAIN HOW YOU SELECTED THESE 24 COMPANIES FOR YOUR COMPARABLE GROUP

A. All of the companies in my comparable group are listed in The Value Line Investment Survey "Electric Utility Industry" group.

A further screen I used in developing my comparable group was to include only those companies in the comparable group that have an S&P Quality Rating of a B. This quality rating is an appropriate screening method because the S&P Quality Rating measures stability of earnings and dividends. The parent company of Tampa Electric, TECO Energy, Inc., has an S&P Stock Rating of B, so I chose to include only those companies that had S&P Stock ratings of B.

I also chose to exclude companies that either paid no dividend, had recently reinstated their dividends, had recently purchased another company, or were the subject of takeover discussions.

Q. WHAT DIVIDEND YIELD DO YOU THINK IS APPROPRIATE FOR USE IN THE DCF MODEL?

A. I have calculated the appropriate dividend yield by averaging the dividend yield expected over the next 12 months for each company, as reported by the Value Line Investment Survey. The period covered is from August 29, 2008, through November 21, 2008. To study the short-term as well as long-term movements in dividend yields, I examined the 13-week, 4-week, and 1-week dividend yields for the comparable group as well as TECO Energy. My results appear in O'Donnell Exhibit No. KWO-1 and show a dividend yield range of 4.9% to 5.4% for the comparable group and 5.4% to 6.7% for TECO Energy for the same 3 time periods that I examined.

As I am sure the Commission is aware, the stock market has been extremely volatile since the beginning of October. The reason for the wide range in the above-stated dividend yields is that the stock market has dropped rather dramatically thereby increasing the current, otherwise known as spot market, yields on utility investments. The good news is that utility investors are now recognizing higher dividend yields. The bad news is that the drop in the stock market is a sign that our economy is headed for tough economic times thereby putting a damper on future corporate earnings.

Q PLEASE EXPLAIN HOW YOU DEVELOPED THE DIVIDEND YIELD RANGES DISCUSSED ABOVE?

A. I developed the dividend yield range for the comparable group by averaging each Company's dividend yield over the above-stated 13-week and 4-week

periods as well as examining the most recent dividend yield reported by Value Line for each company.

Q. HOW DID YOU DERIVE THE EXPECTED GROWTH RATE?

A. I used several methods in determining the growth in dividends that investors expect. The first method I used was an analysis commonly referred to as the "plowback ratio" method. If a company is earning a rate of return (r) on its common equity, and it retains a percentage of these earnings (b), then each year the earnings per share (EPS) are expected to increase by the product (br) of its earnings per share in the previous year. Therefore, br is a good measure of growth in dividends per share. For example, if a company earns 10% on its equity and retains 50% (the other 50% being paid out in dividends), then the expected growth rate in earnings and dividends is 5% (50% of 10%). To calculate a plowback for the comparable group, I used the following formula:

$$g = \frac{br\ (2007) + br\ (2008E) + br\ (2009E) + br\ (2011E\text{-}2013E\ Avg)}{4}$$

The plowback estimates for all companies in the comparable group can be obtained from The Value Line Investment Survey under the title "percent retained to common equity." O'Donnell Exhibit No. 3 lists the plowback ratios for each company in the comparable group. This exhibit contains one reference to "NMF" which is the abbreviation for "no meaningful figure". When "NMF" appears, a company's earnings were less than the dividend paid out, which means that the Company did not reinvest or "plowback" any earnings from that year's operations. For purposes of being conservative, I treated the "NMF" entries as a 0 for purposes of my analysis. The plowback method is a very useful tool for comparing the comparable group's growth rates on a recent historical basis as well as a short-term forecasted basis.

A key component in the DCF Method is the expected growth in dividends. In analyzing the proper dividend growth rate to use in the DCF Method, the analyst must consider how dividends are created. Since dividends cannot be paid out without the company first earning the paid out funds, earnings growth is a key element in analyzing the expected growth in dividends. Similarly, what remains in a company after it pays its dividend is reinvested, or "plowed back", into the company in order to generate future growth. As a result, book value growth is another element that, in my opinion, must be considered in analyzing a company's expected dividend growth. To analyze the expected growth in dividends, I believe the analyst should first examine the historical record of past earnings, dividends, and book value. Hence, the second method I used to estimate the expected growth rate was to analyze the historical 10-year and 5-year historical compound annual rates of change for earnings per share (EPS), dividends per share (DPS), and book value per share (BPS) as reported by Value Line.

Value Line is the most recognized investment publication in the industry and, as such, is used by professional money managers, financial analysts, and individual investors worldwide. A prudent investor examines all aspects of a Company's performance when making a capital investment decision. As such, it is only practical to examine historical growth rates for the company for which the analysis is being performed. The historical growth rates for the comparable group as well as TECO Energy can be seen in O'Donnell Exhibit No. KWO-1.

The third method I used was the Value Line forecasted compound annual rates of change for earnings per share, dividends per share, and book value per share.

The fourth method I used was the forecasted rate of change for earnings per share that analysts supplied to Charles Schwab & Co. This forecasted rate of change is not a forecast supplied by Charles Schwab & Co. but is, instead, a compilation of forecasts by industry analysts.

The details of my DCF results can be seen in O'Donnell Exhibit No. KWO-1 and a summary of these results can be found in O'Donnell Exhibit No. KWO-2.

Once I gathered all the above data, I examined the results as found in Exhibit Nos. KWO-1 and KWO-2. It is important, in my view, to attempt to understand the reasons why the various data results appear. For example, in the early 1980s, utilities were undergoing expansion of base load plants that caused earnings growth to slow substantially. However, in the early 1990s, most baseload plant construction had ended and utilities were flush with a good bit of cash thereby creating, for the most part, solid earnings growth. It is important, therefore, to understand current and past market conditions so the analyst can use his/her best judgment in determining the market expected dividend growth rate in the future.

Q. WHAT IS THE INVESTOR RETURN REQUIREMENT FROM THE DCF ANALYSIS?

A. As can be seen on O'Donnell Exhibit No. 2, the dividend yield for the three time frames studied ranges from 4.9% to 5.4% for the comparable group and 5.4% to 6.7% for TECO Energy. Given the recent drop in the stock market, I believe the dividend yield range should incorporate the recent price changes as well as the realization that fear has taken over strong fundamentals in today's marketplace.

To be specific, the most representative dividend yield for the comparable group is in the range of 4.9% to 5.4%. For TECO Energy, I believe the proper dividend yield to use in the DCF analysis is in the range of 6.00%to 6.50%. This dividend yield range represents the upper end of the wide range of dividend yields experienced by TECO Energy over the 13-week period of August 29, 2008 through November 21, 2008. The reason for the wide range in the TECO Energy dividend yields goes beyond the recent downturn in the stock market. On Oct. 30, 2008, TECO Energy announced third quarter results that were down from $0.44 per share in 2007 to $0.28 per share in 2008. These weak results were due to lower results in TECO Energy's non-regulated operations as well as a relatively mild summer season that depressed Tampa Electric's expected air conditioning load.

The TECO Energy stock price has fluctuated dramatically over the past year, from a high this summer near $22 per share to a low of less than $11 per share in mid-November. I believe investors are indicating that, on a longer term basis, TECO Energy must recover its earnings fundamentals. For this reason, investors have bid down the stock price thereby driving the dividend yield upward. Corresponding to the higher dividend yield is the realization that future dividend growth will be very constrained while TECO Energy solidifies its financial footing.

In terms of the proper dividend growth rate to employ in this analysis, I believe that it is appropriate to examine the recent history of earnings and dividend growth to assess and provide the best estimate of the dividend growth that investors expect in the future. A quick examination of the 10-year and 5-year historical growth rates for the comparable group and TECO Energy show very vividly the problems in the electric industry over the past decade.

The future of the utility industry can, in my opinion, be described as "back to the future" in which utilities will expand their earnings by expanding and growing their rate base investments through large capital projects. Throughout the 1990s and earlier this decade, it was rare to see a general rate case for any utility in the southeastern U.S. Today, however, utilities across the country are coming in for rate cases at an increasing pace. The future holds much the same as numerous large power plant investments are currently being planned. Thus, it is reasonable to expect that the next ten years should look somewhat like the 1980s when utilities were involved in large generation construction projects.

Due in large part to the future expected capital expenditures of utilities throughout the country, I believe that investors have recognized, and embedded in their stock prices, that dividend growth in the short-term, meaning in the next ten years or less, must be less than earnings growth. As can be seen in O'Donnell Exhibit No. KWO-1, the comparable group's forecasted dividend growth rates are slightly less than the forecasted earnings growth rates, but the earnings growth rate for TECO Energy is more than double its expected dividend growth rate. On a long-term basis, however, earnings and dividends will grow more in-line with one another.

Due to the effects of fundamental changes that have occurred in the utility industry over the past ten years, I believe that it is proper to place more weight on forecasted figures than historical figures in estimating the cost of equity for TECO Energy and the comparable group. However, it is important to note that most of the forecasted Value Line figures contained in the attached O'Donnell Exhibit No. KWO-1 and O'Donnell Exhibit No. KWO-2 were published prior to the stock market meltdown that occurred in October, 2008. Since the stock market fall, the general conclusion is that our country is headed for a severe economic recession that may last for an extended time. As a result, I believe

that it is proper to use a lower growth rate in the DCF analysis to account for the expected drop in economic activity for TECO Energy as well as the comparable group and the entire United States economy. As we get closer to hearing in this case, I will update the entire analysis so as to give the Commission an up-to-date view of current investor return requirements.

I believe that the proper growth rate range for the comparable group of companies to use in the DCF analysis is 4.0% to 4.5%. The 4.0% is particularly appropriate for the lower end of this range since it is approximately equal to the plowback ratio, which is a mix of near-term historical and forecasted earnings retention ratios, of the comparable group. I also believe that 4.5% is appropriate for the high end of the range as it is slightly lower than the group's Value Line average forecasted dividend growth rate thereby accounting for the slowdown in the US economy.

Combining the comparable group's dividend yield range of 4.9% to 5.4% with the growth rate range of 4.0% to 4.5% produces a DCF range of 8.9% to 9.9%.

Based on the results shown in O'Donnell Exhibits No. KWO-1 and KWO-2, I believe that investors are expecting TECO Energy's dividends to grow in the range of 3.25% to 3.75%. The 3.25% low end of the dividend growth rate range is close to the Value Line forecasted dividend growth rate. I believe that 3.75% is appropriate for the high-end of the growth rate range because it is approximately halfway between the Value line forecasted dividend growth rate and the plowback growth rate of TECO Energy.

Combining the TECO Energy current dividend yield range of 6.00%% to 6.50% with the above-stated dividend growth rate range of 3.25% to 3.75% produces a DCF cost of equity range of 9.25% to 10.25%.

The above-stated comparable group and TECO Energy cost of equity ranges represent only one analysis I used in the examination of the proper cost of equity to apply in the current rate case.

B. Comparable Earnings Analysis

Q. MR. O'DONNELL, WOULD YOU PLEASE EXPLAIN WHY YOU PERFORMED A COMPARABLE EARNINGS ANALYSIS IN ADDITION TO YOUR DCF ANALYSIS?

A. Yes. The comparable earnings method provides investors with actual historical earned returns on common equity. Investors use this information as a guide to assess an investment's current required rate of return. I used the comparable earnings method in my analysis in this case to assess the reasonableness of my DCF results and to provide an independent methodological estimate of the return that investors would consider reasonable for Tampa Electric as the regulated electric company subsidiary of TECO Energy. It obviously makes economic common sense that the common stock shares of companies with comparable risks should yield very close to the same returns.

Q. WOULD YOU PLEASE EXPLAIN HOW YOU PERFORMED THE COMPARABLE EARNINGS ANALYSIS?

A. O'Donnell Exhibit No. KWO-4 presents a list of the earned returns on equity of the comparable group over the period of 2004 through 2007. As can be seen in this exhibit, the comparable companies' earned returns on equity have ranged from 8.3% in 2004 to a high of 9.7% in 2006. For TECO the highest return on equity over this four-year period was 14.1% in 2006 whereas the lowest return on equity, which was 10.7%, occurred in 2004. For the four-

year period of 2002 through 2006, the average return on equity was 9.0% for the comparable group and 12.8% for TECO.

In addition to the above analysis of market earned returns on equity, I also examined recently allowed returns on equity granted by utility state regulators from around the country. Table 1 below shows what other states have granted for allowed returns on equity for electric utilities from the period of July, 2007 through August, 2008.

Table 1: Authorized Returns

Company	Jurisdiction	Authorized ROE	Authorized Overall	Date of Order
Entergy Arkansas,Inc.	AR	9.90%	N/A	06/15/2007
Arizona Public Service Company	AZ	10.75%	8.32%	06/28/2007
Potomac Electric Power Company	MD	10.00%	7.68%	07/19/2007
Georgia Power Company	GA	11.25%	N/A	12/18/2007
Duke Energy Carolinas	NC	11.00%	8.57%	12/20/2007
Wisconsin Electric Power Company	WI	10.75%	8.33%	01/17/2008
Potomac Electric Power Company	DC	10.00%	7.96%	01/30/2008
Fitchburg Gas & Electric (Unitil)	MA	10.25%	8.38%	02/29/2008
Northern States Power Company	WI	10.75%	8.60%	01/08/2008
Central Vermont Public Service Co.	VT	10.71%	N/A	01/31/2008
Consolidated Edison of NY	NY	9.10%	7.30%	03/25/2008
Montana-Dakota Utilities Company	MT	10.25%	8.58%	04/23/2008
Hawaiian Electric Company	HI	10.70%	8.66%	05/01/2008
Consumers Energy	NY	10.70%	6.93%	06/10/2008
Orange and Rockland Utilities, Inc.	NY	9.10%	N/A	07/23/2008
Average		10.35%		

Source: Public Utilities Reports, Volume Nos. 258-266 as provided by the NC Utilities Commission in its "Quarterly Review" for the quarter ending March 31, 2008

As can be seen from the information above, the average allowed return on equity granted by state regulators for utilities operating in regulated states was, on average, 10.35%. Even more striking is that in only two of the fourteen cases were the utilities allowed a return of equal to or greater than 11%. Dr. Murry, however, recommends the Commission approve a 12.0% return on equity for Tampa Electric. When compared to returns approved in other states, Dr. Murry's recommendation of 12.0% is clearly and unequivocally excessive and unreasonable.

Q. WHAT CONCLUSIONS DO YOU DRAW FROM THE COMPARABLE EARNINGS ANALYSIS?

A. Given the slowdown in the Florida economy, the housing market decline, and the credit crunch, I believe that it is unrealistic to expect TECO's historical returns of-late to continue unabated in the future. In addition, state regulatory orders over the past year have granted vertically integrated electric utilities returns on equity of approximately 10.35%. Based on these findings, I believe the proper rate of return using a comparable earnings analysis is in the range of 9.5% to 10.5%. This rate of return range is very close to the return on equity range found appropriate through use of the DCF model.

C. Return on Equity Recommendation

Q. WHAT IS YOUR ESTIMATE OF THE COST OF EQUITY CAPITAL FORTAMPA ELECTRIC?

A. As I mentioned earlier, the results from my DCF Analysis resulted in an investor return requirement range of 8.9% to 9.9% for the comparable group and 9.25% to 10.25% for TECO Energy. The comparable earnings method produces a return on equity in the range of 9.5% to 10.5%. Based on these results, I believe the investor requirement range for TECO Energy is in the range of 9.25%, which is the middle of the comparable group DCF range, to 10.25%, which is the high-end of the range for the TECO Energy DCF analysis as well as the comparable earnings range.

In determining the proper return on equity to recommend in this proceeding, it is critical, in my opinion, to acknowledge that the utility industry is on a track to return to its regulated roots and, hence, investors expect more modest future growth rates. As a result of this return-to-the-basics mentality, I believe that the proper return on equity to use for determining Tampa Electric's revenue requirements and for setting Tampa Electric's rates in this proceeding is 9.75%, which is approximately in the middle of all the above-stated ranges. This recommended return on equity of 9.75% is also very close to the average return on equity granted by state utility commissions across the country from July, 2007 through August, 2008.

Q. HOW DOES THIS 9.75% RATE OF RETURN COMPARE TO THE RETURNS THAT MONEY MANAGERS NOW EXPECT TO EARN ON LONG-TERM STOCK INVESTMENTS?

A. In my opinion, a 9.75% rate of return on an investment in a electric utility would be deemed fair and appropriate by most money managers and that determining Tampa Electric's revenue requirements and setting its rates on this basis would provide more than adequate incentives to investors to purchase TECO Energy's common stock at reasonable prices, thereby enabling Tampa Electric to obtain needed capital. As noted in my resumé, I also work as a senior financial analyst for a money management firm in New Jersey. In that role, I am often asked to examine market returns and risks. As a money manager, I can assure the Commission that most professional investors would be very pleased if their managed portfolios produced overall annual returns of 9.75% in todays investment climate. The stock market is down over 40% from its peak in late 2007. Investors are, naturally, very nervous about their stock investments. Of all the investment opportunities available, utility investments are considered some of the safest. In fact, Tampa Electric is an incredibly safe investment that, at the present time, can and does recover 60% to 70%% of its total expenses through pass-through clauses. The remaining costs are Tampa Electric's fixed costs, including debt service and return, and operating costs that are recovered through base rates, and the recovery of these costs is very secure and low-risk because of Tampa Electric's monopoly position as a provider of a necessity. If the remaining base-rate operating expenses were to get sufficiently high such that the Company needs more revenue to cover them, Tampa Electric also has the option of filing for a rate case to increase rates to cover these higher operating costs. As a result, earning 9.75% on a relatively risk-free investment in a solid utility such as Tampa Electric is a very attractive investment for anyone looking to maximize his or her returns while keeping risk at a minimum.

III. CAPITAL STRUCTURE AND OVERALL RATE OF RETURN

Q. WHAT IS A CAPITAL STRUCTURE AND HOW WILL IT IMPACT THE REVENUES THAT TAMPA ELECTRIC OR ANY OTHER UTILITY IS SEEKING IN A RATE CASE?

A. The term "capital structure" refers to the relative percentage of debt, equity, and other financial components that are used to finance a company's investments.

For simplicity purposes, there are basically three financing methods. The first method is to finance an investment with common equity, which essentially represents ownership in a company and its investments. Common equity returns, which take the form of dividends to stockholders, are not tax deductible which, on a pre-tax basis alone, makes this form of financing about 40% more expensive than debt financing, for which interest is a tax-deductible expense of the company. The second form of corporate financing is preferred stock, which is normally used to a much smaller degree in capital structures. Dividend payments associated with preferred stock are not tax deductible. Corporate debt is the other major form of financing used in the corporate world. There are two basic types of corporate debt: long-term and short-term. Long-term debt is generally understood to be debt that matures in a period of more than one year. Short-term debt is debt that matures in less that one-year. Both long-term debt and short-term debt represents liabilities on the company's books that must be repaid prior to any common stockholders or preferred stockholders receiving a return on their investment.

In the current Tampa Electric case, the Company has also included other financing means such as deferred income taxes, customer deposits, and tax credit. The concept in including these items in the capital structure is that these funds are used by the Company in the provision of utility electric service and, as such, should be reflected in the utility's regulated capital structure.

A utility's total return is developed by multiplying the component percentages of its capital structure represented by the percentage ratios of the various forms of capital financing relative to the total financing on the company's books) by the cost rates associated with each form of capital and then summing the results over all of the capital components. When these percentage ratios are applied to various cost rates, a total after-tax rate of return is developed Since the utility must pay dividends associated with common equity and preferred stock with after-tax funds, the post-tax returns is then converted to a pre-tax return by grossing up the common equity and preferred stock returns for taxes. The final pre-tax return is then multiplied by the Company's rate base in order to develop the amount of money that customers must pay to the utility for its return on investment and tax payments associated with that investment.

From the above discussion, it is clear to see that costs to consumers are greater when the utility finances a higher proportion of its rate base investment with common equity and preferred stock versus long-term debt. However, long-term debt, which is first in-line for repayment, is more risky to the utility than is common equity due to the fact that debt is a contractual obligation as opposed to common equity where no obligations exist. As a result, regulators and the utility must balance off the needs of consumers, who desire low rates derived from the use of long-term debt, versus the desire of the utility to minimize the use of the more risky long-term debt.

Q. MR. O'DONNELL, WHAT CAPITAL STRUCTURE IS TAMPA ELECTRIC SEEKING IN THIS CASE?

A. According to the testimony of Donald A. Murry and the Company's Minimum Filing Requirements, the Company is seeking approval of the following capital structure in this case:

Long-Term Debt	38.22%
Short-Term Debt	0.22%
Customer Deposits	2.84%
Tax Credits	0.24%
Deferred Income Taxes	8.28%
Common Equity	50.21%

Q. WHAT WOULD BE THE RESULTS OF ALLOWING TAMPA ELECTRIC TO SET ITS RATES ON THE BASIS OF THIS HYPOTHETICAL CAPITAL STRUCTURE?

A. Allowing Tampa Electric's rates to be set using this capital structure would cause customers to over-pay for Tampa Electric's true cost of capital by forcing captive customers to pay for a hypothetical, non-existent capital structure that does not, in my opinion, accurately reflect the way the Company finances its rate base investment. The use of the Company proposed capital structure would result in Tampa Electric's rates being grossly unfair, unjust, and unreasonable.

Q. PLEASE DESCRIBE WHY YOU BELIEVE TAMPA ELECTRIC'S REQUESTED CAPITAL STRUCTURE DOES NOT ACCURATELY REFLECT THE COMPANY'S RATE BASE INVESTMENT?

Tampa Electric is a wholly-owned subsidiary of TECO Energy. Due to the parent/subsidiary relationship, there are no market forces that influence the shape of the Tampa Electric capital structure. As a result, TECO Energy can issue long-term debt on its consolidated balance sheet and then invest the funds into Tampa Electric and call it common equity. By doing so, TECO Energy can effectively create whatever capital structure it desires for Tampa Electric and its other subsidiaries.

Q. WHY SHOULD THE FLORIDA PUBLIC SERVICE COMMISSION BE CONCERNED ABOUT HOW TAMPA ELECTRIC FINANCES ITS RATE BASE INVESTMENT?

A. There are two reasons that the Commission should be concerned about how Tampa Electric finances its rate base investment. The first reason is that the cost of common equity is higher than the cost of long-term debt, so that a higher equity percentage will translate into higher costs to Tampa Electric's customers with no corresponding improvements in quality of service. Long-term debt is a financial promise made by the company and is carried as a liability on the company's books. Common stock is ownership in the company. Due to the nature of this investment, common stockholders require higher rates of return to compensate them for the extra risk involved in owning part of the company versus having a promissory note from the company.

The second reason the Commission should be concerned about Tampa Electric's capital structure is due to the tax treatment of debt versus common equity. Public corporations, such as TECO Energy, can write-off interest payments associated with debt financing. Corporations are not, however, allowed to deduct common stock dividend payments for tax purposes. All dividend payments must be made with after-tax funds, which are more

expensive than pre-tax funds. Since the regulatory process allows utilities to recover all expenses, including taxes, rates must be set so that the utility pays all its taxes and has enough left over to pay its common stock dividend. If a utility is allowed to use a capital structure for ratemaking purposes that is top-heavy in common stock, customers will be forced to pay the associated income tax burden, resulting in unfairly, unreasonably, and unnecessarily high rates. This will harm the economy of the utility's service area and violate the fundamental principles of utility regulation that rates must be fair but only high enough to support the utility's provision of safe, adequate, and reliable service at a fair price.

In my opinion, using Tampa Electric's requested capital structure in this proceeding will grant the utility unnecessarily and unreasonably high rates to cover tax payments for common equity that is not, in my view, truly an equity investment. In this particular case, TECO Energy, as the sole upstream owner of Tampa Electric, is attempting to use the regulatory process to force captive customers to pay rates higher than is necessary to support the Company's rate base investment. In utility regulation, a parent company's use of long-term debt as common equity in a regulated subsidiary is called double-leveraging.

On the unregulated side, there is no real problem with this practice because the unregulated subsidiaries are subject to competitive market discipline, but on the regulated side – i.e., for Tampa Electric Company and its customers – this practice is wholly inappropriate manipulation of the claimed capital structure to effectively arbitrage what is debt investment into equity returns, and the Commission should reject and prohibit such manipulation.

Even assuming that the Commission sets Tampa Electric's return on equity at 9.75% as I recommend, allowing the Company's rates to be set using its

proposed capital structure will violate principles of fair and reasonable ratemaking by forcing customers to pay for equity capital that really doesn't exist.

Q. DO YOU HAVE ANY EVIDENCE THAT TECO ENERGY IS DOUBLE-LEVERAGING ITS REGULATED ASSET INVESTMENTS?

A. Yes. Below is a table that list the total common equity that TECO Energy, Inc. had on its books as of Dec. 31, 2007 as well as the per books common equity component for Tampa Electric and the other wholly-owned subsidiaries of TECO Energy.

Table 2: Per Books Common Equity Positions

Company	Equity ($)
TECO Energy, Inc.	$2,017,045
Tampa Electric	$1,532,687
Peoples Gas	$268,286
Non-Regulated	$819,265
Total Subsidiary Equity	$2,620,238

As can be seen in the table above, the total common equity investment that TECO Energy **CLAIMS** exists in its subsidiaries, is approximately $600 million GREATER than the total per books common equity of the parent company, TECO Energy, Inc. The above table clearly shows that TECO Energy is attempting to use its debt financing to create an illusion to the Commission that Tampa Electric has more equity in its capital structure than exists in reality. Allowing this illusion to determine Tampa Electric's revenue requirements would result in higher rates for consumers of Tampa Electric who are already struggling to pay high bills in an uncertain economy. Worse still, this burden would be forced upon the utility's captive customers based on purported costs of equity capital that is, at bottom, debt capital provided by TECO Energy bondholders.

Q. **DOES THE COMPANY EXPLAIN THIS DIFFERENCE IN EQUITY COMPONENTS IN ITS PRE-FILED TESTIMONY?**

A. Company Witness Gillette does not explicitly address the difference in the equity amounts of all the subsidiaries versus the amount found in the parent company. However, Mr. Gillette does claim that the $404 million in debt found in the parent company capital structure is related to TECO Energy, Inc.'s failed investment in TPS merchant power business and was not infused

in equity into Tampa Electric. Mr. Gillette does not, however, specifically address why the sum of the subsidiary equity amounts are greater than the parent company equity amount.

Q. MR. O'DONNELL, WHAT CAPITAL STRUCTURE DO YOU RECOMMEND FOR USE IN THIS PROCEEDING?

A. In keeping with Commission Rule 25-14.004, I recommend that the Commission adjust the Tampa Electric 13-month average capital structure as of Dec. 31, 2009 to account for a proportionate amount of long-term debt in the parent company capital structure that should be accounted for as long-term debt and not common equity in the Tampa Electric capital structure. That capital structure and associated cost rates are as follows:

Table 3: Recommended Capital Structure

Component	Ratio (%)	Cost Rate (%)
Long-Term Debt	44.68%	6.81%
Short-Term Debt	0.22%	4.63%
Customer Deposits	2.84%	6.07%
Tax Credits	0.24%	8.28%
Deferred Inc. Taxes	8.27%	0.00%
Common Equity	44.00%	9.75%
	100.00%	

In my opinion, the TECO Energy capital structure that I recommend in this proceeding is more transparent to investors and to the Commission, reflects the manner in which the utility actually finances its rate base investment, prevents consumers from paying high equity returns on non-existent equity capital, and prevents customers from paying income taxes that are not in reality paid by Tampa Electric in the provision of electric service in Florida.

My recommended return on equity and capital structure can be seen in Exhibit KWO-5.

Q. WHAT IS THE OVERALL RATE OF RETURN ON INVESTMENT THAT THE COMMISSION SHOULD APPLY USING YOUR RECOMMENDED RATE OF RETURN ON EQUITY AND YOUR RECOMMENDED ADJUSTMENTS TO TAMPA ELECTRIC'S CAPITAL STRUCTURE?

A. My recommended overall rate of return on investment is 7.52%

IV. REVIEW OF COMPANY WITNESS MURRY'S TESTIMONY

Q. WHAT METHODS DID DR. MURRY USE IN HIS ANALYSIS OF THE COST OF EQUITY FOR TAMPA ELECTRIC?

A. Dr. Murry used the DCF model and the Capital Asset Pricing Model (CAPM) in his return on equity analysis of Tampa Electric.

Q. WHAT ARE THE PRIMARY DIFFERENCES BETWEEN YOUR APPLICATION OF THE DCF MODEL AND DR. MURRY'S APPLICATION OF THE DCF?

A. One difference between Dr. Murry and myself is that Dr. Murry uses forecasted earnings growth estimates as the primary source of dividend growth in the DCF model whereas I use a more global approach that examines historical and forecasted growth in earnings, dividends, and book value. In my opinion, investors are competent enough to understand that dividend growth, which is the basis for the DCF model, originates from earnings growth and book value growth. Hence, it is only logical to examine all of these factors in the determination of the proper growth rate to use in the DCF model. By doing so, investors can and do recognize and understand that such a range will include high growth rates and low growth rates. Investors use all this information in determining the price they are willing to pay for the stock and, hence, the underlying investor return requirement using the DCF model.

The largest single difference, however, between Dr. Murry and myself is how we treat the results from our respective DCF analyses.. In my opinion, Dr. Murry, in his prefiled testimony, indicates a predetermined preference for a higher return on equity than can be justified in this proceeding. Support for my opinion is found on pp. 38-39 of Dr. Murry's testimony when he states:

> If a DCF-based cost of common equity, even if realistically developed, becomes the allowed return for a regulated utility, this will not provide enough cushion as the realized return will be sufficient to attract and maintain capital.

Given that consumers in Florida must pay higher rates for Dr. Murry's "cushion", I don't believe it would be proper for the Commission to recognize Dr. Murry's application of the DCF model in this case. Put another way, I believe it is simply wrong to ask consumers struggling to stay in their homes with plummeting values to pay higher rates so that Tampa Electric can have a "cushion" built into its profits through the cost of equity granted by this Commission. Many residential customers and families living in the real world do not have such a "cushion." School boards and local governments in Florida do not have a "cushion" and retail merchants operating in today's marketplace certainly do not have the "cushion" to which Dr. Murry argues for Tampa Electric in this case.

Another difference between Dr. Murry and myself is that Dr. Murry does not perform a rate of return analysis specifically on TECO Energy. Dr. Murry openly admits that he does not think it is appropriate to perform a rate of return analysis on TECO Energy. To be specific, Dr. Murry states:

> The risks associated with the recent financial difficulties of TECO Energy are not relevant to measuring the cost of capital of Tampa Electric. Consequently, I did not use the market-based calculations of the cost of capital of TECO Energy and the financial information of TECO Energy had little bearing on my analysis. (p. 23 of direct testimony)

Q. DO YOU AGREE WITH DR. MURRY THAT THE FINANCIAL ASPECTS OF TECO ENERGY ARE NOT RELEVANT IN THIS PROCEEDING?

A. No. Investing in TECO Energy is largely synonymous in investing in Tampa Electric. Dr. Murry would like to ignore the fact that TECO's past financial difficulties are not relevant to Tampa Electric, but the two entities are inextricably linked. Approximately 75% of the common equity found in the TECO Energy, Inc. reported capital structure comes from the common equity of Tampa Electric. One simply cannot invest in TECO Energy without investing in Tampa Electric, and one can only invest in Tampa Electric by investing in TECO Energy.

Both in terms of the appropriate capital structure and return on equity to use in this proceeding, the Company is attempting to use hypothetical values.. Florida electric customers should not be asked to pay higher costs that are based on "theory" when real values are available from the Company.

Q. MR. O'DONNELL, WHY DO YOU NOT USE THE CAPM IN DETERMINING RETURNS ON EQUITY IN UTILITY REGULATORY PROCEEDINGS?

A. The CAPM is a model that essentially compares market returns to fixed-income yields to arrive at a forecasted return on equity. The underlying assumption of the CAPM is that calculated risk premiums stay relatively constant over time. Unlike Dr. Murry, I have found such assumptions to be unrealistic and extremely naïve.

Current economic conditions are vastly different from conditions that existed in the marketplace since 1926, which is the start date of the risk premium analysis used by Dr. Murry. For example, from the end of WWII until the mid-1990s, the United States economy was generally seen as the dominant market in the world. Today, however, China, Japan, and India are all making strong economic strides that are threatening our dominance in world markets.

Dr. Murry's risk premium model, by definition and specification, ignores the changing world markets.

Furthermore, the equity risk premium of 7.1% employed by Dr. Murry incorporates only a subset of historical returns and, in my opinion, is a gross exaggeration of what financial analysts expect in future market returns. In 2004, Dr. Jeremy J. Siegel from the University of Pennsylvania published a paper for the Chartered Financial Analysts Institute Conference Proceedings entitled "The Long-Run Equity Risk Premium." In this study, Dr. Siegel examined stock and bond market return returns from 1802 through 2003. Over this extended period of time, the real return on common stocks was 6.8% whereas the real return on long-term government bonds was 3.5% thereby producing a risk-premium of 3.3%. Dr. Siegel summarized his conclusions by stating:

> This is a lower return world because the P/E for equities is justifiably higher than it has been historically, which implies lower long-term real equity returns. Siegel's constant of a 6.5-7 percent return equity returns problem will not hold for all future periods. Investors probably will receive closer to 5 percent. Nevertheless, the real equity risk premium will still be roughly 3 percent. Investors will certainly seek other higher yielding real assets, but of the three major asset classes – stocks, bonds, and real estate – all are probably going to realize lower return that their historical averages. Consequently, equities still offer an attractive premium for long-term investors.

Also in 2004, Mr. Robert D. Arnott, editor of the Financial Analysts Journal, wrote an article entitled "The Meaning of a Slender Risk Premium." Mr. Arnott concluded his piece by stating that

> The risk premium rules of thumb we've relied on are shaky. Indeed, the risk premium is a skinny hook to hang our future

> prosperity on. Should we rely on the risk premium for profit, or should we look more aggressively for other paths to profit? I think the latter is by far the more sensible route.

As a financial analyst, the use of a risk premium as high as 7.1% is, in my opinion, nonsensical given the current world markets. It might make some simplistic sense to pick a period of time over which to study equity risk premiums, but it is imperative that the analyst performing the study consider current market conditions. The world we live in today is vastly different than the world we have experienced over the past 200 years. Ignoring this fact will lead the analyst to erroneous conclusions that, in the current case, will cause consumers in Florida to overpay for electric service thereby harming the Florida economy.

Q. ARE YOU AWARE OF ANY STATE REGULATORY COMMISSION THAT HAS BEEN CRITICAL OF THE USE OF THE CAPM?

A. Yes. In 1991, the North Carolina Utilities Commission made the following statement in Docket No. G-21, Sub 293 and 295:

> The commission is further convinced of the inadvisability of relying on CAPM results due to the same flaw in the traditional risk premium method: the time period over which one calculates an equity risk differential can greatly alter the results for no theoretically explainable reason.

Q. HOW DOES THE CAPM ATTEMPT TO CAPTURE COMPANY-SPECIFIC RISK?

A. The CAPM uses a beta variable to measure the risk of the company studied relative to the market. In my view, this beta is highly subjective and can only be used with the utmost care. Since the beta is calculated with historical returns relative to market returns, it is very possible, and in fact quite likely,

that sudden changes in a company's stock price will not be captured in the beta thereby producing meaningless answers. If, for example, the beta used in the analysis was calculated over an extended time period, such as how Value Line calculates its beta, and then a company suddenly encountered severe financial problems, the CAPM would produce meaningless results as the calculated return on equity would be grossly low.

An example of the problem with beta can be seen in the situation involving Countrywide Financial, which is the world's largest independent residential mortgage lender and service company, in 2007. Countrywide has symbolically become the poster child for the credit meltdown that has now occurred in the marketplace thereby setting off recession worries for the entire country. The August 24, 2007 edition of Value Line stated that Countrywide's stock price fell 54% since its May, 2007 report. However, even with this price decline, the calculated beta for Countrywide was just 1.15 meaning that Countrywide was only 15% more risky than the overall stock market. Given the collapse of the credit markets due, in large part, to risky mortgages created by companies the likes of Countrywide, it is hard to believe that Countrywide's beta could have been was just 1.15. Of course, this nonsensical financial situation was borne out later when Bank of American acquired Countrywide. Applying the Countrywide beta of 1.15 in a CAPM in the summer of 2007 would have provided a ludicrous answer and very bad investment guidance.

Q. HOW DOES THE DCF CAPTURE SUCH A SUDDEN CHANGE IN THE MARKET PRICE OF A STOCK?

A. Since the DCF can incorporate daily fluctuations in stock prices via the dividend yield, it can capture sudden price movements and ongoing risk changes of a company. The CAPM relies on extensive historical data on

which to calculate the beta. As such, it simply cannot capture sudden risk movements.

Q. DO YOU HAVE ANY BASELINE COMPARISON OF DR. MURRY'S COST OF EQUITY RECOMMENDATION IN THIS CASE?

A. Yes, as noted previously, the average return on equity granted by various state commissions across the country was approximately 10.35%over the past year. Dr. Murry's recommendation of a 12.0% return on equity is grossly out-of-line with what state commissions around the United States are granting regulated utilities.

As another comparison, I urge the Commission to look at other investment opportunities available to conservative investors that are primarily seeking income. As of this writing, on November 24, 2008, 30-year US Treasury bonds, which are widely recognized as the yardstick for long-term risk-free investments, are currently yielding less than 4.0%,. The return on equity that I am recommending in this case is well more than double the yield on these ultra-safe 30-year bonds. Given the fact that Tampa Electric has very little risk, it is easy to see that, relative to fixed income securities, a 9.75% return on equity is very attractive return for investors.

V. REVIEW OF COMPANY WITNESS ABBOTT'S TESTIMONY AND RELATED RATE CASE EXPENSES

Q. HAVE YOU REVIEWED THE TESTIMONY OF TECO WITNESS ABBOTT?

A. Yes, I have.

Q. WHAT IS THE PURPOSE OF MS. ABBOTT'S TESTIMONY IN THIS PROCEEDING?

A. In her prefiled testimony, Ms. Abbott states that the purpose of her testimony was to describe

> how rating agencies rate companies, the importance of regulation to ratings, and the basis of Tampa Electric Company's ("Tampa Electric" or "company") current and targeted ratings (p. 3 of direct testimony)

When one reads through Ms. Abbott's testimony, it is clear that Ms. Abbott is, essentially testifying in support of the Company's requested return on equity and its requested capital structure, without any independent analysis of these issues and, thus, without any substantive contribution to the case.

Q. DO YOU AGREE WITH MS. ABBOTT'S CONCLUSIONS IN THIS CASE?

A. No. I believe that Ms. Abbott has misunderstood the purpose in utility regulation. Ms. Abbott's testimony implies that Tampa Electric needs a certain return on equity and capital structure in order to ensure the utility will have a credit rating that she deems suitable for the Company's credit needs. I do not agree with Ms. Abbott in that the Florida Public Service Commission

should set a rate of return based on a credit rating set by investment banks in New York.

If this Commission, or any other utility commission in the United States, were to ever begin to set returns on equity based on credit standards, it would essentially be ceding its regulatory control to rating agencies which often, have substantial conflicts of interest. Furthermore, setting a return on equity to achieve a predetermined credit rating would, in my view, send a signal to utility executives that it is acceptable to take risks since the Commission is targeting a credit rating as opposed to granting the utility an OPPORTUNITY to earn its allowed rate of return.

Furthermore, I believe the Commission should examine the concept of exactly what Ms. Abbott is stating in her testimony. Ms. Abbott states that a 12.0% return on equity is needed in order for the utility to achieve a set credit rating in the marketplace. However, the cost of equity, on a pre-tax basis, is more than twice the cost of debt. Hence, Ms. Abbott is advocating that consumers pay higher rates to support an excessive return on equity so that the Company can achieve a lower cost of debt. Such a recommendation is similar to asking consumers to pay $30,000 for a car that is worth $15,000 so they can get a $500 rebate from the manufacturer.

Q, CAN YOU PROVIDE A NUMERICAL EXAMPLE TO SUPPORT YOUR CLAIM THAT CONSUMERS SHOULD NOT PAY FOR AN EXCESSIVE RETURN ON EQUITY TO JUSTIFY LOWER DEBT COSTS?

A. In the current case, the Company's cost of debt is 6.80%, its requested return on equity is 12.0%, its equity ratio is 50.21%, and its rate base is about $3.66 billion. Including income tax effects, for every 100 basis points in a higher

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A. In the current case, the Company's cost of debt is 6.80%, its requested return on equity is 12.0%, its equity ratio is 50.21%, and its rate base is about $3.66 billion. Including income tax effects, for every 100 basis points in a higher

return on equity granted Tampa Electric in this case, consumers must pay approximately $30 million more each year. However, if Tampa Electric experienced a decrease in its bond rating, the Company might pay an additional 50 basis point premium associated with a lower credit rating. The cost for an additional 50 basis points on the cost of debt for Tampa Electric would cost consumers an additional $7.1 million. Hence, it is easy to see that Ms. Abbott's recommendation for consumers to pay a higher return on equity to obtain a lower cost of debt is simply illogical and would force Tampa Electric's customers to pay excessive, unjust rates for exactly the same service.

The reality of Ms. Abbott's recommendation is that the group that would benefit the most from a higher return on equity would be TECO executives and stockholders. Consumers, on the other hand, would suffer with unjustifiably higher rates to pay for an unreasonable return on equity.

Q. HOW DO YOU RECOMMEND THE COMMISSION TREAT THE TESTIMONY OF MS. ABBOTT?

A. In my opinion, I do not believe that consumers should pay for the testimony of Ms. Abbot. I have no issue at all with Tampa Electric absorbing Ms. Abbott's $290,000 in fees for this case, but I do not agree with the Company seeking rate recovery of her fees. Ms. Abbott does not provide a rate of return nor a capital structure recommendation in this case. Instead, she simply supports the Company's requests. Of the $290,000 in rate case fees requested for Ms. Abbott, the Company is also seeking $20,000 for travel expenses. In my view, asking ratepayers to pay such huge consulting fees in today's dire economic conditions is simply wrong. The high flying days of excessive pay by Wall Street executives is, hopefully, behind us. Such rate case fees should

not be recovered from Tampa Electric customers who are struggling to make ends meet in very tough economic times.

My recommendation is that the fees of Ms. Abbott be deducted from rate case expenses allowed for recovery by Tampa Electric in this proceeding.

Q. DO YOU TAKE ISSUE WITH ANY OTHER RATE CASE EXPENSES REQUESTED BY TAMPA ELECTRIC IN THIS CASE?

A. Yes. According to item C-10 of the minimum filing requirements (MFRs), Tampa Electric is seeking recovery of $116,000 to pay for "Analysis/Testimony/Discovery" of JM Cannell. According to this same MFR document, Ms. Cannell is to assist on the issue of "financial integrity." However, Ms. Cannell did not file any testimony. Furthermore, Ms. Abbott was retained by Tampa Electric for the same purpose of supporting the utility in regard to "financial integrity." Between Ms. Abbott and Ms. Cannell, Tampa Electric is seeking to recover $406,000 from its customers to pay for its concern regarding "financial integrity." When one adds in the $68,000 Tampa Electric is seeking for the testimony of Dr. Murry, the Company is seeking almost a half-million dollars from customers for Tampa Electric's and TECO Energy's chosen witnesses just to support TECO Energy's profit levels.

I recommend to the Commission that is also disallow the $116,000 in rate case expenses that Tampa Electric is seeking in this case to pay for the services of Ms. Cannell.

VI. SUMMARY

Q. MR. O'DONNELL, PLEASE SUMMARIZE YOUR TESTIMONY IN THIS PROCEEDING.

A. In the current proceeding, Tampa Electric is requesting this Commission to set rates so that the Company can earn a 12.0% return on equity. In my opinion, this requested return is excessive and cannot be supported by a logical evaluation of current market returns as well as the returns that other state regulators across the country are granting for their regulated utilities.

I performed my cost of equity analysis using the DCF model as well as the comparable earnings model. My conclusion is that 9.75% is the proper return on equity to grant TECO in this proceeding.

In evaluating the Company's requested capital structure, I found evidence of double-leverage in Tampa Electric's capital structure, using parent (TECO Energy) debt to create the appearance that the regulated utility's (Tampa Electric) equity is significantly greater than it is in reality. As a result, I do not believe the Company's requested capital structure is appropriate for use in this proceeding. As an alternative, I recommend the Commission grant Tampa Electric a total rate of return that is based on the capital structure of Tampa Electric adjusted for the parent company's (TECO Energy) use of debt infused as equity into Tampa Electric.

I also recommend that the Commission deduct the fees of Company Witness Abbott from rate case expenses associated in this proceeding. Ms. Abbott does not provide any specific recommendations in this case. The sole purpose of Ms. Abbott's testimony appears to be to support the testimony of other Company witnesses. In my view, it is unconscionable to ask Florida

ratepayers to pay $290,000 in fees for Ms. Abbott's testimony that simply supports positions taken by other company witnesses.

Lastly, I recommend the Commission also disallow the $116,000 in rate case expenses requested by Tampa Electric for the service of JM Cannell. Ms. Cannell does not present any testimony in this proceeding nor does the Company provide any evidence to support this requested rate case expense for Ms. Cannell.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes, it does.

APPENDIX A

APPENDIX A

Appendix A

Kevin W. O'Donnell, CFA
President
Nova Energy Consultants, Inc.
1350 SE Maynard Rd.
Suite 101
Cary, NC 27511

Education

I received a B.S. degree in Civil Engineering - Construction Option from North Carolina State University in May of 1982 and a Masters of Business Administration in Finance from Florida State University in August of 1984.

Professional Certification

I am a Chartered Financial Analyst (CFA) and a member of the Association of Investment Management and Research.

Work Experience

In September of 1984, I joined the Public Staff of the North Carolina Utilities Commission as a Public Utilities Engineer in the Natural Gas Division. In December of 1984, I transferred to the Public Staff's Economic Research Division and held the position of Public Utility Financial Analyst. In September of 1991, I joined Booth & Associates, Inc., a Raleigh, North Carolina, based electrical engineering firm, as a Senior Financial Analyst. I stayed in this position until June 1994, when I accepted employment as the Director of Retail Rates for the North Carolina Electric Membership Corporation. In January 1995, I formed Nova Utility Services, Inc., an

energy consulting firm. In May of 1999, I changed the name of Nova Utility Services, Inc. to Nova Energy Consultants, Inc.

Along with my work with Nova Energy Consultants, Inc., I am also a senior financial analyst for MAKROD Investment Associates of Verona, NJ. MAKROD is a money management firm that specializes in portfolio management services for high wealth individuals and institutional investors.

Testimonies

North Carolina

I have testified before the North Carolina Utilities Commission in the following general rate case proceedings: Public Service Company of North Carolina, Inc. (Docket No. G-5, Sub 200, Sub 207, Sub 246, Sub 327, and Sub 386); Piedmont Natural Gas Company (Docket No. G-9, Sub 251 and Sub 278); General Telephone of the South (Docket No. P-19, Sub 207); North Carolina Power (Docket No. E-22, Sub 314); Piedmont Natural Gas Company (Docket No. E-7, Sub 487); Pennsylvania & Southern Gas Company (Docket No. G-3, Sub 186); and in several water company rate increase proceedings. I also submitted pre-filed testimony, and/or assisted in the settlement process, in Docket Nos. G-9, Sub 378, Sub 382, Sub 428 and Sub 461, which were general rate cases involving Piedmont Natural Gas Company; in Docket No. G-21, Sub 334, North Carolina Natural Gas' most recent general rate case; in Docket No. G-5, Sub 356, Public Service of North Carolina's 1995 general rate case; and in Docket No. G-39, Sub 0, Cardinal Extension Company's rate case. Furthermore, I testified in the 1995 fuel adjustment proceeding for Carolina Power & Light Company (Docket No. E-2, Sub 680) and submitted pre-filed testimony in Docket No. E-7, Sub 559, which was Duke Power's 1995 fuel adjustment proceeding. I also submitted pre-filed testimony and testified in Duke's 2001 fuel adjustment proceeding, which was Docket No. E-7, Sub 685.

Furthermore, I testified in Docket No. G-21, Sub 306 and 307, in which North Carolina Natural Gas Corporation petitioned the Commission to establish a natural gas expansion fund. I also submitted testimony in the Commission's 1998 study of natural gas transportation rates that was part of Docket No. G-5, Sub 386, which was the 1998 general rate case of Public Service Company of North Carolina. In September of 1999, I testified in Docket Nos. G-5, Sub 400 and G-43, which was the merger case of Public Service Company of North Carolina and SCANA Corp. I also submitted testimony and stood cross-examination in the holding company application of NUI Corporation, a utility holding company located in New Jersey, which was NCUC Docket No. G-3, Sub 224, as well as NUI's merger application with Virginia Gas Company, which was Docket No. G-3, Sub 232. I also submitted pre-filed testimony and stood cross-examination in Docket No. G-3, Sub 235, which involved a tariff change request by NUI Corporation. I testified in another holding company application in Docket No. E-2, Sub 753; G-21, Sub 387; and P-708, Sub 5 which was the holding company application of Carolina Power & Light. In June of 2001, I submitted testimony and stood cross-examination in Docket No. E-2, Sub 778, which was CP&L's application to transfer Certificates of Public Convenience and Necessity (CPCN) from two of the Company's generating units to its non-regulated sister company, Progress Energy Ventures. In November of 2001, I testified in Duke Energy's restructuring application, which was Docket No. E-7, Sub 694. In January 2002, I presented testimony in the merger application of Duke Energy Corp. and Westcoast Energy. In April of 2003, I submitted testimony in Dockets Nos. G-9, Sub 470, Sub 430, and E-2, Sub 825, which was the merger application of Piedmont Natural Gas and North Carolina Natural Gas. In May of 2003, I submitted testimony in the general rate case of Cardinal Pipeline Company, which was Docket No. G-39, Sub 4. In July 2003, I filed testimony in Docket No. E-2, Sub 833, which was CP&L's 2003 fuel case proceeding. I prepared pre-filed testimony and stood cross-examination in the merger application of Piedmont Natural Gas and Eastern North Carolina Natural Gas. In July of 2005, I prepared pre-filed testimony in Carolina

Power & Light's fuel case in North Carolina. In August of 2005 I assisted in the settlement of Piedmont's 2005 general rate case. In June, 2006, I submitted rebuttal testimony in Docket No. E-100, Sub 103, which was the investigation of integrated resource planning (IRP) in North Carolina. Also in the month of June, 2006, I submitted testimony in Docket No. G-9, Sub 519, which was the application of Piedmont Natural Gas to change its tariffs and service regulations. In August, 2006, I assisted in the settlement of the rate case of Public Service of North Carolina in Docket No. G-5, Sub 481. In December of 2006, I prepared direct testimony and stood cross-examination in Docket No. E-7, Sub 751, which was application of Duke Power to share net revenues from certain wholesale power transactions. In January, 2007, I submitted testimony in the application of Duke Energy in Docket No. E-7, Sub 790, which was in regard to the construction of two 800 MW coal fired generation units in Rutherford County, North Carolina. In June, 2008, I filed testimony in Duke Energy's Save-A-Watt energy efficiency filing.

South Carolina

In August of 2002, I submitted pre-filed testimony and stood cross-examination before the South Carolina Public Service Commission in Docket No. 2002-63-G, which was Piedmont's 2002 general rate case. In October of 2004, I submitted pre-filed testimony and stood cross-examination in the general rate case of South Carolina Electric & Gas. In March 2005, I prepared pre-filed testimony and assisted in the settlement involving the fuel application proceeding of South Carolina Electric & Gas. In April of 2005, I prepared pre-filed testimony and assisted in the settlement of Carolina Power & Light's fuel case in South Carolina. In March 2006, I assisted in the settlement involving the fuel application proceeding of South Carolina Electric & Gas. In November of 2007 I assisted in the settlement of the 2007 South Carolina Electric & Gas general rate case proceeding. In October, 2008, I submitted testimony in the 2008 South Carolina Electric & Gas base load review act proceeding.

United States Congress

In May of 1996, I testified before the U.S. House of Representatives, Committee on Commerce and Subcommittee on Energy and Power concerning competition within the electric utility industry.

I have also worked with North Carolina and South Carolina municipalities in presenting comments to the Federal Energy Regulatory Commission regarding the opening of the wholesale power markets in the Carolinas.

Publications

I have also published the following articles: Municipal Aggregation: The Future is Today, *Public Utilities Fortnightly*, October 1, 1995; Small Town, Big Price Cuts, *Energy Buyers Guide*, January 1, 1997; and Worth the Wait, But Still at Risk, *Public Utilities Fortnightly*, May 1, 2000. All of these articles dealt with my firm's experience in working with small towns that purchase their power supplies in the open wholesale power markets.

Tampa Electric Company
Docket No. 080317-EI

Company	DCF Results												
	13 Wk. Avg. Dividend Yield	4 Wk. Avg. Dividend Yield	Current Dividend Yield									Plowback Growth Rate	Schwab Forecasted EPS
Alliant Energy	4.7%	5.0%	5.2%	0.5%	-5.0%	1.5%	3.0%	-10.5%	0.5%	6.0%	9.0%	6.0%	5.1%	7.0%
Amer. Elec. Power	5.0%	5.5%	5.6%	-1.0%	-4.5%	---	3.0%	-9.0%	---	7.5%	8.0%	6.5%	5.5%	5.1%
Avista Corp.	3.5%	3.9%	4.1%	-4.0%	-7.5%	2.5%	-3.0%	3.5%	2.0%	9.0%	12.5%	3.5%	3.0%	6.3%
CenterPoint Energy	5.8%	6.7%	6.4%	---	---	---	NMF	NMF	NMF	8.0%	9.0%	10.5%	7.9%	12.5%
DTE Energy	5.5%	5.9%	5.9%	-0.5%	---	3.5%	-2.0%	---	4.0%	5.0%	1.5%	4.0%	2.5%	6.3%
Duke Energy	5.5%	5.7%	5.9%	---	---	---	---	---	---	4.5%	4.5%	2.5%	2.4%	5.3%
Edison Int'l	3.3%	3.7%	3.6%	7.0%	1.0%	4.5%	---	---	17.5%	5.0%	7.0%	9.0%	6.4%	8.1%
Empire Dist. Elec.	6.4%	6.9%	7.0%	-1.0%	---	2.0%	2.0%	---	2.0%	10.0%	1.5%	3.5%	2.0%	6.0%
G't Plains Energy	7.9%	8.9%	9.3%	0.5%	0.5%	1.5%	---	---	4.5%	1.0%	Nil	4.0%	1.2%	7.6%
Hawaiian Elec.	4.7%	4.7%	4.6%	-0.5%	0.5%	1.5%	-3.0%	---	2.0%	5.0%	1.0%	2.5%	2.3%	4.5%
IDACORP, Inc.	4.2%	4.6%	4.4%	-1.0%	-4.5%	3.5%	-7.0%	-8.5%	2.5%	2.0%	Nil	2.0%	3.1%	6.0%
NISource Inc.	6.4%	7.1%	7.5%	-2.5%	0.5%	7.0%	-5.5%	-2.5%	2.0%	5.0%	1.5%	1.0%	1.8%	3.0%
Northeast Utilities	3.8%	3.9%	3.8%	11.0%	-4.5%	0.5%	8.5%	10.0%	2.5%	11.5%	8.0%	5.5%	4.8%	7.4%
Pepco Holdings	5.0%	5.6%	6.2%	---	---	---	-4.5%	---	1.0%	13.0%	15.0%	3.0%	4.0%	10.3%
PG&E Corp.	4.3%	4.5%	4.4%	1.5%	-3.0%	---	---	---	16.5%	5.0%	9.0%	6.0%	5.7%	7.3%
PNM Resources	4.9%	5.5%	5.8%	2.0%	14.5%	5.5%	-5.0%	9.5%	5.0%	-6.0%	-9.0%	Nil	1.3%	13.5%
Progress Energy	5.9%	6.3%	6.4%	---	3.0%	6.0%	-4.5%	2.5%	3.0%	5.0%	1.0%	1.5%	1.6%	6.2%
SCANA Corp.	5.2%	5.7%	5.7%	3.5%	1.0%	4.5%	4.0%	6.5%	4.0%	4.5%	4.0%	5.5%	4.3%	4.6%
Sierra Pacific Res.	4.6%	4.9%	4.4%	-6.5%	---	-3.5%	---	---	-5.5%	7.5%	NMF	5.5%	4.6%	15.2%
UIL Holdings	5.3%	5.5%	5.5%	-2.0%	---	0.5%	-6.0%	---	-1.0%	4.5%	Nil	1.0%	1.9%	6.0%
UniSource Energy	3.4%	3.7%	3.8%	-5.5%	---	17.5%	3.0%	15.5%	8.5%	nil	3.0%	3.0%	2.1%	NA
Wester Energy	5.6%	6.2%	6.1%	1.0%	-7.0%	-4.0%	32.0%	-5.0%	-4.5%	2.0%	5.5%	4.5%	3.3%	4.4%
Wisconsin Energy	2.7%	2.8%	2.8%	5.5%	-4.5%	4.0%	9.0%	-1.0%	7.0%	8.0%	9.5%	6.5%	6.9%	10.2%
Xcel Energy Inc.	5.0%	5.5%	5.6%	-3.5%	-4.5%	-1.0%	-2.0%	-8.5%	-1.5%	7.5%	3.0%	4.0%	3.8%	6.2%
Average	4.9%	5.3%	5.4%	0.2%	-1.6%	3.0%	1.2%	0.2%	3.4%	6.5%	6.1%	4.4%	3.7%	7.4%
TECO Energy	5.4%	6.1%	6.7%	-3.5%	-3.5%	-2.0%	-11.0%	-11.0%	-9.0%	7.0%	3.0%	6.5%	4.4%	12.8%

Sources:
The Value Line Investment Survey, August 29, 2008; September26, 2008; and November 7, 2008
Schwab Earnings Reports as of Oct. 17, 2008.

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DCF Results
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Attachment B

Docket No. 080317-EI
DCF Summary
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Tampa Electric Company
Docket No. 080317-EI

Company	13 Wk. Avg. Dividend Yield	4 Wk. Avg. Dividend Yield	Current Week Dividend Yield	Average Growth Rate	Historical Growth Rate	Plowback Growth Rate	Fore. Growth Rate
Alliant Energy	4.7%	5.0%	5.2%	2.1%	-1.7%	5.1%	7.0%
Amer. Elec. Power	5.0%	5.5%	5.8%	2.3%	-2.9%	5.5%	6.8%
Avista Corp.	3.5%	3.9%	4.1%	2.7%	-1.1%	3.0%	8.3%
CenterPoint Energy	5.8%	6.7%	6.4%	9.2%	---	7.9%	9.5%
DTE Energy	5.5%	5.9%	5.9%	2.7%	1.3%	2.5%	4.2%
Duke Energy	5.5%	5.7%	5.9%	3.8%	---	2.4%	4.2%
Edison Int'l	3.3%	3.7%	3.8%	7.5%	7.5%	8.4%	7.3%
Empire Dist. Elec.	6.4%	6.9%	7.0%	3.1%	1.3%	2.0%	5.3%
G't Plains Energy	7.9%	8.9%	9.3%	2.6%	1.8%	1.2%	3.2%
Hawaiian Elec.	4.7%	4.7%	4.6%	1.6%	0.1%	2.3%	3.3%
IDACORP, Inc.	4.2%	4.6%	4.4%	-0.2%	-2.5%	3.1%	2.5%
NiSource Inc.	6.4%	7.1%	7.6%	1.0%	-0.2%	1.8%	2.6%
Northeast Utilities	3.6%	3.9%	3.8%	5.7%	4.7%	4.6%	7.6%
Pepco Holdings	5.0%	5.6%	6.2%	6.0%	-1.8%	4.0%	10.3%
PG&E Corp.	4.3%	4.5%	4.4%	6.0%	5.0%	5.7%	6.8%
PNM Resources	4.9%	5.5%	5.8%	3.1%	5.3%	1.3%	-0.4%
Progress Energy	5.9%	6.3%	6.4%	2.5%	2.0%	1.6%	3.4%
SCANA Corp.	5.2%	5.7%	5.7%	4.2%	3.9%	4.3%	4.7%
Sierra Pacific Res.	4.6%	4.9%	4.4%	2.5%	-5.2%	4.6%	7.1%
UIL Holdings	5.3%	5.5%	5.5%	0.6%	-2.1%	1.9%	2.9%
UniSource Energy	3.4%	3.7%	3.8%	5.9%	7.8%	2.1%	2.0%
Westar Energy	5.6%	6.2%	6.1%	2.9%	2.1%	3.3%	4.1%
Wisconsin Energy	2.7%	2.8%	2.8%	5.6%	3.3%	6.9%	8.6%
Xcel Energy Inc.	5.0%	5.5%	5.6%	0.3%	-3.5%	3.8%	5.2%
Average	**4.9%**	**5.3%**	**5.4%**	**3.5%**	**1.1%**	**3.7%**	**5.3%**
TECO	**5.4%**	**6.1%**	**6.7%**	**-0.6%**	**-6.7%**	**4.4%**	**7.3%**

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Plowback
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Tampa Electric Company
Docket No. 080317-EI

Company	% Retained to Common Equity				
	2007	2008E	2009E	11-'13E	Average
Alliant Energy	5.9%	5.0%	5.0%	4.5%	5.1%
Amer. Elec. Power	5.1%	6.0%	6.0%	5.0%	5.5%
Avista Corp.	0.8%	4.0%	4.0%	3.0%	3.0%
CenterPoint Energy	10.0%	8.0%	7.0%	6.5%	7.9%
DTE Energy	1.5%	2.0%	3.0%	3.5%	2.5%
Duke Energy	2.0%	2.5%	2.5%	2.5%	2.4%
Edison Int'l	9.2%	9.0%	8.5%	7.0%	8.4%
Empire Dist. Elec.	NMF	1.0%	2.0%	3.0%	2.0%
G't Plains Energy	0.9%	NMF	NMF	1.5%	1.2%
Hawaiian Elec.	0.8%	NMF	2.5%	3.5%	2.3%
IDACORP, Inc.	2.4%	3.0%	3.5%	3.5%	3.1%
NiSource Inc.	1.2%	1.5%	2.0%	2.5%	1.8%
Northeast Utilities	4.3%	5.0%	4.5%	4.5%	4.6%
Pepco Holdings	2.3%	4.0%	4.0%	5.5%	4.0%
PG&E Corp.	5.9%	6.0%	6.0%	5.0%	5.7%
PNM Resources	NMF	NMF	0.5%	2.0%	1.3%
Progress Energy	0.7%	1.5%	1.5%	2.5%	1.6%
SCANA Corp.	4.0%	4.5%	4.0%	4.5%	4.3%
Sierra Pacific Res.	5.4%	4.5%	4.5%	4.0%	4.6%
UIL Holdings	3.1%	1.0%	1.5%	2.0%	1.9%
UniSource Energy	3.9%	0.5%	2.0%	2.0%	2.1%
Westar Energy	4.3%	4.0%	2.5%	2.5%	3.3%
Wisconsin Energy	7.1%	6.5%	6.5%	7.5%	6.9%
Xcel Energy Inc.	3.1%	3.5%	3.5%	5.0%	3.8%
Average					3.7%
TECO Energy	5.1%	0.5%	6.0%	6.0%	4.4%

Sources:

The Value Line Investment Survey, August 28, 2008; September26, 2008; and November 7, 2008

Attachment B

Docket No. 080317-EI
Returns
KWO-4, Page 1 of 1

Tampa Electric Company
Docket No. 080317-EI

Company	% Return on Common Equity			
	2004	2005	2006	2007
Alliant Energy	8.2%	13.1%	9.1%	11.3%
Amer. Elec. Power	12.2%	11.3%	12.0%	11.4%
Avista Corp.	4.7%	5.9%	8.0%	4.2%
CenterPoint Energy	18.6%	17.4%	27.8%	22.0%
DTE Energy	8.0%	10.0%	7.5%	7.7%
Duke Energy	na	na	4.1%	7.2%
Edison Int'l	3.5%	16.8%	14.0%	13.0%
Empire Dist. Elec.	5.8%	6.0%	8.5%	6.2%
G't Plains Energy	15.5%	13.3%	9.4%	10.1%
Hawaiian Elec.	8.9%	9.7%	9.9%	7.2%
IDACORP, Inc.	7.2%	6.2%	8.9%	6.8%
NiSource Inc.	9.0%	6.0%	6.3%	6.1%
Northeast Utilities	5.1%	5.1%	4.3%	8.4%
Pepco Holdings	7.7%	7.7%	7.0%	7.4%
PG&E Corp.	10.3%	12.3%	12.5%	11.7%
PNM Resources	8.0%	8.2%	7.2%	3.5%
Progress Energy	9.9%	9.0%	6.1%	8.2%
SCANA Corp.	12.2%	11.8%	10.5%	10.8%
Sierra Pacific Res.	4.8%	4.0%	9.0%	6.6%
UIL Holdings	6.7%	5.8%	9.9%	10.1%
UniSource Energy	7.9%	7.5%	10.6%	8.5%
Westar Energy	7.1%	9.5%	10.7%	9.2%
Wisconsin Energy	8.8%	11.3%	10.8%	10.9%
Xcel Energy Inc.	10.0%	9.2%	9.7%	9.1%
Average	**8.3%**	**9.0%**	**9.7%**	**9.1%**
TECO Energy	**10.7%**	**13.3%**	**14.1%**	**13.2%**

Sources:

The Value Line Investment Survey, August 28, 2008; September26, 2008; and November 7, 2008

Attachment B

Docket No. 080317-EI
Capital Structure
KWO-5, Page 1 of 1

Tampa Electric Company
Docket No. 080317-EI

Component	Per Books Acounts	Adjustments	Adjusted Amounts	Ratio (%)	Cost Rate (%)	Wgtd. Cost Rate (%)
	(000's)	(000's)	(000's)			
Long-Term Debt	$1,397,565	$226,998	$1,624,563	44.43%	6.81%	3.03%
Short-Term Debt	$8,002		$8,002	0.22%	4.63%	0.01%
Customer Deposits	$103,724		$103,724	2.84%	6.07%	0.17%
Tax Credits	$8,780		$8,780	0.24%	8.27%	0.02%
Deferred Inc. Taxes	$302,744		$302,744	8.28%	0.00%	0.00%
Common Equity	$1,835,985	-$226,998	$1,608,987	44.00%	9.75%	4.29%
	$3,656,800		$3,656,800	100.00%		7.52%

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Tampa Electric Company

/

DOCKET NO. 080317-EI

FILED: November 26, 2008

DIRECT TESTIMONY

OF

DR. J. RANDALL WOOLRIDGE

On Behalf of the Citizens of the State of Florida

J.R. Kelly
Public Counsel

Office of Public Counsel
c/o The Florida Legislature
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Of the State of Florida

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DIRECT TESTIMONY

OF

DR. J. RANDALL WOOLRIDGE

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 080317-EI

Q. PLEASE STATE YOUR FULL NAME, ADDRESS, AND OCCUPATION

A. My name is J. Randall Woolridge, and my business address is 120 Haymaker Circle, State College, PA 16801. I am a Professor of Finance and the Goldman, Sachs & Co. and Frank P. Smeal Endowed University Fellow in Business Administration at the University Park Campus of the Pennsylvania State University. I am also the Director of the Smeal College Trading Room and President of the Nittany Lion Fund, LLC. A summary of my educational background, research, and related business experience is provided in Appendix A.

I. SUBJECT OF TESTIMONY AND SUMMARY OF RECOMMENDATIONS

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I have been asked by the Florida Office of People's Counsel ("OPC") to provide an opinion as to the overall fair rate of return or cost of capital for the Tampa Electric

Company ("Tampa" or "Company") and to evaluate Tampa's rate of return testimony in this proceeding.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. First I will review my cost of capital recommendation for Tampa, and review the primary areas of contention between Tampa's rate of return position and OPC. Second, I provide an assessment of capital costs in today's capital markets. Third, I discuss my proxy group of electric utility companies for estimating the cost of capital for Tampa. Fourth, I present my recommendations for the Company's capital structure and debt cost rate. Fifth, I discuss the concept of the cost of equity capital, and then estimate the equity cost rate for Tampa. Finally, I critique Tampa's rate of return analysis and testimony. I have a table of contents just after the title page for a more detailed outline.

Q. PLEASE REVIEW YOUR RECOMMENDATIONS REGARDING THE APPROPRIATE RATE OF RETURN FOR TAMPA.

A. I am developed a capital structure and debt cost rate for Tampa that reflects its past and present capitalization. I have applied the Discounted Cash Flow Model ("DCF") and the Capital Asset Pricing Model ("CAPM") to a proxy group of publicly-held electric utility companies ("Electric Proxy Group"). My analysis indicates an equity cost rate in the range of 8.2%-9.8% for Tampa. I have used an equity cost rate at the upper end of the range, 9.75%, in recognition of the current volatile capital market conditions. However, I reserve the right to update my

equity cost rate recommendations prior to hearings. This is because, in my opinion, the current market conditions are in disequilibrium as investors attempt to sort out the economic consequences of the collapse of the financial sector and the unprecedented bail out by the U. S. government. In addition, certain financial data have not been updated to reflect the current economic situation. Using my capital structure and debt and equity cost rates, I am recommending an overall rate of return of 7.33% for Tampa. These findings are summarized in Exhibit JRW-1.

Q. PLEASE SUMMARIZE THE PRIMARY ISSUES REGARGING RATE OF RETURN IN THIS PROCEEDING.

A. Mr. Gordon L. Gillette provides the Company's proposed capital structure and debt cost rates and Dr. Donald A. Murry provides Tampa's proposed common equity cost rate. My analysis suggests that the Company's recommended capital structure with a common equity ratio of 55.3% is equity-rich when compared to the actual capitalization of the Company as well as the capitalization of electric utility companies. I have identified improper adjustments made by the Company that serve to inflate the projected equity in the capital structure. I have adjusted the Company's proposed debt cost rate to reflect market interest rates.

As for the equity cost rate, Dr. Murry's estimate is 12.0%, whereas my analysis indicates an equity cost rate of 9.75% is appropriate for Tampa. We have both used DCF and CAPM approaches to estimating an equity cost rate for the

Company. Dr. Murry has applied these approaches to a proxy group of electric utility companies as well as to TECO Energy.

In terms of the DCF approaches, the two major areas of disagreement are (1) the relevance of DCF equity cost rate results and (2) the estimation of the expected growth rate. With respect to (1), Dr Murry has ignored the vast majority of his own DCF results for the proxy group and TECO Energy in estimating a DCF equity cost rate range of 11.12% to 13.27%. In this regard, he argues that he uses the high end of his DCF range to account for flotation costs and market pressure. I demonstrate that this represents an erroneous adjustment since these costs are undocumented and unnecessary. With respect to (2), Dr. Murry has relied exclusively on the forecasted earnings per share growth rates of Wall Street analysts and *Value Line* in estimating a DCF equity cost rate. I have used both historic and projected growth rate measures, and have evaluated growth in dividends, book value, and earnings per share. A very significant factor that I consider and highlight is the upwardly-biased expected earnings growth rates of Wall Street analysts and *Value Line*.

The CAPM approach requires an estimate of the risk-free interest rate, beta, and the equity risk premium. Whereas there is general agreement on the beta and risk-free interest rate, we have significantly different views on the alternative approaches to measuring the equity risk premium as well as the magnitude of equity risk premium. As I highlight in my testimony, there are three procedures

for estimating an equity risk premium – historic returns, surveys, and expected return models. Dr. Murry relies solely on historic measures of the equity risk premium and has used equity risk premiums of 7.10% and 8.50% in his two versions of the CAPM. I provide evidence that risk premiums based on historic returns series are subject to a myriad of empirical flaws and, as a result, are upwardly biased measures of expected risk premiums. I have used an equity risk premium of 4.56% which (1) uses all three approaches to estimating an equity premium and (2) employs the results of many studies of the equity risk premium. As I note, my equity risk premium is consistent with the equity risk premiums (1) discovered in recent academic studies by leading finance scholars, (2) employed by leading investment banks and management consulting firms, and (3) found in surveys of financial forecasters and corporate CFOs.

Dr. Murry and I also disagree on the need for a size premium adjustment to the CAPM. The size premium is based on historical stock returns and, as discussed in my testimony, there are a number of errors in using historical market returns to compute risk premiums. In addition, I argue that any equity cost rate adjustment based on the relative size of a public utility is inappropriate. One study noted in my testimony tested for a size premium in utilities and concluded that, unlike industrial stocks, utility stocks do not exhibit a significant size premium. The primary reason that a size premium is not required for utilities is that utilities are regulated closely by state and federal agencies and commissions, and hence, their

financial performance is monitored on an on-going basis by agencies of both the state and federal governments.

In the end, the most significant areas of disagreement between Dr. Murry and me with respect to the cost of equity are (1) the relevance of the DCF model and its results in determining an equity cost rate for the Company, and (2) the measurement and magnitude of the equity risk premium.

II. CAPITAL COSTS IN TODAY'S MARKETS

Q. PLEASE DISCUSS CAPITAL COSTS IN TODAY'S MARKETS.

A. Long-term capital cost rates for U.S. corporations are currently at their lowest levels in more than four decades. Corporate capital cost rates are determined by the level of interest rates and the risk premium demanded by investors to buy the debt and equity capital of corporate issuers. The base level of long-term interest rates in the U.S. economy is indicated by the rates on ten-year U.S. Treasury bonds. The rates are provided in Exhibit JRW-2 from 1953 to the present. As indicated, prior to the decline in rates that began in the year 2000, the 10-year Treasury yield had not consistently been in the 4-5 percent range over an extended period of time since the 1960s.

The second base component of the corporate capital cost rates is the risk premium. The risk premium is the return premium required by investors to purchase riskier securities. The equity risk premium is the return premium required to purchase stocks as opposed to bonds. Since the equity risk premium is not readily observable in the markets (as are bond risk premiums), and there are alternative approaches to estimating the equity premium, it is the subject of much debate. One way to estimate the equity risk premium is to compare the mean returns on bonds and stocks over long historical periods. Measured in this manner, the equity risk premium has been in the 5-7 percent range. But recent studies by leading academics indicate the forward-looking equity risk premium is in the 3-4 percent range. These authors indicate that historical equity risk premiums are upwardly biased measures of expected equity risk premiums. Jeremy Siegel, a Wharton finance professor and author of the book *Stocks for the Long Term*, published a study entitled "The Shrinking Equity Risk Premium."[1] He concludes:

> The degree of the equity risk premium calculated from data estimated from 1926 is unlikely to persist in the future. The real return on fixed-income assets is likely to be significantly higher than estimated on earlier data. This is confirmed by the yields available on Treasury index-linked securities, which currently exceed 4%. Furthermore, despite the acceleration in earnings growth, the return on equities is likely to fall from its historical level due to the very high level of equity prices relative to fundamentals.

[1] Jeremy J. Siegel, "The Shrinking Equity Risk Premium," *The Journal of Portfolio Management* (Fall, 1999), p. 15.

Alan Greenspan, the former Chairman of the Federal Reserve Board, indicated in an October 14, 1999, speech on financial risk that the fact that equity risk premiums declined during 1990s is "not in dispute." His assessment focused on the relationship between information availability and equity risk premiums.

> There can be little doubt that the dramatic improvements in information technology in recent years have altered our approach to risk. Some analysts perceive that information technology has permanently lowered equity premiums and, hence, permanently raised the prices of the collateral that underlies all financial assets.
>
> The reason, of course, is that information is critical to the evaluation of risk. The less that is known about the current state of a market or a venture, the less the ability to project future outcomes and, hence, the more those potential outcomes will be discounted.
>
> The rise in the availability of real-time information has reduced the uncertainties and thereby lowered the variances that we employ to guide portfolio decisions. At least part of the observed fall in equity premiums in our economy and others over the past five years does not appear to be the result of ephemeral changes in perceptions. It is presumably the result of a permanent technology-driven increase in information availability, which by definition reduces uncertainty and therefore risk premiums. This decline is most evident in equity risk premiums. It is less clear in the corporate bond market, where relative supplies of corporate and Treasury bonds and other factors we cannot easily identify have outweighed the effects of more readily available information about borrowers.[2]

[2] Alan Greenspan, "Measuring Financial Risk in the Twenty-First Century," Office of the Comptroller of the Currency Conference, October 14, 1999.

In sum, the relatively low interest rates in today's markets as well as the lower risk premiums required by investors indicate that capital costs for U.S. companies are the lowest in decades.

Q. FINALLY, PLEASE DISCUSS THE IMPACT OF RECENT CAPITAL MARKET VOLATILITY CONDITIONS ON THE EQUITY RISK PREMIUM AND THE EQUITY COST RATE.

A. The mortgage, subprime, and credit crises on Wall Street have led to increased market volatility and the unprecedented actions by the U.S. government to resolve the financial crisis. To assess the impact of recent capital market volatility on the equity risk premium and the equity cost rate, one must look at the volatility of stocks relative to bonds. I have performed such an analysis below. To compare the volatility of stocks and bonds, one must standardize the volatility measure. This is normally done by dividing the volatility measure, the standard deviation, by the mean. This standardized volatility measure is known as the Coefficient of Variation ("CV").

Q. GIVEN THESE OBSERVATIONS, PLEASE PROVIDE YOUR ASSESSMENT OF THE IMPACT OF RECENT CAPITAL MARKET CONDITIONS ON THE EQUITY COST RATE.

A. I have performed an analysis of the volatility of stocks relative to bonds since 1997. I have used the S&P 500 and the Bear Sterns Bond Price Index ("BSBPI") and computed the CV using a 200-day mean and standard deviation. In Exhibit

JRW-5, I have graphed the ratio of the CV(Stock CV)/CV(Bond CV). Hence, this graph shows the standardized volatility of stocks relative to bonds. Higher levels of this ratio represent time periods when stock volatility is high relative to bond volatility, and low levels of this ratio occur during time periods when stock volatility is low relative to bonds. During the last two quarters of 2007, the volatility of bonds increased relative to stocks due to the subprime mortgage crisis. Through October of this year, stocks have increased in volatility relative to bonds. On the relative CV measure, stocks reached a five-year high in terms of relative volatility. As such, current market conditions suggest that stock volatility is high relative to bond volatility.

III. PROXY GROUP SELECTION

Q. PLEASE DESCRIBE YOUR APPROACH TO DEVELOPING A FAIR RATE OF RETURN RECOMMENDATION FOR TAMPA.

A. To develop a fair rate of return recommendation for Tampa, I have evaluated the return requirements of investors on the common stock of a proxy group of publicly-held electric utility companies.

Q. PLEASE DESCRIBE YOUR PROXY GROUP OF ELECRIC UTILITY COMPANIES.

A. My Electric Proxy Group consists of thirteen electric utility companies. These companies met the following selection criteria: (1) listed as a Electric Utility in *AUS*

Utility Reports; (2) listed as a Electric Utility in the Standard Edition of the *Value Line Investment Survey*; (3) at least 75% regulated electric revenues; (4) operating revenues of less than $10B; and (5) an investment grade bond rating by Moody's and Standard & Poor's. Summary financial statistics for the Electric Proxy Group are listed in Exhibit JRW-3. The average operating revenues and net plant for the group are $2,908.2M and $5,173.3M, respectively. On average, the group receives 91% of revenues from regulated electric operations, has a 'Baa1' Moody's bond rating, a current common equity ratio of 45%, and an earned return on common equity of 8.9%.

IV. CAPITAL STRUCTURE RATIOS AND DEBT COST RATES

Q. WHAT IS THE RECOMMENDED CAPITAL STRUCTURE OF THE COMPANY?

A. The Company's recommended capital structure is shown in Panel A of page 1 of Exhibit JRW-4. The Company is requesting a capital structure consisting of 0.24% short-term debt, 42.11% long-term debt, and a 55.32% common equity. This is a 2009 test-year capital structure average and includes a number of adjustments as well as several equity infusions from TECO Energy.

Q. IS THE COMPANY'S RECOMMENDED CAPITAL STRUCTURE APPROPRIATE FOR TAMPA?

A. No. This capital structure is not appropriate for Tampa for several reasons. First, the proposed capital structure ratios do not reflect the actual capitalization of

Tampa Electric. Panel B of Exhibit JRW-4 shows the average capital structure ratios for the Company over the past three years. The average common equity ratio over this time period is 49.02%. Second, the proposed capital structure ratios do not reflect the capitalization of electric utility companies. Panel C of Exhibit JRW-4 shows the average capital structure ratios for the Electric Proxy Group in 2008. The average common equity for the first eleven months of 2008 for the group is 45.7%. Third, the proposed capital structure includes a number of adjustments as well as proposed infusions which serve to increase the equity in the capital structure. The Company's proposed adjustments are discussed in the rebuttal section of my testimony.

Q. WHAT CAPITAL STRUCTURE ARE YOU EMPLOYING FOR TAMPA?

A. Page 4 of Exhibit JRW-4 provides the Company's capitalization for the years 2007, 2008, and 2009. As discussed, the 2009 pro forma capital structure includes a number of adjustments as well as proposed equity infusions. Some of these adjustments are improper, as will be discussed in my rebuttal testimony. The 2007 and 2008 capital structures are provided in Panel D of Exhibit JRW-4. These capital structures reflect the actual capitalizations of the company as it has been financed. As such, I am using the average of the 2007 and 2008 capital structures as my proposed capital structure ratios for Tampa. These figures are shown in Panel E of Exhibit JRW-4.

Q. WHY DO YOU BELIEVE THAT YOUR RECOMMENDED CAPITAL STRUCTURE IS MORE APPROPRIATE THAN THE CAPITAL STRUCTURE PROPOSED BY THE COMPANY?

A. My capital structure is more appropriate for four reasons. My capital structure, with a common equity ratio of 48.89%: (1) much more accurately reflects how the Company has been financed in the past. The Company's average common equity ratio over the past three years has been 49.02%; (2) much more closely reflects the capitalizations of electric utility companies. The average capital structure ratio for the Electric Proxy Group in 2008 is 45.7%; (3) does not include a number of questionable and uncertain adjustments and equity injections; and (4) much more accurately reflects the Company's capital structure as viewed by investors.

Q. WHAT SHORT-TERM DEBT COST RATES ARE YOU USING IN THE COST OF CAPITAL FOR TAMPA?

A. The Company's short-term debt cost rate is based on a short-term debt rate assumption of 4.5%. This rate, in turn, is based on the historic London Interbank Offered Rate ("LIBOR") between 1991-2008 (see Tampa response to OPC 3-60, part 1) of 4.37% plus a program financing fee. This has very little to do with current LIBOR rates. Page 5 of Exhibit JRW-4 shows LIBOR rates over the past five years. During 2008, LIBOR rates declined to the 2.75% range early in the summer in response to Federal Reserve actions to lower interest rates. These rates increased dramatically to the 4.75% range in September in response to the

spreading credit crisis. However, the intervention of the Federal Reserve, the Treasury Department, and U.S. government has resulted in a significant decline in the LIBOR rate. As of November 13, 2008, the three-month LIBOR rate was 2.15%. Including the financing program fee of 18 basis points, I will use a short-term debt cost rate of 2.33% (2.15% + 0.18% = 2.33%).

Q. WHAT LONG-TERM DEBT COST RATE ARE YOU USING IN THE COST OF CAPITAL FOR TAMPA?

A. The Company's long-term debt cost rate for rate year 2009 is 6.80%. Details of the development of this debt cost rate were provided in Tampa's response to OPC 3-60, part 2. This is shown on page 6 of Exhibit JRW-4. This debt cost rate includes a 2009 bond issue with a 6.90% coupon rate. I will adopt the Company's long-term debt cost rate of 6.80%.

V. THE COST OF COMMON EQUITY CAPITAL

A. Overview

Q. WHY MUST AN OVERALL COST OF CAPITAL OR FAIR RATE OF RETURN BE ESTABLISHED FOR A PUBLIC UTILITY?

A. In a competitive industry, the return on a firm's common equity capital is determined through the competitive market for its goods and services. Due to the capital requirements needed to provide utility services, however, and to the economic benefit to society from avoiding duplication of these services, some public utilities are monopolies. It is not appropriate to permit monopoly utilities to

set their own prices because of the lack of competition and the essential nature of the services. Thus, regulation seeks to establish prices that are fair to consumers and at the same time are sufficient to meet the operating and capital costs of the utility (i.e., provide an adequate return on capital to attract investors).

Q. PLEASE PROVIDE AN OVERVIEW OF THE COST OF CAPITAL IN THE CONTEXT OF THE THEORY OF THE FIRM.

A. The total cost of operating a business includes the cost of capital. The cost of common equity capital is the expected return on a firm's common stock that the marginal investor would deem sufficient to compensate for risk and the time value of money. In equilibrium, the expected and required rates of return on a company's common stock are equal.

Normative economic models of the firm, developed under very restrictive assumptions, provide insight into the relationship between firm performance or profitability, capital costs, and the value of the firm. Under the economist's ideal model of perfect competition where entry and exit is costless, products are undifferentiated, and there are increasing marginal costs of production, firms produce up to the point where price equals marginal cost. Over time, a long-run equilibrium is established where price equals average cost, including the firm's capital costs. In equilibrium, total revenues equal total costs, and because capital costs represent investors' required return on the firm's capital, actual returns equal

required returns and the market value and the book value of the firm's securities must be equal.

In the real world, firms can achieve competitive advantage due to product market imperfections. Most notably, companies can gain competitive advantage through product differentiation (adding real or perceived value to products) and by achieving economies of scale (decreasing marginal costs of production). Competitive advantage allows firms to price products above average cost and thereby earn accounting profits greater than those required to cover capital costs. When these profits are in excess of that required by investors, or when a firm earns a return on equity in excess of its cost of equity, investors respond by valuing the firm's equity in excess of its book value.

James M. McTaggart, founder of the international management consulting firm Marakon Associates, has described this essential relationship between the return on equity, the cost of equity, and the market-to-book ratio in the following manner:[3]

> Fundamentally, the value of a company is determined by the cash flow it generates over time for its owners, and the minimum acceptable rate of return required by capital investors. This "cost of equity capital" is used to discount the expected equity cash flow, converting it to a present value. The cash flow is, in turn, produced by the interaction of a company's return on equity and the annual rate of equity growth. High return on equity (ROE) companies in low-growth markets, such as

[3] James M. McTaggart, "The Ultimate Poison Pill: Closing the Value Gap," *Commentary* (Spring 1988), p. 2.

> Kellogg, are prodigious generators of cash flow, while low ROE companies in high-growth markets, such as Texas Instruments, barely generate enough cash flow to finance growth.
>
> A company's ROE over time, relative to its cost of equity, also determines whether it is worth more or less than its book value. If its ROE is consistently greater than the cost of equity capital (the investor's minimum acceptable return), the business is economically profitable and its market value will exceed book value. If, however, the business earns an ROE consistently less than its cost of equity, it is economically unprofitable and its market value will be less than book value.

As such, the relationship between a firm's return on equity, cost of equity, and market-to-book ratio is relatively straightforward. A firm that earns a return on equity above its cost of equity will see its common stock sell at a price above its book value. Conversely, a firm that earns a return on equity below its cost of equity will see its common stock sell at a price below its book value.

Q. PLEASE PROVIDE ADDITIONAL INSIGHTS INTO THE RELATIONSHIP BETWEEN RETURN ON EQUITY AND MARKET-TO-BOOK RATIOS.

A. This relationship is discussed in a classic Harvard Business School case study entitled "A Note on Value Drivers." On page 2 of that case study, the author describes the relationship very succinctly:[4]

> For a given industry, more profitable firms – those able to generate higher returns per dollar of equity – should have

[4] Benjamin Esty, "A Note on Value Drivers," Harvard Business School, Case No. 9-297-082, April 7, 1997.

higher market-to-book ratios. Conversely, firms which are unable to generate returns in excess of their cost of equity should sell for less than book value.

Profitability	*Value*
If ROE > K	*then Market/Book > 1*
If ROE = K	*then Market/Book =1*
If ROE < K	*then Market/Book < 1*

To assess the relationship by industry, as suggested above, I have performed a regression study between estimated return on equity and market-to-book ratios using natural gas distribution, electric utility and water utility companies. I used all companies in these three industries which are covered by *Value Line* and who have estimated return on equity and market-to-book ratio data. The results are presented in Panels A-C of Exhibit JRW-6. The average R-squares for the electric, gas, and water companies are 0.65, 0.60, and 0.92.[5] This demonstrates the strong positive relationship between ROEs and market-to-book ratios for public utilities. This means that utilities with higher expected ROEs sell at higher market-to-book ratios.

Q. WHAT ECONOMIC FACTORS HAVE AFFECTED THE COST OF EQUITY CAPITAL FOR PUBLIC UTILITIES?

A. Exhibit JRW-7 provides indicators of public utility equity cost rates over the past decade. Page 1 shows the yields on 10-year 'A' rated public utility bonds. These yields peaked in the 1990s at 8.5%, then declined and again hit the 8.0 percent range in the year 2000. They subsequently declined, hovering in the 4.5 to 5.0

[5] R-square measures the percent of variation in one variable (e.g., market-to-book ratios) explained by another variable (e.g., expected return on equity). R-squares vary between zero and 1.0, with values closer to 1.0 indicating a higher relationship between two variables.

percent range between 2003 and 2005. They increased to 6.0% in June 2006, declined and then once again increased to over 6.0% in the summer of 2007. They retreated to the 5.50% range by the end of 2007. Page 2 provides the dividend yields for the fifteen utilities in the Dow Jones Utilities Average over the past decade. These yields peaked in 1994 at 7.2% and have gradually declined over the past decade. As of 2007, these yields were 3.35%.

Average earned returns on common equity and market-to-book ratios are given on page 3 of Exhibit JRW-7. Over the past decade, earned returns on common equity have consistently been in the 11.0%-13.0% range. The average ROE peaked at 13.45% in 2001 and subsequently declined through the year 2006 before recovering in 2007. Over the past decade, market-to-book ratios for this group have increased gradually but with several ups and downs. The market-to-book average was 1.83 as of 2001, declined to 1.50 in 2003 and increased to 2.2 as of 2007.

The indicators in Exhibit JRW-7, coupled with the overall decrease in interest rates, suggest that capital costs for the Dow Jones Utilities have decreased over the past decade.

Q. WHAT FACTORS DETERMINE INVESTORS' EXPECTED OR REQUIRED RATE OF RETURN ON EQUITY?

A. The expected or required rate of return on common stock is a function of market-wide, as well as company-specific, factors. The most important market factor is the time value of money as indicated by the level of interest rates in the economy. Common stock investor requirements generally increase and decrease with like changes in interest rates. The perceived risk of a firm is the predominant factor that influences investor return requirements on a company-specific basis. A firm's investment risk is often separated into business and financial risk. Business risk encompasses all factors that affect a firm's operating revenues and expenses. Financial risk results from incurring fixed obligations in the form of debt in financing its assets.

Q. HOW DOES THE INVESTMENT RISK OF PUBLIC UTILITY COMPANIES COMPARE WITH THAT OF OTHER INDUSTRIES?

A. Due to the essential nature of their service as well as their regulated status, public utilities are exposed to a lesser degree of business risk than other, non-regulated businesses. The relatively low level of business risk allows public utilities to meet much of their capital requirements through borrowing in the financial markets, thereby incurring greater than average financial risk. Nonetheless, the overall investment risk of public utilities is below most other industries.

Exhibit JRW-8 provides an assessment of investment risk for 100 industries as measured by beta, which according to modern capital market theory is the only relevant measure of investment risk. These betas come from the *Value Line*

Investment Survey and are compiled by Aswath Damodoran of New York University.[6] The study shows that the investment risk of public utilities is relatively low. The average beta for electric utility industry is 0.88. This figure put electric utility companies in the bottom twenty percent of all industries and well below the *Value Line* average of 1.24. As such, the cost of equity for the electric utility industry is relatively low compared to other industries in the U.S.

Q. HOW CAN THE EXPECTED OR REQUIRED RATE OF RETURN ON COMMON EQUITY CAPITAL BE DETERMINED?

A. The costs of debt and preferred stock are normally based on historical or book values and can be determined with a great degree of accuracy. The cost of common equity capital, however, cannot be determined precisely and must instead be estimated from market data and informed judgment. This return to the stockholder should be commensurate with returns on investments in other enterprises having comparable risks.

According to valuation principles, the present value of an asset equals the discounted value of its expected future cash flows. Investors discount these expected cash flows at their required rate of return that, as noted above, reflect the time value of money and the perceived riskiness of the expected future cash flows. As such, the cost of common equity is the rate at which investors discount expected cash flows associated with common stock ownership.

[6] They may be found on the Internet at http:// www.stern.nyu.edu/~adamodar.

Models have been developed to ascertain the cost of common equity capital for a firm. Each model, however, has been developed using restrictive economic assumptions. Consequently, judgment is required in selecting appropriate financial valuation models to estimate a firm's cost of common equity capital, in determining the data inputs for these models, and in interpreting the models' results. All of these decisions must take into consideration the firm involved as well as current conditions in the economy and the financial markets.

Q. HOW DO YOU PLAN TO ESTIMATE THE COST OF EQUITY CAPITAL FOR THE COMPANY?

A. I rely primarily on the DCF model to estimate the cost of equity capital. Given the investment valuation process and the relative stability of the utility business, I believe that the DCF model provides the best measure of equity cost rates for public utilities. It is my experience that this Commission has traditionally relied on the DCF method. I have also performed a CAPM study, but I give these results less weight because I believe that risk premium studies, of which the CAPM is one form, provide a less reliable indication of equity cost rates for public utilities.

B. <u>Discounted Cash Flow Analysis</u>

Q. DESCRIBE THE THEORY BEHIND THE TRADITIONAL DCF MODEL.

A. According to the DCF model, the current stock price is equal to the discounted value of all future dividends that investors expect to receive from investment in the firm. As such, stockholders' returns ultimately result from current as well as future dividends. As owners of a corporation, common stockholders are entitled to a pro-rata share of the firm's earnings. The DCF model presumes that earnings that are not paid out in the form of dividends are reinvested in the firm so as to provide for future growth in earnings and dividends. The rate at which investors discount future dividends, which reflects the timing and riskiness of the expected cash flows, is interpreted as the market's expected or required return on the common stock. Therefore, this discount rate represents the cost of common equity. Algebraically, the DCF model can be expressed as:

$$P = \frac{D_1}{(1+k)^1} + \frac{D_2}{(1+k)^2} + \ldots \frac{D_n}{(1+k)^n}$$

where P is the current stock price, D_n is the dividend in year n, and k is the cost of common equity.

Q. IS THE DCF MODEL CONSISTENT WITH VALUATION TECHNIQUES EMPLOYED BY INVESTMENT FIRMS?

A. Yes. Virtually all investment firms use some form of the DCF model as a valuation technique. One common application for investment firms is called the three-stage DCF or dividend discount model ("DDM"). The stages in a three-stage DCF model are presented in Exhibit JRW-9. This model presumes that a company's dividend payout progresses initially through a growth stage, then

proceeds through a transition stage, and finally assumes a steady-state stage. The dividend-payment stage of a firm depends on the profitability of its internal investments, which, in turn, is largely a function of the life cycle of the product or service.

1. Growth stage: Characterized by rapidly expanding sales, high profit margins, and abnormally high growth in earnings per share. Because of highly profitable expected investment opportunities, the payout ratio is low. Competitors are attracted by the unusually high earnings, leading to a decline in the growth rate.

2. Transition stage: In later years, increased competition reduces profit margins and earnings growth slows. With fewer new investment opportunities, the company begins to pay out a larger percentage of earnings.

3. Maturity (steady-state) stage: Eventually the company reaches a position where its new investment opportunities offer, on average, only slightly attractive returns on equity. At that time its earnings growth rate, payout ratio, and return on equity stabilize for the remainder of its life. The constant-growth DCF model is appropriate when a firm is in the maturity stage of the life cycle.

In using this model to estimate a firm's cost of equity capital, dividends are projected into the future using the different growth rates in the alternative stages,

and then the equity cost rate is the discount rate that equates the present value of the future dividends to the current stock price.

Q. HOW DO YOU ESTIMATE STOCKHOLDERS' EXPECTED OR REQUIRED RATE OF RETURN USING THE DCF MODEL?

A. Under certain assumptions, including a constant and infinite expected growth rate, and constant dividend/earnings and price/earnings ratios, the DCF model can be simplified to the following:

$$P = \frac{D_1}{k - g}$$

where D_1 represents the expected dividend over the coming year and g is the expected growth rate of dividends. This is known as the constant-growth version of the DCF model. To use the constant-growth DCF model to estimate a firm's cost of equity, one solves for k in the above expression to obtain the following:

$$k = \frac{D_1}{P} + g$$

Q. IN YOUR OPINION, IS THE CONSTANT-GROWTH DCF MODEL APPROPRIATE FOR PUBLIC UTILITIES?

A. Yes. The economics of the public utility business indicate that the industry is in the steady-state or constant-growth stage of a three-stage DCF. The economics include the relative stability of the utility business, the maturity of the demand for

public utility services, and the regulated status of public utilities (especially the fact that their returns on investment are effectively set through the ratemaking process). The DCF valuation procedure for companies in this stage is the constant-growth DCF. In the constant-growth version of the DCF model, the current dividend payment and stock price are directly observable. However, the primary problem and controversy in applying the DCF model to estimate equity cost rates entails estimating investors' expected dividend growth rate.

Q. WHAT FACTORS SHOULD ONE CONSIDER WHEN APPLYING THE DCF METHODOLOGY?

A. One should be sensitive to several factors when using the DCF model to estimate a firm's cost of equity capital. In general, one must recognize the assumptions under which the DCF model was developed in estimating its components (the dividend yield and expected growth rate). The dividend yield can be measured precisely at any point in time, but tends to vary somewhat over time. Estimation of expected growth is considerably more difficult. One must consider recent firm performance, in conjunction with current economic developments and other information available to investors, to accurately estimate investors' expectations.

Q. PLEASE DISCUSS EXHIBIT JRW-10.

A. My DCF analysis is provided in Exhibit JRW-10. The DCF summary is on page 1 of this Exhibit, and the supporting data and analysis for the dividend yield and expected growth rate are provided on the following pages of the Exhibit.

Q. WHAT DIVIDEND YIELDS ARE YOU EMPLOYING IN YOUR DCF ANALYSIS FOR THE PROXY GROUP?

A. The dividend yields on the common stock for the companies in the proxy group are provided on page 2 of Exhibit JRW-10 for the six-month period ending November 2008. For the DCF dividend yields for the group, I am using the average of the six month and November 2008 dividend yields, which is 5.2%.

Q. PLEASE DISCUSS THE APPROPRIATE ADJUSTMENT TO THE SPOT DIVIDEND YIELD.

A. According to the traditional DCF model, the dividend yield term relates to the dividend yield over the coming period. As indicated by Professor Myron Gordon, who is commonly associated with the development of the DCF model for popular use, this is obtained by: (1) multiplying the expected dividend over the coming quarter by 4 and (2) dividing this dividend by the current stock price to determine the appropriate dividend yield for a firm, that pays dividends on a quarterly basis.[7] In applying the DCF model, some analysts adjust the current dividend for growth over the coming year as opposed to the coming quarter. This can be complicated because firms tend to announce changes in dividends at different times during the year. As such, the dividend yield computed based on presumed growth over the coming quarter as opposed to the coming year can be quite different.

[7] *Petition for Modification of Prescribed Rate of Return*, Federal Communications Commission, Docket No. 79-05, Direct Testimony of Myron J. Gordon and Lawrence I. Gould at 62 (April 1980).

Consequently, it is common for analysts to adjust the dividend yield by some fraction of the long-term expected growth rate.

Q. GIVEN THIS DISCUSSION, WHAT ADJUSTMENT FACTOR WILL YOU USE FOR YOUR DIVIDEND YIELD?

A. I will adjust the dividend yield by one-half (1/2) the expected growth so as to reflect growth over the coming year.

Q. PLEASE DISCUSS THE GROWTH RATE COMPONENT OF THE DCF MODEL.

A. There is much debate as to the proper methodology to employ in estimating the growth component of the DCF model. By definition, this component is investors' expectation of the long-term dividend growth rate. Presumably, investors use some combination of historical and/or projected growth rates for earnings and dividends per share and for internal or book value growth to assess long-term potential.

Q. WHAT GROWTH DATA HAVE YOU REVIEWED FOR THE PROXY GROUP?

A. I have analyzed a number of measures of growth for companies in the proxy group. I have reviewed *Value Line's* historical and projected growth rate estimates for earnings per share ("EPS"), dividends per share ("DPS"), and book value per

share ("BVPS"). In addition, I have utilized the average EPS growth rate forecasts of Wall Street analysts as provided by Bloomberg, and Zacks. These services solicit five-year earnings growth rate projections from securities analysts, and compile and publish the means and medians of these forecasts. Finally, I have also assessed prospective growth as measured by prospective earnings retention rates and earned returns on common equity.

Q. PLEASE DISCUSS HISTORICAL GROWTH IN EARNINGS AND DIVIDENDS AS WELL AS INTERNAL GROWTH.

A. Historical growth rates for EPS, DPS, and BVPS are readily available to virtually all investors and presumably an important ingredient in forming expectations concerning future growth. However, one must use historical growth numbers as measures of investors' expectations with caution. In some cases, past growth may not reflect future growth potential. Also, employing a single growth rate number (for example, for five or ten years), is unlikely to accurately measure investors' expectations due to the sensitivity of a single growth rate figure to fluctuations in individual firm performance as well as overall economic fluctuations (i.e., business cycles). However, one must appraise the context in which the growth rate is being employed. According to the conventional DCF model, the expected return on a security is equal to the sum of the dividend yield and the expected long-term growth in dividends. Therefore, to best estimate the cost of common

equity capital using the conventional DCF model, one must look to long-term growth rate expectations.

Internally generated growth is a function of the percentage of earnings retained within the firm (the earnings retention rate) and the rate of return earned on those earnings (the return on equity). The internal growth rate is computed as the retention rate times the return on equity. Internal growth is significant in determining long-run earnings and, therefore, dividends. Investors recognize the importance of internally generated growth and pay premiums for stocks of companies that retain earnings and earn high returns on internal investments.

Q. WHY ARE YOU NOT RELYING EXCLUSIVELY ON THE EPS FORECASTS OF WALL STREET ANALYSTS IN ARRIVING AT A DCF GROWTH RATE FOR THE PROXY GROUP?

A. There are several issues with using the EPS growth rate forecasts of Wall Street analysts as DCF growth rates. First, the appropriate growth rate in the DCF model is the dividend growth rate, not the earnings growth rate. Nonetheless, over the very long-term, dividend and earnings will have to grow at a similar growth rate. Therefore, in my opinion, consideration must be given to other indicators of growth, including prospective dividend growth, internal growth, as well as projected earnings growth. Second, and most significantly, it is well-known that the EPS growth rate forecasts of Wall Street securities analysts are overly optimistic and upwardly biased. Hence, using these growth rates as a DCF

growth rate will provide an overstated equity cost rate. This issue is discussed at length in the rebuttal section of this testimony.

Q. PLEASE DISCUSS THE HISTORICAL GROWTH OF THE COMPANIES IN THE GROUP AS PROVIDED IN THE *VALUE LINE INVESTMENT SURVEY.*

A. Historic growth rates for the companies in the group, as published in the *Value Line Investment Survey*, are provided on page 3 of Exhibit JRW-10. Due to the presence of outliers among the historic growth rate figures, both the mean and medians are used in the analysis.[8] The historical growth measures in EPS, DPS, and BVPS for the Electric Proxy Group, as measured by the means and medians, range from -2.3% to 3.0%, with an average of 1.0%.

Q. PLEASE SUMMARIZE *VALUE LINE'S* PROJECTED GROWTH RATES FOR THE COMPANIES IN THE PROXY GROUP.

A. *Value Line's* projections of EPS, DPS, and BVPS growth for the companies in the proxy group are shown on page 4 of Exhibit JRW-10. As stated above, due to the presence of outliers, both the mean and medians are used in the analysis. For the Electric Proxy Group, the central tendency measures range from 1.0% to 6.3%, with an average of 3.8%.

[8] Outliers are observations that are much larger or smaller than the majority of the observations that are being evaluated.

Also provided on page 4 of Exhibit JRW-10 is prospective internal growth for the proxy group as measured by *Value Line*'s average projected retention rate and return on shareholders' equity. As noted above, internal growth is significant in a primary driver of long-run earnings growth. For the Electric Proxy Group, the average prospective internal growth rate is 3.6%.

Q. PLEASE ASSESS GROWTH FOR THE PROXY GROUP AS MEASURED BY ANALYSTS' FORECASTS OF EXPECTED 5-YEAR EPS GROWTH.

A. Zacks, and Bloomberg collect, summarize, and publish Wall Street analysts' five-year EPS growth rate forecasts for the companies in the proxy group. These forecasts are provided for the companies in the proxy group on page 5 of Exhibit JRW-10. The median of analysts' projected EPS growth rates for the Electric Proxy Group is 6.13%.[9]

Q. PLEASE SUMMARIZE YOUR ANALYSIS OF THE HISTORICAL AND PROSPECTIVE GROWTH OF THE PROXY GROUP.

A. Page 6 of Exhibit JRW-10 shows the summary DCF growth rate indicators for the proxy group. The average of the historic and projected growth rate indicators for the Electric Proxy Group is 3.63%. The average of the projected growth rate

[9] Since there is considerable overlap in analyst coverage between the three services, and not all of the companies have forecasts from the different services, I have averaged the expected five-year EPS growth rates from the three services for each company to arrive at an expected EPS growth rate by company.

indicators and internal growth, excluding historical growth, is 4.5%. I will use this figure as the expected DCF growth rate for the Electric Proxy Group.

Q. BASED ON THE ABOVE ANALYSIS, WHAT ARE YOUR INDICATED COMMON EQUITY COST RATES FROM THE DCF MODEL FOR THE GROUP?

A. My DCF-derived equity cost rate for the group is summarized on page 1 of Exhibit JRW-10.

$$\text{DCF Equity Cost Rate (k)} = \frac{D}{P} + g$$

$$\text{DCF Equity Cost Rate (k)} = 5.3\% + 4.5\% = 9.8\%$$

C. <u>Capital Asset Pricing Model Results</u>

Q. PLEASE DISCUSS THE CAPITAL ASSET PRICING MODEL ("CAPM").

A. The CAPM is a risk premium approach to gauging a firm's cost of equity capital. According to the risk premium approach, the cost of equity is the sum of the interest rate on a risk-free bond (R_f) and a risk premium (RP), as in the following:

$$k = R_f + RP$$

The yield on long-term Treasury securities is normally used as R_f. Risk premiums are measured in different ways. The CAPM is a theory of the risk and expected returns of common stocks. In the CAPM, two types of risk are associated with a stock: firm-specific risk or unsystematic risk, and market or systematic risk, which is measured by a firm's beta. The only risk that investors receive a return for bearing is systematic risk.

According to the CAPM, the expected return on a company's stock, which is also the equity cost rate (K), is equal to:

$$K = (R_f) + \beta * [E(R_m) - (R_f)]$$

Where:

- K represents the estimated rate of return on the stock;
- $E(R_m)$ represents the expected return on the overall stock market. Frequently, the 'market' refers to the S&P 500;
- (R_f) represents the risk-free rate of interest;
- $[E(R_m) - (R_f)]$ represents the expected equity or market risk premium—the excess return that an investor expects to receive above the risk-free rate for investing in risky stocks; and
- *Beta*—(ß) is a measure of the systematic risk of an asset.

To estimate the required return or cost of equity using the CAPM requires three inputs: the risk-free rate of interest (R_f), the beta (ß), and the expected equity or market risk premium $[E(R_m) - (R_f)]$. R_f is the easiest of the inputs to measure – it is the yield on long-term Treasury bonds. ß, the measure of systematic risk, is a little more difficult to measure because there are different opinions about what adjustments, if any, should be made to historical betas due to their tendency to

regress to 1.0 over time. And finally, an even more difficult input to measure is the expected equity or market risk premium ($E(R_m)$ - (R_f)). I will discuss each of these inputs below.

Q. PLEASE DISCUSS EXHIBIT JRW-11.

A. Exhibit JRW-11 provides the summary results for my CAPM study. Page 1 shows the results, and the following pages contain the supporting data.

Q. PLEASE DISCUSS THE RISK-FREE INTEREST RATE.

A. The yield on long-term U.S. Treasury bonds has usually been viewed as the risk-free rate of interest in the CAPM. The yield on long-term U.S. Treasury bonds, in turn, has been considered to be the yield on U.S. Treasury bonds with 30-year maturities. However, when the Treasury's issuance of 30-year bonds was interrupted for a period of time in recent years, the yield on 10-year U.S. Treasury bonds replaced the yield on 30-year U.S. Treasury bonds as the benchmark long-term Treasury rate. The 10-year U.S. Treasury yields over the past five years are shown on page 2 of Exhibit JRW-11. These rates hit a 60-year low in the summer of 2003 at 3.33%. They increased with the rebounding economy and fluctuated in the 4.0-4.50 percent range in recent years until advancing to 5.0% in early 2006 in response to a strong economy and increases in energy, commodity, and consumer prices. In late 2006, long-term interest rates retreated to the 4.5 percent area as commodity and energy prices declined and inflationary pressures subsided. These rates rebounded to the 5.0% level in the first half of 2007. However, ten-year

Treasury yields have again fallen below 4.0 percent due to the housing and sub-prime mortgage crises and its affect on the economy and financial markets.

Q. WHAT RISK-FREE INTEREST RATE ARE YOU USING IN YOUR CAPM?

A. The U.S. Treasury began to issue the 30-year bond in the early 2000s as the U.S. budget deficit increased. As such, the market has once again focused on its yield as the benchmark for long-term capital costs in the U.S. As noted above, the yields on the 10- and 30- year U.S. Treasuries decreased to below 5.0% in 2007 and have remained at these lower levels. In 2008 Treasury yields have been pushed even lower as a result of the mortgage and sub-prime market credit crisis, the turmoil in the financial sector, the prospect of an economic recession, and the government bailout of financial institutions. As of November 3, 2008, as shown on page 2 of Exhibit JRW-11, the rates on 10- and 30- U.S. Treasury Bonds were 3.93% and 4.35%, respectively. However, these yields have been highly volatile over the past two months. Given this recent range and volatility, along with the prospect of higher rates, I will use 4.5% as the risk-free rate, or R_f, in my CAPM.

Q. WHAT BETAS ARE YOU EMPLOYING IN YOUR CAPM?

A. Beta (ß) is a measure of the systematic risk of a stock. The market, usually taken to be the S&P 500, has a beta of 1.0. The beta of a stock with the same price

movement as the market also has a beta of 1.0. A stock whose price movement is greater than that of the market, such as a technology stock, is riskier than the market and has a beta greater than 1.0. A stock with below average price movement, such as that of a regulated public utility, is less risky than the market and has a beta less than 1.0. Estimating a stock's beta involves running a linear regression of a stock's return on the market return.

As shown on page 3 of Exhibit JRW-11, the slope of the regression line is the stock's ß. A steeper line indicates the stock is more sensitive to the return on the overall market. This means that the stock has a higher ß and greater than average market risk. A less steep line indicates a lower ß and less market risk.

Numerous online investment information services, such as Yahoo! and Reuters, provide estimates of stock betas. These services routinely report different betas for the same stock. The differences are usually due to: (1) the time period over which the ß is measured and (2) any adjustments that are made to reflect the fact that betas tend to regress to 1.0 over time. In estimating an equity cost rate for the proxy group, I am using the betas for the companies as provided in the *Value Line Investment Survey*. As shown on page 3 of Exhibit JRW-11, the average beta for the companies in Electric Proxy Group is 0.82.

Q. PLEASE DISCUSS THE OPPOSING VIEWS REGARDING THE EQUITY RISK PREMIUM.

A The equity or market risk premium - $(E(R_m) - R_f)$ - is equal to the expected return on the stock market (e.g., the expected return on the S&P 500 ($E(R_m)$) minus the risk-free rate of interest (R_f). The equity premium is the difference in the expected total return between investing in equities and investing in "safe" fixed-income assets, such as long-term government bonds. However, while the equity risk premium is easy to define conceptually, it is difficult to measure because it requires an estimate of the expected return on the market.

Q. PLEASE DISCUSS THE ALTERNATIVE APPROACHES TO ESTIMATING THE EQUITY RISK PREMIUM.

A. Page 4 of Exhibit JRW-11 highlights the primary approaches to, and issues in, estimating the expected equity risk premium. The traditional way to measure the equity risk premium was to use the difference between historical average stock and bond returns. In this case, historical stock and bond returns, also called ex post returns, were used as the measures of the market's expected return (known as the ex ante or forward-looking expected return). This type of historical evaluation of stock and bond returns is often called the "Ibbotson approach" after Professor Roger Ibbotson who popularized this method of using historical financial market returns as measures of expected returns. Most historical assessments of the equity risk premium suggest an equity risk premium of 5-7 percent above the rate on

long-term U.S. Treasury bonds. However, this can be a problem because: (1) ex post returns are not the same as ex ante expectations, (2) market risk premiums can change over time; increasing when investors become more risk-averse and decreasing when investors become less risk-averse, and (3) market conditions can change such that ex post historical returns are poor estimates of ex ante expectations.

The use of historical returns as market expectations has been criticized in numerous academic studies.[10] The general theme of these studies is that the large equity risk premium discovered in historical stock and bond returns cannot be justified by the fundamental data. These studies, which fall under the category "Ex Ante Models and Market Data," compute ex ante expected returns using market data to arrive at an expected equity risk premium. These studies have also been called "Puzzle Research" after the famous study by Mehra and Prescott in which the authors first questioned the magnitude of historical equity risk premiums relative to fundamentals.[11]

Q. PLEASE SUMMARIZE SOME OF THE ACADEMIC STUDIES THAT DEVELOP EX ANTE EQUITY RISK PREMIUMS.

A. Two of the most prominent studies of ex ante expected equity risk premiums were by Eugene Fama and Ken French (2002) and James Claus and Jacob Thomas

[10] The problems with using ex post historical returns as measures of ex ante expectations will be discussed at length later in my testimony.

[11] R. Mehra and Edward Prescott, "The Equity Premium: A Puzzle," *Journal of Monetary Economics* (1985).

(2001). The primary debate in these studies revolves around two related issues: (1) the size of expected equity risk premium, which is the return equity investors require above the yield on bonds and (2) the fact that estimates of the ex ante expected equity risk premium using fundamental firm data (earnings and dividends) are much lower than estimates using historical stock and bond return data.

Fama and French (2002), two of the most preeminent scholars in finance, use dividend and earnings growth models to estimate expected stock returns and ex ante expected equity risk premiums.[12] They compare these results to actual stock returns over the period 1951-2000. Fama and French estimate that the expected equity risk premium from DCF models using dividend and earnings growth to be between 2.55% and 4.32%. These figures are much lower than the ex post historical equity risk premium produced from the average stock and bond return over the same period, which is 7.40%. Fama and French conclude that the ex ante equity risk premium estimates using DCF models and fundamental data are superior to those using ex post historical stock returns for three reasons: (1) the estimates are more precise (a lower standard error); (2) the Sharpe ratio, which is measured as the [(expected stock return – risk-free rate)/standard deviation], is constant over time for the DCF models but varies considerably over time and more than doubles for the average stock-bond return model; and (3) valuation theory specifies relationships between the market-to-book ratio, return on

[12] Eugene F. Fama and Kenneth R. French, "The Equity Premium," *The Journal of Finance*, (April 2002).

investment, and cost of equity capital that favor estimates from fundamentals. They also conclude that the high average stock returns over the past 50 years were the result of low expected returns and that the average equity risk premium has been in the 3-4 percent range.

The study by Claus and Thomas of Columbia University provides direct support for the findings of Fama and French.[13] These authors compute ex ante expected equity risk premiums over the 1985-1998 period by: (1) computing the discount rate that equates market values with the present value of expected future cash flows and (2) then subtracting the risk-free interest rate. The expected cash flows are developed using analysts' earnings forecasts. The authors conclude that over this period, the ex ante expected equity risk premium is in the range of 3.0%. Claus and Thomas note that, over this period, ex post historical stock returns overstate the ex ante expected equity risk premium because, as the expected equity risk premium has declined, stock prices have risen. In other words, from a valuation perspective, the present value of expected future returns increase when the required rate of return decreases. The higher stock prices have produced stock returns that have exceeded investors' expectations, and therefore, ex post historical equity risk premium estimates are biased upwards as measures of ex ante expected equity risk premiums.

[13] James Claus and Jacob Thomas, "Equity Risk Premia as Low as Three Percent? Empirical Evidence from Analysts' Earnings Forecasts for Domestic and International Stock Market," *Journal of Finance.* (October 2001).

Q. PLEASE PROVIDE A SUMMARY OF THE EQUITY RISK PREMIUM STUDIES.

A. Derrig and Orr (2003), Fernandez (2007), and Song (2007) have completed the most comprehensive reviews to date of the research on the equity risk premium.[14] Derrig and Orr's study evaluated the various approaches to estimating equity risk premiums as well as the issues with the alternative approaches and summarized the findings of the published research on the equity risk premium. Fernandez examined four alternative measures of the equity risk premium – historical, expected, required, and implied. He also reviewed the major studies of the equity risk premium and presented the summary equity risk premium results. Song provides an annotated bibliography and highlights the alternative approaches to estimating the equity risk summary.

Page 5 of Exhibit JRW-11 provides a summary of the results of the primary risk premium studies reviewed by Derrig and Orr, Fernandez, and Song. In developing page 5 of Exhibit JRW-11, I have categorized the studies as discussed on page 4 of Exhibit JRW-11. I have also included the results of the "Building Blocks" approach to estimating the equity risk premium, including a study I performed, which is presented below. The Building Blocks approach is a hybrid approach employing elements of both historic and ex ante models.

[14] Richard Derrig and Elisha Orr, "Equity Risk Premium: Expectations Great and Small," Working Paper (version 3.0), Automobile Insurers Bureau of Massachusetts, (August 28, 2003), Pablo Fernandez, "Equity Premium: Historical, Expected, Required, and Implied," IESE Business School Working Paper, (2007), and Zhiyi Song, "The Equity Risk Premium: An Annotated Bibliography," CFA Institute, (2007).

Q. PLEASE DISCUSS YOUR DEVELOPMENT OF AN EQUITY RISK PREMIUM COMPUTED USING THE BUILDING BLOCKS METHODOLOGY.

A. Ibbotson and Chen (2003) evaluate the ex post historical mean stock and bond returns in what is called the Building Blocks approach.[15] They use 75 years of data and relate the compounded historical returns to the different fundamental variables employed by different researchers in building ex ante expected equity risk premiums. Among the variables included were inflation, real EPS and DPS growth, ROE and book value growth, and price-earnings ("P/E") ratios. By relating the fundamental factors to the ex post historical returns, the methodology bridges the gap between the ex post and ex ante equity risk premiums. Ilmanen (2003) illustrates this approach using the geometric returns and five fundamental variables – inflation ("CPI"), dividend yield ("D/P"), real earnings growth ("RG"), repricing gains ("PEGAIN") and return interaction/reinvestment ("INT").[16] This is shown on page 6 of Exhibit JRW-11. The first column breaks the 1926-2000 geometric mean stock return of 10.7% into the different return components demanded by investors: the historical U.S. Treasury bond return (5.2%), the excess equity return (5.2%), and a small interaction term (0.3%). This 10.7% annual stock return over the 1926-2000 period can then be broken down

[15] Roger Ibbotson and Peng Chen, "Long Run Returns: Participating in the Real Economy," *Financial Analysts Journal*, (January 2003).

[16] Antti Ilmanen, Expected Returns on Stocks and Bonds," *Journal of Portfolio Management*, (Winter 2003), p. 11.

into the following fundamental elements: inflation (3.1%), dividend yield (4.3%), real earnings growth (1.8%), repricing gains (1.3%) associated with higher P/E ratios, and a small interaction term (0.2%).

Q. HOW ARE YOU USING THIS METHODOLOGY TO DERIVE AN EX ANTE EXPECTED EQUITY RISK PREMIUM?

A. The third column in the graph above shows current inputs to estimate an ex ante expected market return. These inputs include the following:

CPI – To assess expected inflation, I have employed expectations of the short-term and long-term inflation rate. Page 7 of Exhibit JRW-11 shows the expected annual inflation rate according to consumers, as measured by the CPI, over the coming year. This survey is published monthly by the University of Michigan Survey Research Center. In the most recent report, the expected one-year inflation rate was 3.9%.

Longer term inflation forecasts are available in the Federal Reserve Bank of Philadelphia's publication entitled *Survey of Professional Forecasters*.[17] This survey of professional economists has been published for almost 50 years. While

[17]Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters,* (February 12, 2008). The *Survey of Professional Forecasters* was formerly conducted by the American Statistical Association ("ASA") and the National Bureau of Economic Research ("NBER") and was known as the ASA/NBER survey. The survey, which began in 1968, is conducted each quarter. The Federal Reserve Bank of Philadelphia, in cooperation with the NBER, assumed responsibility for the survey in June 1990.

this survey is published quarterly, only the first quarter survey includes long-term forecasts of gross domestic product ("GDP") growth, inflation, and market returns. In the first quarter 2008 survey, published on February 12, 2008, the median long-term (10-year) expected inflation rate as measured by the CPI was 2.5% (see page 8 of Exhibit JRW-11).

Given these results, I will use the average of the surveys of the University of Michigan and Federal Reserve Bank of Philadelphia (3.9% and 2.5%), or 3.2%.

D/P – As shown on page 9 of Exhibit JRW-11, the dividend yield on the S&P 500 has decreased gradually over the past decade. Today, it is far below its average of 4.3% over the 1926-2000 time period. Whereas the S&P dividend yield bottomed out at less than 1.4% in 2000, it is currently at 2.85% which I use in the ex ante risk premium analysis.

RG – To measure expected real growth in earnings, I use: (1) the historical real earnings growth rate for the S&P 500 and (2) expected real GDP growth. The S&P 500 was created in 1960. It includes 500 companies which come from ten different sectors of the economy. Over the 1960-2007 period, nominal growth in EPS for the S&P 500 was 7.36%. On page 10 of Exhibit JRW-11, real EPS growth is computed using the CPI as a measure of inflation. As indicated by Ibbotson and Chen, real earnings growth over the 1926-2000 period was 1.8%. The real growth figure over 1960-2007 period for the S&P 500 is 3.0 %.

The second input for expected real earnings growth is expected real GDP growth. The rationale is that over the long-term, corporate profits have averaged a relatively consistent 5.50% of U.S. GDP.[18] Real GDP growth, according to McKinsey, has averaged 3.5% over the past 80 years. Expected GDP growth, according to the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters,* is 2.75% (see page 8 of Exhibit JRW-11).

Given these results, I will use the average of the historical S&P EPS real growth and the projected real GDP growth (as reported by the Federal Reserve Bank of Philadelphia Survey) -- 3.0% and 2.75% -- or 2.85%, for real earnings growth.

PEGAIN – PEGAIN is the repricing gain associated with an increase in the P/E ratio. It accounted for 1.3% of the 10.7% annual stock return in the 1926-2000 period. In estimating an ex ante expected stock market return, one issue is whether investors expect P/E ratios to increase from their current levels. The P/E ratios for the S&P 500 over the past 25 years are shown on page 9 of Exhibit JRW-11. The run-up and eventual peak in P/Es is most notable in the chart. The relatively low P/E ratios (in the range of 10) over two decades ago are also quite notable. As of October 31, 2008, the P/E for the S&P 500 was 18.86. [19]

[18] Marc. H. Goedhart, et al, "The Real Cost of Equity," *McKinsey on Finance* (Autumn 2002), p.14.
[19] Source: www.standardandpoors.com.

Given the current economic and capital markets environment, I do not believe that investors expect even higher P/E ratios. Therefore, a PEGAIN would not be appropriate in estimating an ex ante expected stock market return. There are two primary reasons for this. First, the average historical S&P 500 P/E ratio is 15.74 – thus the current P/E exceeds this figure. Second, as previously noted, interest rates are at a cyclical low not seen in almost 50 years. This is a primary reason for the high current P/Es. Given the current market environment with relatively high P/E ratios and low relative interest rates, investors are not likely to expect to get stock market gains from lower interest rates and higher P/E ratios.

Q. GIVEN THIS DISCUSSION, WHAT IS YOUR EX ANTE EXPECTED MARKET RETURN AND EQUITY RISK PREMIUM USING THE "BUILDING BLOCKS METHODOLOGY"?

A. My expected market return is represented by the last column on the right in the graph entitled "Decomposing Equity Market Returns: The Building Blocks Methodology" set forth on page 6 of Exhibit JRW-11. As shown, my expected market return of 8.90% is composed of 3.20% expected inflation, 2.85% dividend yield, and 2.85% real earnings growth rate.

Q. GIVEN THAT THE HISTORICAL COMPOUNDED ANNUAL MARKET RETURN IS IN EXCESS OF 10%, WHY DO YOU BELIEVE THAT YOUR EXPECTED MARKET RETURN OF 8.90% IS REASONABLE?

A. As discussed above, in the development of the expected market return, stock prices are relatively high at the present time in relation to earnings and dividends, and interest rates are relatively low. Hence, it is unlikely that investors are going to experience high stock market returns due to higher P/E ratios and/or lower interest rates. In addition, as shown in the decomposition of equity market returns, whereas the dividend portion of the return was historically 4.3%, the current dividend yield is only 2.85%. Due to these reasons, lower market returns are expected for the future.

Q. IS YOUR EXPECTED MARKET RETURN OF 8.90% CONSISTENT WITH THE FORECASTS OF MARKET PROFESSIONALS?

A. Yes. In the first quarter 2008 *Survey of Financial Forecasters*, published on February 12, 2008, by the Federal Reserve Bank of Philadelphia, the mean long-term expected return on the S&P 500 was 6.8% (see page 4 of Exhibit JRW-7).

Q. IS YOUR EXPECTED MARKET RETURN CONSISTENT WITH THE EXPECTED MARKET RETURNS OF CORPORATE CHIEF FINANCIAL OFFICERS (CFOs)?

A. Yes. John Graham and Campbell Harvey of Duke University conduct a quarterly survey of corporate CFOs. The survey is a joint project of Duke University and

CFO Magazine. In the third quarter 2008 survey, the mean expected return on the S&P 500 over the next ten years was 7.79%.[20]

Q. GIVEN THIS EXPECTED MARKET RETURN, WHAT IS YOUR EX ANTE EQUITY RISK PREMIUM USING THE BUILDING BLOCKS METHODOLOGY?

A. As shown on page 2 of Exhibit JRW-11, the current 30-year U.S. Treasury yield is 4.35%. My ex ante equity risk premium is simply the expected market return from the Building Blocks methodology minus this risk-free rate:

Ex Ante Equity Risk Premium = 8.90% - 4.35% = 4.55%

Q. GIVEN THIS DISCUSSION, HOW ARE YOU MEASURING AN EXPECTED EQUITY RISK PREMIUM IN THIS PROCEEDING?

A. As discussed above, page 5 of Exhibit JRW-11 provides a summary of the results of the equity risk premium studies that I have reviewed. These include the results of: (1) the various studies of the historical risk premium, (2) ex ante equity risk premium studies, (3) equity risk premium surveys of CFOs, Financial Forecasters, and academics, and (4) the Building Block approaches to the equity risk premium.

[20] The survey results are available at www.cfosurvey.org.

There are results reported for over thirty studies, and the average equity risk premium is 4.56%, which I will use as the equity risk premium in my CAPM study.

Q. IS YOUR EX ANTE EQUITY RISK PREMIUM CONSISTENT WITH THE EQUITY RISK PREMIUMS OF LEADING INVESTMENT FIRMS?

A. Yes. One of the first studies in this area was by Stephen Einhorn, one of Wall Street's leading investment strategists.[21] His study showed that the market or equity risk premium had declined to the 2.0 - 3.0 percent range by the early 1990s. Among the evidence he provided in support of a lower equity risk premium is the inverse relationship between real interest rates (observed interest rates minus inflation) and stock prices. He noted that the decline in the market risk premium has led to a significant change in the relationship between interest rates and stock prices. One implication of this development was that stock prices had increased higher than would be suggested by the historical relationship between valuation levels and interest rates.

The equity risk premiums of some of the other leading investment firms today support the result of the academic studies. An article in *The Economist* indicated that some other firms like J.P. Morgan are estimating an equity risk premium for

[21] Steven G. Einhorn, "The Perplexing Issue of Valuation: Will the Real Value Please Stand Up?" *Financial Analysts Journal* (July-August 1990), pp. 11-16.

an average risk stock in the 2.0 - 3.0 percent range above the interest rate on U.S. Treasury Bonds.[22]

Q. IS YOUR EX ANTE EQUITY RISK PREMIUM CONSISTENT WITH THE EQUITY RISK PREMIUMS USED BY CFOS?

A. Yes. In the previously referenced third quarter 2008 CFO survey conducted by *CFO Magazine* and Duke University, the expected 10-year equity risk premium was 3.99%.

Q. IS YOUR EX ANTE EQUITY RISK PREMIUM CONSISTENT WITH THE EX ANTE EQUITY RISK PREMIUMS OF PROFESSIONAL FORECASTERS?

A. Yes. The financial forecasters in the previously referenced Federal Reserve Bank of Philadelphia survey project both stock and bond returns. As shown on page 8 of Exhibit JRW-11, the mean long-term expected stock and bond returns were 6.80% and 4.84%, respectively. This provides an ex ante equity risk premium of 1.96%.

[22] For example, see "Welcome to Bull Country," *The Economist* (July 18, 1998), pp. 21-3, and "Choosing the Right Mixture," *The Economist* (February 27, 1999), pp. 71-2.

Q. IS YOUR EX ANTE EQUITY RISK PREMIUM CONSISTENT WITH THE EQUITY RISK PREMIUMS USED BY THE LEADING CONSULTING FIRMS?

A. Yes. McKinsey & Co. is widely recognized as the leading management consulting firm in the world. It published a study entitled "The Real Cost of Equity" in which the McKinsey authors developed an ex ante equity risk premium for the U.S. In reference to the decline in the equity risk premium, as well as what is the appropriate equity risk premium to employ for corporate valuation purposes, the McKinsey authors concluded the following:

> We attribute this decline not to equities becoming less risky (the inflation-adjusted cost of equity has not changed) but to investors demanding higher returns in real terms on government bonds after the inflation shocks of the late 1970s and early 1980s. We believe that using an equity risk premium of 3.5 to 4 percent in the current environment better reflects the true long-term opportunity cost of equity capital and hence will yield more accurate valuations for companies.[23]

Q. WHAT EQUITY COST RATES ARE INDICATED BY YOUR CAPM ANALYSIS?

A. The results of my CAPM study for the proxy group are provided below:

$$K = (R_f) + \beta * [E(R_m) - (R_f)]$$
$$K = 4.5\% + 0.82 * 4.56\%$$
$$K = 8.2\%$$

[23] Marc H. Goedhart, et al, "The Real Cost of Equity," *McKinsey on Finance* (Autumn 2002), p. 15.

D. **Equity Cost Rate Summary**

Q. PLEASE SUMMARIZE YOUR EQUITY COST RATE STUDY.

A. The results for my DCF and CAPM analyses for the Electric Proxy Group indicates equity cost rates of 9.8% and 8.2%, respectively.

Q. GIVEN THESE RESULTS, WHAT IS YOUR ESTIMATED EQUITY COST RATE FOR THE GROUP?

A. Given these results, I conclude that the appropriate equity cost rate for the Electric Proxy Group is in the 8.2%-9.8% range. However, due to the current volatile market conditions which were discussed above, I am using the upper end of the range as the equity cost rate. Therefore, I am recommending an equity cost rate of 9.75% for Tampa. In addition, due to the uncertain market conditions, I reserve the right to update my study prior to hearings.

Q. ISN'T YOUR EQUITY COST RATE RECOMMENDATION LOW BY HISTORICAL STANDARDS?

A. Yes, it is and appropriately so. My rate of return is low by historical standards for two reasons. First, as discussed above, current capital costs are low by historical standards, with interest rates at a cyclical low not seen since the 1960s. And second, as previously discussed, the equity or market risk premium has declined.

Q. HOW DO YOU TEST THE REASONABLENESS OF YOUR COST OF EQUITY AND OVERALL RATE OF RETURN RECOMMENDATION?

A. To test the reasonableness of my equity cost rate recommendation, I examine the relationship between the return on common equity and the market-to-book ratios for the companies in the Electric Proxy Group.

Q. WHAT DO THE RETURNS ON COMMON EQUITY AND MARKET-TO-BOOK RATIOS FOR THE PROXY GROUP INDICATE ABOUT THE REASONABLENESS OF YOUR RECOMMENDATION?

A. Exhibit JRW-3 provides financial performance and market valuation statistics for companies in the proxy group. The mean current return on equity and market-to-book ratio for the group are 8.9% and 1.36, respectively. These results indicate that, on average, these companies are earning returns on equity above their equity cost rates. As such, this observation provides evidence that my recommended equity cost rate is reasonable and fully consistent with the financial performance and market valuation of the proxy group of electric utility companies.

VI. CRITIQUE OF TAMPA'S RATE OF RETURN TESTIMONY

A. Testimonies of Mr. Gordon Gillette and Dr. Donald Murry

Q. WHAT ISSUES DO YOU HAVE WITH THE COMPANY'S COST OF CAPITAL POSITION?

A. I have issues with the Company's debt cost rate, capital structure, and equity cost rate. The debt cost rate was previously discussed. I focus below on the capital structure and equity cost rate.

Q. PLEASE EVALUATE THE COMPANY'S RECOMMENDED CAPITAL STRUCTURE.

A. The Company's recommended capital structure is not appropriate for ratemaking purposes in this proceeding for four reasons. The recommended capital structure: (1) is not reflective of the recent capitalization of the company; (2) is equity rich and has a much higher common equity ratio than that employed by other electric companies; (3) includes a number of inappropriate adjustments that result in the inflated common equity ratio; and (4) is not reflective of the capital structure used by Tampa to attract capital from investors. Items (1), (2), and (4) were previously discussed. I will now turn to issue (3).

Q. WHAT ADJUSTMENTS ARE MADE TO THE COMPANY'S DEBT AND EQUITY AMOUNTS IN ARRIVING AT THEIR RECOMMENDED CAPITAL STRUCTURE?

A. The Company's recommended capital structure includes a number of adjustments to debt and equity amounts. These adjustments are detailed in MFR, Schedule D-1a and D-1b. OPC Witness Mr. Hugh Larkin has evaluated most of the adjustments.

The adjustment that I am focusing on is the $77M equity adjustment for the Company's Purchased Power Agreements ("PPAs").

Q. PLEASE EXPLAIN WHY AN ADJUSTMENT TO EQUITY TO ACCOUNT FOR PPAs IS NOT APPROPRIATE.

A. Mr. Gillette has adjusted Tampa's equity by $77M to account for the Company's PPAs. The $77M is computed by multiplying a risk factor of 25% to the present value of the Company's capacity contracts. In computing credit rating metrics, S&P applies such a risk factor ranging from 0% to 100% which is intended to reflect the risk of recovery of the PPA payments. However, S&P does not indicate how the risk factor that ranges from 0% to 100% is determined. Given a recovery mechanism for PPA payments, the financial condition of an electric utility company is not impaired by entering into these contracts. Hence, providing incremental revenues through a higher equity ratio and overall rate of return are unnecessary and would result in an unwarranted revenue benefit to the utility. I have identified several flaws in the adjustment.

<u>One: Risk Factor</u>

Given the methodology for imputing debt from PPAs, the risk factor is extremely important. Mr. Gillette has presumed that a risk factor of 25% is appropriate for Tampa. However, S&P does not indicate how the risk factor that ranges from 0% to 100% is determined. Hence, the S&P risk factor for imputing debt is not well defined and cannot be assessed in this situation Given the Commission's support

for the collection of long-term contractual payments, the risk of non-recovery appears to be extremely low (perhaps even zero percent). Hence, a risk factor as high as 25% seems out of line. But, given the lack of guidance from S&P, it is impossible to properly assess the risk factor in this situation.

In addition, as opposed to S&P, Moody's appears to recognize some of the benefits of PPAs and looks at them in a more positive manner. For example, Moody's states:[24]

> "If a utility enters into a PPA for the purpose of providing an assured supply and there is reasonable assurance that regulators will allow the costs to be recovered in regulated rates, Moody's may view the PPA as being most akin to an operating cost. In this circumstance, there most likely will be no imputed adjustment to the obligations of the utility."

In other words, under this scenario Moody's would rate the risk factor at 0% and there would be no imputed debt.

Two: S&P Adjustments are Not GAAP Accounting

Even if debt were imputed by S&P from a PPA (assuming a risk factor greater than 0%), no changes would be made to the company's GAAP financial statements. Hence, investors would not see the impact of S&P's adjustment. In addition, the Company does not incur a liability on its GAAP-based financial statements for the PPAs. Furthermore, given a regulatory-mandated recovery method for the payments, investors should be indifferent to a utility entering into a PPA.

[24] Moody's Rating Methodology: Global Regulated Electric Utilities, March 2005, page 10.

Three: From a Regulatory Perspective, PPA Payments are Unlike Debt

In a regulatory setting, a utility is given the 'opportunity to earn' its cost of debt as well as its overall cost of capital through the ratemaking process. Given the many uncertainties associated with revenues and expenses between rate cases, there is no guarantee that the overall cost of debt can be earned. However, with long-term PPAs, the timely and certain recovery of fixed payments is assured. That is, PPA costs do not feature the uncertainty associated with the 'opportunity to earn' as do debt payments. In sum, given S&P's lack of guidance on the risk factor, the Commission's support for the collection of payments for PPAs, the notion that these are not GAAP adjustments that are not recorded as liabilities on the books of the company, and the fact that, from a regulatory perspective, PPA payments are unlike debt, the PPA adjustment to the Company's capital structure is inappropriate.

Q. PLEASE REVIEW DR. MURRY'S EQUITY COST RATE APPROACHES.

A. Dr. Murry uses a proxy group of electric utility companies as well as TECO Energy and employs CAPM and DCF equity cost rate approaches.

Q. PLEASE SUMMARIZE DR. MURRY'S EQUITY COST RATE RESULTS.

A. Dr. Murry's equity cost rate estimates for Tampa are summarized in Panel A of Exhibit JRW-12. Based on these figures, he concludes that the appropriate equity cost rate for the Company is 12.0%.

Q. PLEASE DISCUSS YOUR ISSUES WITH DR. MURRY'S RECOMMENDED EQUITY COST RATE.

A. Dr. Murry's proposed return on common equity is too high primarily due to: (1) an inappropriate group of comparable electric companies; (2) an excessive adjustment to the dividend yield and an inflated growth rate in his DCF approach; (3) his use of the higher end of his DCF results to compensate for flotation costs, market pressure, and market value – book value adjustment; and (4) overstated equity risk premium estimates, as well as the inclusion of a size premium, in his CAPM approaches.

1. Comparable Electric Companies

Q. PLEASE DISCUSS THE PROBLEM WITH DR. MURRY'S ELECTRIC UTILITY GROUP.

A. Dr. Murry's utility proxy group includes a number of companies that are not appropriate because their operating revenues are from sources other than regulated electric utility services. These companies, and their percent of regulated electric revenues, include: OGE Energy Corp. - 48%, PEPCO Holdings - 55%, SCANA Corp. - 42%, and, and Wisconsin Energy - 62%.

2. DCF Approach

Q. PLEASE SUMMARIZE DR. MURRY'S DCF ESTIMATES.

A. On pages 33-52 of his testimony and in Documents DAM-13 – DAM-19, Dr. Murry develops an equity cost rate by applying a DCF model to TECO Energy and his group of comparable companies. In the traditional DCF approach, the equity cost rate is the sum of the dividend yield and expected growth. For TECO Energy and the comparable group, he performs two DCF analyses – a 52-week DCF using stock prices over the past year, and a Current DCF using stock prices over the past two weeks. For each of these DCFs, he computes equity cost rates using (1) projected DPS growth rates, (2) *Value Line* projected EPS over the 2002-04 to the 2011-13 time period, and (3) projected EPS growth rates estimates from *Value Line* (from 2006-07 to 2011-13) and from analysts as compiled by Yahoo! Dr. Murry's DCF results are provided in Panel B of Exhibit JRW-12. Based on these figures, Dr. Murry claims that the relevant DCF results for Tampa are in the range of 11.12% to 13.27%.

Q. PLEASE EXPRESS YOUR CONCERNS WITH DR. MURRY'S DCF STUDY.

A. I have several major concerns with Dr. Murry's DCF analyses. These are: (1) he has ignored results using projected DPS growth rates for both TECO Energy and the comparable electric utility group; (2) he has totally ignored the DCF results for TECO Energy and relied on highly selected results of his comparable group of electric utility companies; (3) his selected DCF results rely on the upwardly biased EPS growth rates estimates from *Value Line* and from Wall Street analysts

as compiled by Yahoo!; and (4) he has erroneously relied on the upper end of the DCF results to account for undocumented flotation costs and market pressure.

Q. PLEASE ADDRESS YOUR FIRST ISSUE.

A. Dr. Murry has ignored the DCF results for both TECO Energy and the comparable group using projected DCF growth rates. In the DCF model, the cash flows that investors receive are in the form of dividends. The average projected DPS growth for TECO Energy and the comparable electric utility group are in the 2.0% and 3.0% range, respectively. Ignoring the DCF results which use projected DPS growth rates leads to an upwardly biased estimate of a DCF equity cost rate.

Q. YOU CLAIM THAT DR. MURRY HAS ALSO IGNORED THE VAST MAJORITY OF HIS DCF RESULTS. PLEASE EXPLAIN.

A. Dr. Murry's summary results are provided in Schedule DAM-23. On page 64 of his testimony, Dr. Murry claims that the relevant DCF results are from 11.12% to 13.27%. However, these are the high-end of the range of DCF figures for the comparison group using: (1) 2000-02 to 2009-11 EPS growth rates; and (2) analysts' projected EPS growth rates from *Value Line* and Wall Street analysts as compiled by Yahoo! This relevant range simply represents the high end of the range using these two growth rate measures. As such, he has totally ignored the DCF results for TECO Energy as well as the majority of the DCF results for his comparable group of electric utility companies. By ignoring these results, he is recommending a DCF equity cost rate using the results for the company which is

200-300 basis points higher than that of his comparable electric utility company group.

Q. PLEASE REVIEW DR. MURRY'S EXCESSIVE RELIANCE UPON THE PROJECTED EPS GROWTH RATE ESTIMATES OF WALL STREET ANALYSTS' AND *VALUE LINE.*

A. It seems highly unlikely that investors today would rely excessively on the forecasts of securities analysts and ignore historical growth in arriving at expected growth. It is well known in the academic world that the EPS forecasts of securities analysts are overly optimistic and biased upwards. In addition, as I show below, *Value Line's* EPS forecasts are excessive and unrealistic.

Q. PLEASE REVIEW THE BIAS IN ANALYSTS' GROWTH RATE FORECASTS.

A. Analysts' growth rate forecasts are collected and published by Bloomberg, Zacks, First Call, I/B/E/S, and Reuters. These services retrieve and compile EPS forecasts from Wall Street analysts. These analysts come from both the sell side (Merrill Lynch, Paine Webber) and the buy side (Prudential Insurance, Fidelity).

The problem with using these forecasts to estimate a DCF growth rate is that the objectivity of Wall Street research has been challenged, and many have argued that analysts' EPS forecasts are overly optimistic and biased upwards. To evaluate the accuracy of analysts' EPS forecasts, I have compared actual 3-5 year EPS

growth rates with forecasted EPS growth rates on a quarterly basis over the past 20 years for all companies covered by the I/B/E/S data base. In Panel A of Exhibit JTW-13, I show the average analysts' forecasted 3-5 year EPS growth rate with the average actual 3-5 year EPS growth rate. Because of the necessary 3-5 year follow-up period to measure actual growth, the analysis in this graph only: (1) covers forecasted and actual EPS growth rates through 1999 and (2) includes only companies that have 3-5 years of actual EPS data following the forecast period.

The following example shows how the results can be interpreted. For the 3-5year period prior to the first quarter of 1999, analysts had projected an EPS growth rate of 15.13%, but companies only generated an average annual EPS growth rate over the 3-5 years of 9.37%. This projected EPS growth rate figure represented the average projected growth rate for over 1,510 companies, with an average of 4.88 analysts' forecasts per company. For the entire twenty-year period of the study, for each quarter there were on average 5.60 analysts' EPS projections for 1,281 companies. Overall, my findings indicate that forecast errors for long-term estimates are predominantly positive, which indicates an upward bias in growth rate estimates. The mean and median forecast errors over the observation period are 143.06% and 75.08%, respectively. The forecast errors are negative for only eleven of the eighty quarterly time periods: five consecutive quarters starting at the end of 1995 and six consecutive quarters starting in 2006. As shown in the figure below, the quarters with negative forecast errors were for the 3-5 year periods

following earnings declines associated with the 1991 and 2001 economic recessions in the U.S. overall. Thus, there is evidence of a persistent upward bias in long-term EPS growth forecasts.

The post-1999 period has seen the boom and then the bust in the stock market, an economic recession, 9/11, and the Iraq war. Furthermore, and highly significant in the context of this study, we have also had the New York state investigation of Wall Street firms and the subsequent Global Securities Settlement in which nine major brokerage firms paid a fine of $1.5B for their biased investment research.

To evaluate the impact of these events on analysts' forecasts, the average 3-5year EPS growth rate projections for all companies provided in the I/B/E/S database on a quarterly basis from 1988 to 2006 are shown in Panel B of Exhibit JRW-13. In this graph, no comparison to actual EPS growth rates is made, and hence, there is no follow-up period. Therefore, 3-5 year growth rate forecasts are shown until 2006, and since companies are not lost due to a lack of follow-up EPS data, these results are for a larger sample of firms. Analysts' forecasts for EPS growth were higher for this larger sample of firms, with a more pronounced run-up and then decline around the stock market peak in 2000. The average projected growth rate hovered in the 14.5%-17.5% range until 1995 and then increased dramatically over the next five years to 23.3% in the fourth quarter of the year 2000. Forecasted EPS growth has since declined to the 15.0% range.

Q. WHAT IMPACT HAVE RECENT REGULATORY DEVELOPMENTS HAD ON ANALYSTS' EPS GROWTH RATE FORECASTS?

A. Analysts' EPS growth rate forecasts have subsided somewhat since the stock market peak of 2000. In addition, the apparent conflict of interest within investment firms with investment banking and analysts' operations was addressed in the Global Analysts Research Settlements ("GARS"). GARS, as agreed upon on April 23, 2003, between the SEC, NASD, NYSE and ten of the largest U.S. investment firms, includes a number of regulations that were introduced to prevent investment bankers from pressuring analysts to provide favorable projections. Nonetheless, despite the new regulations, analysts' EPS growth rate forecasts have not significantly changed and continue to be overly-optimistic. Analysts' long-term EPS growth rate forecasts before and after GARS, are about two times the level of historic GDP growth. Furthermore, historic growth in GDP and corporate earnings has been in the 7% range.

Finally, these observations are supported by a *Wall Street Journal* article entitled "Analysts Still Coming Up Rosy – Over-Optimism on Growth Rates is Rampant – and the Estimates Help to Buoy the Market's Valuation." The following quote provides insight into the continuing bias in analysts' forecasts:

> Hope springs eternal, says Mark Donovan, who manages Boston Partners Large Cap Value Fund. "You would have thought that, given what happened in the last three years, people would have given up the ghost. But in large measure they have not."

> These overly optimistic growth estimates also show that, even with all the regulatory focus on too-bullish analysts allegedly influenced by their firms' investment-banking relationships, a lot of things haven't changed: Research remains rosy and many believe it always will.[25]

Q. IS THE BIAS IN ANALYSTS' GROWTH RATE FORECASTS GENERALLY KNOWN IN THE MARKETS?

A. Yes. Page 2 of Exhibit JRW-13 provides a recent article published in the *Wall Street Journal* that discusses the upward bias in analysts' EPS growth rate forecasts.

Q. ARE ANALYSTS' EPS GROWTH RATE FORECASTS LIKEWISE UPWARDLY BIASED FOR ELECTRIC UTILITY COMPANIES?

A. Yes. To evaluate whether analysts' EPS growth rate forecasts are upwardly biased for electric utility companies, I conducted a study similar to the one described above using a group of electric utility companies. The results are shown in Panel C of Exhibit JRW-13. The projected EPS growth rates have declined from about six percent in the 1990s to about five percent in the 2000s. As shown, the achieved EPS growth rates have been volatile. Overall, the upward bias in EPS growth rate projections is not as pronounced for electric utility companies as it is for all companies. Over the entire period, the average quarterly 3-5 year projected and actual EPS growth rates are 4.59% and 2.90%, respectively. These results are consistent with the results for companies in general -- analysts' projected EPS growth rate forecasts are upwardly-biased for utility companies.

[25] Ken Brown, "Analysts Still Coming Up Rosy – Over-Optimism on Growth Rates is Rampant – and the Estimates Help to Buoy the Market's Valuation." *Wall Street Journal*, (January 27, 2003), p. C1.

Q. ARE *VALUE LINE*'S GROWTH RATE FORECASTS SIMILARILY UPWARDLY BIASED?

A. Yes. *Value Line* has a decidedly positive bias to its earnings growth rate forecasts as well. To assess *Value Line*'s earnings growth rate forecasts, I used the *Value Line Investment Analyzer*. The results are summarized in Panel A of Exhibit JRW-14. I initially filtered the database and found that *Value Line* has 3-5 year EPS growth rate forecasts for 2,453 firms. The average projected EPS growth rate was 14.6%. This is high given that the average historical EPS growth rate in the U.S. is about 7%. A major factor seems to be that *Value Line* only predicts negative EPS growth for 47 companies. This is less than two percent of the companies covered by *Value Line*. Given the ups and downs of corporate earnings, this is unreasonable.

To put this figure in perspective, I screened the *Value Line* companies to see what percent of companies covered by *Value Line* had experienced negative EPS growth rates over the past five years. *Value Line* reported a five-year historic growth rate for 2,371 companies. The results are shown in Panel B of Exhibit JRW-14 and indicate that the average 5-year historic growth rate was 12.9%, and *Value Line* reported negative historic growth for 476 firms which represents 20.1% of these companies. It should be noted that the past five years have been a period of rapidly rising corporate earnings growth as the economy and businesses have rebounded from the recession of 2001.

These results indicate that *Value Line*'s EPS forecasts are excessive and unrealistic. It appears that the analysts at *Value Line* are similar to their Wall Street brethren in that they are reluctant to forecast negative earnings growth.

Q. FINALLY, ON PAGES 39-43 OF HIS TESTIMONY, DR. MURRY HAS ARGUED THAT HE HAS FOCUSED ON THE HIGHER DCF RESULTS AS AN ALTERNATIVE TO MAKING AN ADJUSTMENT FOR FLOTATION COSTS OR MARKET PRESSURE. PLEASE RESPOND.

A. Dr. Murry's argument for using the higher end DCF results to account for flotation costs or market pressure is in error. There is no need for such an adjustment. Usually it is argued that a flotation cost adjustment is necessary to prevent the dilution of the existing shareholders. Such an adjustment is commonly justified by reference to bonds and the manner in which issuance costs are recovered by including the amortization of bond flotation costs in annual financing costs. However, this is incorrect for several reasons:

(1) If an equity flotation cost adjustment is similar to a debt flotation cost adjustment, the fact that the market-to-book ratios for electric utility companies are nearly 2.0 actually suggests that there should be a flotation cost reduction (and not increase) to the equity cost rate. This is because when (a) a bond is issued at a price in excess of face or book value, and (b) the difference between market price and the book value is greater than the flotation or issuance costs, the cost of that debt is lower than the coupon rate of the debt. The amount by which market

values of electric utility companies are in excess of book values is much greater than flotation costs. Hence, if common stock flotation costs were exactly like bond flotation costs, and one was making an explicit flotation cost adjustment to the cost of common equity, the adjustment would be downward;

(2) It is commonly argued that a flotation cost adjustment is needed to prevent dilution of existing stockholders' investment. However, the reduction of the book value of stockholder investment associated with flotation costs can occur only when a company's stock is selling at a market price at/or below its book value. As noted above, electric utility companies are selling at market prices well in excess of book value. Hence, when new shares are sold, existing shareholders realize an increase in the book value per share of their investment, not a decrease;

(3) Flotation costs consist primarily of the underwriting spread or fee and not out-of-pocket expenses. On a per share basis, the underwriting spread is the difference between the price the investment banker receives from investors and the price the investment banker pays to the company. Hence, these are not expenses that must be recovered through the regulatory process. Furthermore, the underwriting spread is known to the investors who are buying the new issue of stock, who are well aware of the difference between the price they are paying to buy the stock and the price that the Company is receiving. The offering price which they pay is what matters when investors decide to buy a stock based on its expected return and risk prospects. Therefore, the company is not entitled to an

adjustment to the allowed return to account for those costs; and

(4) Flotation costs, in the form of the underwriting spread, are a form of a transaction cost in the market. They represent the difference between the price paid by investors and the amount received by the issuing company. Whereas Dr. Murry believes that the Company should be compensated for these transactions costs by using the high-end DCF results neither he nor I have accounted for other market transaction costs in determining a cost of equity for the Company. Most notably, brokerage fees that investors pay when they buy shares in the open market are another market transaction cost. Brokerage fees increase the effective stock price paid by investors to buy shares. If Dr. Murry and I had included these brokerage fees or transaction costs in our DCF analyses, the higher effective stock prices paid for stocks would lead to lower dividend yields and equity cost rates. To be fair then, if Dr. Murry is to make an upward adjustment for transaction costs in the form of using the high-end DCF results, he also should have made a downward adjustment for transaction costs in the form of brokerage fees.

Q. PLEASE SUMMARIZE YOUR ASSESSMENT OF DR. MURRY'S DCF GROWTH RATE.

A. Dr. Murry's DCF equity cost rate is overstated because he has: (1) employed an inappropriate group of comparable electric companies; (2) made an excessive adjustment to the dividend yield and used the upwardly biased EPS growth rate forecasts of Wall Street analysts and *Value Line* in his DCF approach; and (3)

selectively picked the high end of the range of his DCF equity cost rate estimates to account for undocumented flotation costs and market pressure.

3. CAPM Analysis

Q. PLEASE DISCUSS DR. MURRY'S CAPM.

A. On pages 52-63, in Documents DAM-24 and DAM-25, Dr. Murry applies the CAPM to TECO Energy and the comparison group of electric utility companies. The first CAPM, which he calls the size-adjusted CAPM, is a traditional CAPM with an incremental 0.92%-1.65% adjustment to account for the relative size of TECO Energy and the comparable electric utility companies. The second CAPM, which Dr. Murry calls a historical CAPM, is based strictly on historical stock and bond returns. Dr. Murry's historical CAPM is very untraditional in three ways: (1) the market total return is the average of the historical returns for large and small stocks as reported by Ibbotson Associates, (2) the historic bond return of 6.20% is for long-term corporate bonds, and (3) the risk-free rate Dr. Murry uses is the historic Aaa corporate bond return. The results of Dr. Murry's CAPM analyses are summarized in Panel C of Exhibit JRW-12

Q. PLEASE SUMMARIZE YOUR ASSESSMENT OF DR. MURRY'S CAPM ANALYSES.

A. There are two primary flaws with Dr. Murry's CAPM analyses: (1) his explicit size adjustment of 0.92% for TECO Energy and the comparison electric utility

group in his size-adjusted CAPM and an implicit size premium in his historical CAPM; and (2) most significantly, his equity risk premium of 7.10% in his size-adjusted CAPM and his risk premium of 8.50% in his historical CAPM.

Q. PLEASE DISCUSS DR. MURRY'S EXPLICIT AND IMPLICIT SIZE ADJUSTMENTS.

A. As noted above, Dr. Murry uses explicit size adjustment of 0.92% for TECO Energy and the comparison group in his size-adjusted CAPM and uses an implicit size premium in his historical CAPM. The implicit size premium in his historical CAPM results from the fact that his market total return of 14.70% is the average of the arithmetic mean stock returns for large stocks and for small stocks from Ibbotson Associates. Dr. Murry supports the need for a size premium by citing the work of Ibbotson Associates.

There are several flaws in this analysis. First, as discussed later in my testimony, there are a number of errors in using historical market returns to compute risk premiums. Second, the Ibbotson study used for the explicit size premium is based on the stock returns for companies in the 9^{th} decile. However, a review of the Ibbotson document indicates that these companies have betas that are much larger than the betas of electric utility companies. Hence, these size premiums are not associated with the electric utility industry.

Finally, and most importantly, any equity cost rate adjustment based on the relative size of a public utility is inappropriate. Professor Annie Wong has tested

for a size premium in utilities and concluded that, unlike industrial stocks, utility stocks do not exhibit a significant size premium.[26] As explained by Professor Wong, there are several reasons why such a size premium would not be attributable to utilities. Utilities are regulated closely by state and federal agencies and commissions and, hence, their financial performance is monitored on an on-going basis by both the state and federal governments. In addition, public utilities must gain approval from government entities for common financial transactions such as the sale of securities. Furthermore, unlike their industrial counterparts, accounting standards and reporting are fairly standardized for public utilities. Finally, a utility's earnings are predetermined to a certain degree through the ratemaking process in which performance is reviewed by state commissions and other interested parties. Overall, in terms of regulation, government oversight, performance review, accounting standards, and information disclosure, utilities are much different than industrials which could account for the lack of a size premium.

Q. PLEASE REVIEW THE ERRORS IN DR. MURRY'S EQUITY OR RISK PREMIUM IN HIS TWO CAPM APPROACHES.

A. The primary problem with Dr. Murry's two CAPM analyses is the size of the market or equity risk premium. Dr. Murry uses a risk premium of 7.10% in his size-adjusted CAPM. This is the arithmetic average risk premium of the 1926-

[26] Annie Wong, "Utility Stocks and the Size Effect: An Empirical Analysis", *Journal of the Midwest Finance Association*, 1993, PP. 95-101.

2007 results from the Ibbotson study. He uses a risk premium of 8.50% in his historical CAPM which is the difference between his historic market return of 14.70% (the average of the arithmetic mean stock returns for large stocks of 12.3% and for small stocks of 17.1%) and 6.20% which is the historic long-term corporate bond return. Both of these risk premiums are based solely on the difference in the arithmetic mean stock and bond returns over the 1926-2007 period.

Q. PLEASE ADDRESS THE ISSUES INVOLVED IN USING HISTORICAL STOCK AND BOND RETURNS TO COMPUTE A FORWARD-LOOKING OR EX ANTE RISK PREMIUM.

A. Using the historical relationship between stock and bond returns to measure an ex ante equity risk premium is erroneous and overstates the true market equity risk premium. The equity risk premium is based on expectations of the future and when past market conditions vary significantly from the present, historic data does not provide a realistic or accurate barometer of expectations of the future. At the present time, using historical returns to measure the ex ante equity risk premium ignores current market conditions and masks the dramatic change in the risk and return relationship between stocks and bonds. This change suggests that the equity risk premium has declined.

Q. PLEASE DISCUSS THE ERRORS IN USING HISTORIC STOCK AND BOND RETURNS TO ESTIMATE AN EQUITY RISK PREMIUM.

A. There are a number of flaws in using historic returns over long time periods to estimate expected equity risk premiums. These issues include:

(A) Biased historical bond returns;

(B) The arithmetic versus the geometric mean return;

(C) The large error in measuring the equity risk premium using historical returns;

(D) Biased historical stock returns and transactions costs;

(E) Company survivorship bias;

(F) The "Peso Problem" - U.S. stock market survivorship bias;

(G) Market conditions today are significantly different than the past; and

(H) Changes in risk and return in the markets.

These issues will be addressed in order.

Biased Historical Bond Returns

Q. HOW ARE HISTORICAL BOND RETURNS BIASED?

A. An essential assumption of these studies is that over long periods of time investors' expectations are realized. However, the experienced returns of bondholders in the past violate this critical assumption. Historic bond returns are biased downward as a measure of expectancy because of capital losses suffered by bondholders in the past. As such, risk premiums derived from this data are biased upwards.

The Arithmetic versus the Geometric Mean Return

Q. PLEASE DISCUSS THE ISSUE RELATING TO THE USE OF THE ARITHMETIC VERSUS THE GEOMETRIC MEAN RETURNS IN THE IBBOTSON METHODOLOGY.

A. The measure of investment return has a significant effect on the interpretation of the risk premium results. When analyzing a single security price series over time (i.e., a time series), the best measure of investment performance is the geometric mean return. Using the arithmetic mean overstates the return experienced by investors. In a study entitled "Risk and Return on Equity: The Use and Misuse of Historical Estimates," Carleton and Lakonishok make the following observation: "The geometric mean measures the changes in wealth over more than one period on a buy and hold (with dividends invested) strategy."[27] Since Dr. Murry's study covers more than one period (and he assumes that dividends are reinvested), he should be employing the geometric mean and not the arithmetic mean.

Q. PLEASE PROVIDE AN EXAMPLE DEMONSTRATING THE PROBLEM WITHUSING THE ARITHMETIC MEAN RETURN.

A19 To demonstrate the upward bias of the arithmetic mean, consider the following example. Assume that you have a stock (that pays no dividend) that is selling for $100 today, increases to $200 in one year, and then falls back to $100 in two

[27] Willard T. Carleton and Josef Lakonishok, "Risk and Return on Equity: The Use and Misuse of Historical Estimates," *Financial Analysts Journal* (January-February, 1985), pp. 38-47.

years. The table below shows the prices and returns.

Time Period	Stock Price	Annual Return
0	$100	
1	$200	100%
2	$100	-50%

The arithmetic mean return is simply (100% + (-50%))/2 = 25% per year. The geometric mean return is $((2 * .50)^{(1/2)}) - 1 = 0\%$ per year. Therefore, the arithmetic mean return suggests that your stock has appreciated at an annual rate of 25%, while the geometric mean return indicates an annual return of 0%. Since after two years, your stock is still only worth $100, the geometric mean return is the appropriate return measure. For this reason, when stock returns and earnings growth rates are reported in the financial press, they are generally reported using the geometric mean. This is because of the upward bias of the arithmetic mean. As further evidence of the appropriate mean return measure, the U.S. Securities and Exchange Commission requires equity mutual funds to report historic return performance using geometric mean and not arithmetic mean returns.[28] Therefore, Dr. Murry's arithmetic mean return measures are upwardly biased and should be disregarded.

The Large Error in Measuring Equity Risk Premiums with Historic Data

[28] U.S. Securities and Exchange Commission, Form N-1A.

Q. PLEASE DISCUSS THE LARGE ERROR IN MEASURING THE EQUITY RISK PREMIUM USING HISTORICAL STOCK AND BOND RETURNS.

A. Measuring the equity risk premium using historical stock and bond return is subject to a very large amount of forecasting error. For example, the long-term equity risk premium of 6.5% has a standard deviation of 20.6%. This may be interpreted in the following way with respect to the historical distribution of the long-term equity risk premium using a standard normal distribution and a 95% +/- two standard deviation confidence interval: We can say, with a 95% degree of confidence, that the true equity risk premium is between -34.7% and +47.7%. As such, the historical equity risk premium is measured with a large degree of error.

Biased Historic Stock Returns and Transactions Costs

Q. YOU NOTE THAT HISTORIC STOCK RETURNS ARE BIASED USING THE IBBOTSON METHODOLOGY. PLEASE ELABORATE.

A. Returns developed using Ibbotson's methodology are computed on stock indexes and, therefore (1) cannot be reflective of expectations because these returns are unattainable to investors and (2) produce biased results. This methodology assumes: (a) monthly portfolio rebalancing and (b) reinvestment of interest and dividends. Monthly portfolio rebalancing presumes that investors rebalance their portfolios at the end of each month in order to have an equal dollar amount invested in each security at the beginning of each month. The assumption would obviously generate extremely high transaction costs and thereby render these returns unattainable to

investors. In addition an academic study demonstrates that the monthly portfolio rebalancing assumption produces biased estimates of stock returns.[29]

Transaction costs themselves provide another bias in historic versus expected returns. The observed stock returns of the past were not the realized returns of investors due to the much higher transaction costs of previous decades. These higher transaction costs are reflected through the higher commissions on stock trades and the lack of low cost mutual funds like index funds. Jeremy Siegel estimates that the transactions costs associated with replicating a market portfolio with reinvested dividends would subtract 100-200 basis points from the stock holder returns. In other words, the actual realized equity returns were probably 100-200 basis points below those calculated from historic data.[30]

Company Survivorship Bias

Q. HOW DOES COMPANY SURVIVORSHIP BIAS AFFECT DR. MURRY'S HISTORIC EQUITY RISK PREMIUM?

A. Using historic data to estimate an equity risk premium suffers from company survivorship bias. Company survivorship bias results when using returns from

[29] See Richard Roll, "On Computing Mean Returns and the Small Firm Premium," *Journal of Financial Economics* (1983), pp. 371-86.

[30] Jeremy J. Siegel, "Perspectives on the Equity Risk Premium," *Financial Analysts Journal* (November/December 2005), p. 65.

indexes like the S&P 500. The S&P 500 includes only companies that have survived. The fact that returns of firms that did not perform so well were dropped from these indexes is not reflected. Therefore, these stock returns are upwardly biased because they only reflect the returns from more successful companies.

The "Peso Problem" - U.S. Stock Market Survivorship Bias

Q. WHAT IS THE "PESO PROBLEM," AND HOW DOES IT RELATE TO SURVIVORSHIP BIAS IN U. S. STOCK MARKET RETURNS?

A. Dr. Murry's use of historic return data also suffers from the so-called "Peso problem," which is also known as U.S. stock market survivorship bias. The "Peso problem" issue was first highlighted by the Nobel laureate, Milton Friedman, and gets its name from conditions related to the Mexican peso market in the early 1970s. This issue involves the fact that past stock market returns were higher than were expected at the time because despite war, depression, and other social, political, and economic events, the U.S. economy survived and did not suffer hyperinflation, invasion, and/or the calamities of other countries. As such, highly improbable events, which may or may not occur in the future, are factored into stock prices, leading to seemingly low valuations. Higher than expected stock returns are then earned when these events do not subsequently occur. Therefore, the "Peso problem" indicates that historic stock returns are overstated as measures of expected returns because the U.S. markets have not experienced the disruptions of other major markets around the world.

Market Conditions Today are Significantly Different than in the Past

Q. FROM AN EQUITY RISK PREMIUM PERSPECTIVE, PLEASE DISCUSS HOW MARKET CONDITIONS ARE DIFFERENT TODAY.

A. The equity risk premium is based on expectations of the future. When past market conditions vary significantly from the present, historic data does not provide a realistic or accurate barometer of expectations of the future. As noted previously, stock valuations (as measured by P/E) are relatively high and interest rates are relatively low, on a historic basis. Therefore, given the high stock prices and low interest rates, expected returns are likely to be lower on a going forward basis.

Changes in Risk and Return in the Markets

Q. PLEASE DISCUSS THE NOTION THAT HISTORIC EQUITY RISK PREMIUM STUDIES DO NOT REFLECT THE CHANGE IN RISK AND RETURN IN TODAY'S FINANCIAL MARKETS.

A. The historic equity risk premium methodology is unrealistic in that it makes the explicit assumption that risk premiums do not change over time based on market conditions such as inflation, interest rates, and expected economic growth. Furthermore, using historic returns to measure the equity risk premium masks the dramatic change in the risk and return relationship between stocks and bonds. The nature of the change, as I will discuss below, is that bonds have increased in risk

relative to stocks. This change suggests that the equity risk premium has declined in recent years.

Page 1 of Exhibit JRW-15 provides the yields on long-term U.S. Treasury bonds from 1926 to 2007. One very obvious observation from this graph is that interest rates increase dramatically from the mid-1960s until the early 1980s and have since returned to their 1960 levels. The annual market risk premiums for the 1926 to 2007 period are provided on page 2 of Exhibit JRW-15. The annual market risk premium is defined as the return on common stock minus the return on long-term U.S. Treasury Bonds. There is considerable variability in this series and a clear decline in recent decades. The high was 54% in 1933, and the low was -38% in 1931. Evidence of a change in the relative riskiness of bonds and stocks is provided on page 3 of Exhibit JRW-15, which plots the standard deviation of monthly stock and bond returns since 1930. The plot shows that, whereas stock returns were much more volatile than bond returns from the 1930s to the 1970s, bond returns became more variable than stock returns during the 1980s. In recent years, stocks and bonds have become much more similar in terms of volatility, but stocks are still a little more volatile. The decrease in the volatility of stocks relative to bonds over time has been attributed to several stock related factors: (1) the impact of technology on productivity and the new economy; (2) the role of information (see former Federal Reserve Chairman Greenspan's comments on pages 8-9 in this testimony) on the economy and markets; (3) better cost and risk management by businesses; (4) several bond related factors; (5) deregulation of

the financial system; (6) inflation fears and interest rates; and (7) the increase in the use of debt financing. Further evidence of the greater relative riskiness of bonds is shown on page 4 of Exhibit JRW-15, which plots real interest rates (the nominal interest rate minus inflation) from 1926 to 2007. Real rates have been well above historic norms during the past 10-15 years. These high real interest rates reflect the fact that investors view bonds as riskier investments.

The net effect of the change in risk and return has been a significant decrease in the return premium that stock investors require over bond yields. In short, the equity or market risk premium has declined in recent years. This decline has been discovered in studies by leading academic scholars and investment firms, and has been acknowledged by government regulators. As such, using a historic equity risk premium analysis is simply outdated and not reflective of current investor expectations and investment fundamentals.

Q. DO YOU HAVE ANY OTHER THOUGHTS ON THE USE OF HISTORICAL RETURN DATA TO ESTIMATE AN EQUITY RISK PREMIUM?

A. Yes. Jay Ritter, a Professor of Finance at the University of Florida, identified the use of historical stock and bond return data to estimate a forward-looking equity risk premium as one of the "Biggest Mistakes" taught by the finance profession.[31] His argument is based on the theory behind the equity risk premium, the excessive

[31] Jay Ritter, "The Biggest Mistakes We Teach," *Journal of Financial Research* (Summer 2002).

results produced by historical returns, and the previously-discussed errors such as survivorship bias in historical data.

Q. PLEASE PROVIDE A SUMMARY ASSESSMENT OF DR. MURRY'S HISTORICAL EQUITY RISK PREMIUMS.

A. Dr. Murry's equity risk premiums of 7.1% and 8.5% are derived from historical stock and bond returns is not reflective of market expectations. As noted above, equity risk premiums estimated from historical returns are subject to a myriad of empirical problems that prevent them from being measures of market expectations. Perhaps reflective of these empirical issues, Dr. Murry's equity risk premiums are well in excess of the equity risk premium estimates discovered in recent studies by leading finance scholars.

Q. DO YOU BELIEVE THAT DR. MURRY'S EQUITY COST RATE OF 12.0% IS CONSISTENT WITH THE RETURN REQUIREMENTS OF INVESTORS IN THE FINANCIAL MARKETS?

A. No. Dr. Murry's analysis and results are especially out of touch with the real world of finance. Investment banks, consulting firms, and CFOs use the equity risk premium concept every day in making financing, investment, and valuation decisions. On this issue, the opinions of CFOs are especially relevant. CFOs deal with capital markets on an ongoing basis since they must continually assess and evaluate capital costs for their companies. Furthermore, as is the case with any student of finance, they are well aware of the historical equity risk premium results

as published by Morningstar/Ibbotson Associates. Exhibit JRW-16 shows the equity risk premium results from the Duke University – *CFO Magazine* survey on a quarterly basis from 2000 to 2008. The CFOs in the survey indicate that the appropriate equity risk premium at the present time is in the 4.0% range and certainly not in the 7.1%-8.5% range. As such, the appropriate equity cost rate for a public utility should be in the 9.0% range and not in the 12.0% range.

B. Testimony of Ms. Susan D. Abbott

Q. PLEASE SUMMARIZE MS. ABBOTT'S TESTIMONY.

A. Ms. Abbott's testimony provides an overview of the ratings process of credit rating agencies and also the ratings for Tampa. She discusses the role of rating agencies in the markets, provides an overview of the debt rating process and the impact of regulation of utilities, reviews the rating methodologies and categories of the major rating agencies, as well as the financial metrics employed in the debt rating process. Ms. Abbott also reviews Tampa's financial metrics and bond ratings, recent rating actions by the three major credit rating agencies, and discusses Tampa construction program and credit ratings.

Q. INITIALLY, DOES MS. ABBOTT PERFORM ANY STUDIES TO SUPPORT DR. MURRY'S RECOMMENDED RETURN ON EQUITY OF 12.0%?

A. No. Ms. Abbott does not perform any studies to evaluate the adequacy of Dr. Murry's 12.0% rate of return recommendation.

Q. PLEASE DISCUSS MS. ABBOTT'S EVALUATION OF TAMPA'S CREDIT RATINGS AND CONSTRUCTION PROGRAM.

A. Whereas Ms. Abbott discusses utility construction programs in the context of the debt rating process, her testimony is very general in nature and she performs no studies comparing the magnitude of Tampa's construction program relative to those of other electric utilities and/or the electric utilities in Dr. Murry's proxy group. Therefore, she has made no assessment of the construction program and investment risk of Tampa relative to other electric utility companies.

Q. PLEASE ADDRESS MS. ABBOTT'S DISCUSSION OF THE FINANCIAL METRICS ASSOCIATED WITH THE DEBT RATING PROCESS AND THEIR APPLICATION TO TAMPA.

A. Ms. Abbott reviews the three primary financial metrics used by the debt rating agencies – Funds From Operations/Total Debt ("FFO/TD"), Funds From Operations/Interest ("FFO/INT"), and Debt/Capital ("D/C"). She then computes these metrics for Tampa for the years 2004-2007 and for the year 2009 under two scenarios: (1) Tampa without rate relief; and (2) Tampa with the rate relief requested by the Company. Obviously, the metrics are much more favorable to Tampa under (2) than under (1). However, the metrics computed under (1) are

not realistic. They presume that Tampa gets no rate relief in the current rate case. Nonetheless, even without rate relief, the cash flow metrics (FFO/TD and FFO/INT) for Tampa for 2009 are at the very high end of the BBB rating category. Furthermore, as Ms. Abbott notes on page 19 of her testimony, the debt rating process is a very complex process that involves far more analysis than just the calculation of a few ratios. As Ms. Abbott says, "It is always difficult to predict what a rating agency will do." In addition, as highlighted by S&P, "The ratings matrix is a guideline, not written in stone. The ratings matrix is not meant to be precise. There can always be small positives and negatives that would lead to a notch higher or lower than the typical outcome. Moreover, there will always be exceptions – cases that do not fit neatly into this analytical framework."[32]

Q. ON PAGES 20 OF HER TESTIMONY, MS. ABBOTT CLAIMS THAT TAMPA SHOULD BE TARGETING AN 'A' BOND RATING. HAS EITHER SHE OR MR GILETTE PERFORMED A COST – BENEFIT STUDY TO ASSESS WHETHER THIS MAKES ECONOMIC SENSE?

A. As indicated in Tampa's response to OPC POD 3-82, no such study has been performed.

Q. PLEASE DISCUSS THE RECENT RATINGS DECISIONS ON TAMPA.

A. The three major rating agencies have most recently affirmed or enhanced the outlook for the ratings of Tampa Electric. An important factor in these decisions

[32] Standard & Poor's, *Corporate Ratings Criteria 2008*, page 21.

appears to be the deleveraging of the parent company, TECO Energy, in the wake of the sale of TECO's transport subsidiary.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

CERTIFICATE OF SERVICE
DOCKET NO. 080317-EI

I HEREBY CERTIFY that a true and correct copy of the foregoing Direct Testimony of Dr. J. Randall Woolridge has been furnished by hand delivery or U.S. Mail to the following parties on this 26th day of November, 2008.

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Docket No. 080317-EI

APPENDIX 1
QUALIFICATIONS OF DR. J. RANDALL WOOLRIDGE

Appendix A
Educational Background, Research, and Related Business Experience
J. Randall Woolridge

J. Randall Woolridge is a Professor of Finance and the Goldman, Sachs & Co. and Frank P. Smeal Endowed Faculty Fellow in Business Administration in the College of Business Administration of the Pennsylvania State University in University Park, PA. In addition, Professor Woolridge is Director of the Smeal College Trading Room and President and CEO of the Nittany Lion Fund, LLC.

Professor Woolridge received a Bachelor of Arts degree in Economics from the University of North Carolina, a Master of Business Administration degree from the Pennsylvania State University, and a Doctor of Philosophy degree in Business Administration (major area-finance, minor area-statistics) from the University of Iowa. At Iowa he received a Graduate Fellowship and was awarded membership in Beta Gamma Sigma, a national business honorary society. He has taught Finance courses at the University of Iowa, Cornell College, and the University of Pittsburgh, as well as the Pennsylvania State University. These courses include corporation finance, commercial and investment banking, and investments at the undergraduate, graduate, and executive MBA levels.

Professor Woolridge's research has centered on the theoretical and empirical foundations of corporation finance and financial markets and institutions. He has published over 35 articles in the best academic and professional journals in the field, including the *Journal of Finance*, the *Journal of Financial Economics*, and the *Harvard Business Review*. His research has been cited extensively in the business press. His work has been featured in the *New York Times, Forbes, Fortune, The Economist, Financial World, Barron's, Wall Street Journal, Business Week, Washington Post, Investors' Business Daily, Worth Magazine, USA Today*, and other publications. In addition, Dr. Woolridge has appeared as a guest to discuss the implications of his research on CNN's *Money Line*, CNBC's *Morning Call* and *Business Today*, and Bloomberg Televisions' *Morning Call*.

Professor Woolridge's popular stock valuation book, *The StreetSmart Guide to Valuing a Stock* (McGraw-Hill, 2003), was released in its second edition. He has also co-authored *Spinoffs and Equity Carve-Outs: Achieving Faster Growth and Better Performance* (Financial Executives Research Foundation, 1999) as well as a new textbook entitled *Applied Principles of Finance* (Kendall Hunt, 2006). Dr. Woolridge is a founder and a managing director of www.valuepro.net - a stock valuation website.

Professor Woolridge has also consulted with and prepared research reports for major corporations, financial institutions, and investment banking firms, and government agencies. In addition, he has directed and participated in over 500 university- and company- sponsored professional development programs for executives in 25 countries in North and South America, Europe, Asia, and Africa.

Dr. Woolridge has prepared testimony and/or provided consultation services in the following cases:

Pennsylvania: Dr. Woolridge has prepared testimony on behalf of the Pennsylvania Office of Consumer Advocate in the following cases before the Pennsylvania Public Utility Commission; Bell Telephone Company (R-811819), Peoples Natural Gas Company (R-832315), Pennsylvania Power Company (R-832409), Western Pennsylvania Water Company (R-832381), Pennsylvania Power Company (R-842740), Pennsylvania Gas and Water Company (R-850178), Metropolitan Edison Company (R-860384), Pennsylvania Electric Company (R-860413), North Penn Gas Company (R-860535), Philadelphia Electric Company (R-870629), Western Pennsylvania Water Company (R-870825), York Water Company (R-870749), Pennsylvania-American Water Company (R-880916), Equitable Gas Company (R-880971), the Bloomsburg Water Co. (R-891494), Columbia Gas of Pennsylvania, Inc. (R-891468), Pennsylvania-American Water Company (R-90562), Breezewood Telephone Company (R-901666), York Water Company (R-901813), Columbia Gas of Pennsylvania, Inc. (R-901873), National Fuel Gas Corporation (R-911912), Pennsylvania-American Water Company (R-911909), Borough of Media Water Fund (R-912150), UGI Utilities, Inc. - Electric Utility Division (R-922195), Dauphin Consolidated Water Supply Company - General Waterworks of Pennsylvania, Inc, (R-932604), National Fuel Gas Corporation (R-932548), Commonwealth Telephone Company (I-

Appendix A
Educational Background, Research, and Related Business Experience
J. Randall Woolridge

920020), Conestoga Telephone and Telegraph Company (I-920015), Peoples Natural Gas Company (R-932866), Blue Mountain Consolidated Water Company (R-932873), National Fuel Gas Corporation (R-942991), UGI - Gas Division (R-953297), UGI - Electric Division (R-953534), Pennsylvania-American Water Company (R-973944), Pennsylvania-American Water Company (R-994638), Philadelphia Suburban Water Company (R-994868;R-994877;R-994878; R-9948790), Philadelphia Suburban Water Company (R-994868), Wellsboro Electric Company (R-00016356), Philadelphia Suburban Water Company (R-00016750), National Fuel Gas Corporation (R-00038168), Pennsylvania-American Water Company (R-00038304), York Water Company (R-00049165), Valley Energy Company (R-00049345), Wellsboro Electric Company (R-00049313), National Fuel Gas Corporation (R-00049656), T.W. Phillips Gas and Oil Co. (R-00051178), PG Energy (R-00061365), City of Dubois Water Company (Docket No. R-00050671), R-00049165), York Water Company (R-00061322), Emporium Water Company (R-00061297), Pennsylvania-American Water Company (R-00072229),

New Jersey: Dr. Woolridge prepared testimony for the New Jersey Department of the Public Advocate, Division of Rate Counsel: New Jersey-American Water Company (R-91081399J), New Jersey-American Water Company (R-92090908J), and Environmental Disposal Corp. (R-94070319).

Alaska: Dr. Woolridge prepared testimony for Attorney General's Office of Alaska: Golden Heart Utilities, Inc. and College Utilities Corp. (Water Public Utility Service TA-29-118 and Sewer Public Utility Service TA-82-97), Anchorage Water and Wastewater Utility (TA-106-122).

Arizona: Dr. Woolridge prepared testimony for Utility Division staff of the Arizona Corporation Commission, Arizona Public Service Company (Docket No. E-01345A-06-0009).

Hawaii: Dr. Woolridge prepared testimony for the Hawaii Office of the Consumer Advocate: East Honolulu Community Services, Inc. (Docket No. 7718).

Delaware: Dr. Woolridge prepared testimony for the Delaware Division of Public Advocate: Artesian Water Company (R-00-649). Dr. Woolridge prepared testimony for the staff of the Public Service Commission: Artesian Water Company (R-06-158).

Ohio: Dr. Woolridge prepared testimony for the Ohio Office of Consumers' Council: SBC Ohio (Case No. 02-1280-TP-UNC R-00-649), and Cincinnati Gas & Electric Company (Case No. 05-0059-EL-AIR).

Texas: Dr. Woolridge prepared testimony for the Atmos Cities Steering Committee: Mid-Texas Division of Atmos Energy Corp. (Docket No. 9670).

New York: Dr. Woolridge prepared testimony for the County of Nassau in New York State: Long Island Lighting Company (PSC Case No. 942354).

Florida: Dr. Woolridge prepared testimony for the Office of Public Counsel in Florida: Florida Power & Light Co. (Docket No. 050045-EL), Florida Public Utilities Company (Docket No. 070304-EI).

Indiana: Dr. Woolridge prepared testimony for the Indiana Office of Utility Consumer Counsel (OUCC) in the following cases: Southern Indiana Gas and Electric Company (IURC Cause No. 43111 and IURC Cause No. 43112).

Oklahoma: Dr. Woolridge prepared testimony for the Oklahoma Industrial Energy Companies (OIEC) in the following cases: Public Service Company of Oklahoma (Cause No. PUD 200600285), Oklahoma Gas & Electric Company (Cause No. PUD 200700012

Appendix A
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J. Randall Woolridge

Connecticut: Dr. Woolridge prepared testimony for the Office of Consumer Counsel in Connecticut: United Illuminating (Docket No. 96-03-29), Yankee Gas Company (Docket No. 04-06-01), Southern Connecticut Gas Company (Docket No. 03-03-17), the United Illuminating Company (Docket No. 05-06-04), Connecticut Light and Power Company (Docket No. 05-07-18), Birmingham Utilities, Inc. (Docket No. 06-05-10), Connecticut Water Company (Docket No. 06-07-08), Connecticut Natural Gas Corp. (Docket No. 06-03-04), Aquarion Water Company (Docket No. 07-05-09), Yankee Gas Company (Docket No. 06-12-02), and Connecticut Light and Power Company (Docket No. 07-07-01).

California: Dr. Woolridge prepared testimony for the Office of Ratepayer Advocate in California: San Gabriel Valley Water Company (Docket No. 05-08-021), Pacific Gas & Electric (Docket No. 07-05-008), San Diego Gas & Electric (Docket No. 07-05-007), and Southern California Edison (Docket No. 07-05-003).

South Carolina: Dr. Woolridge prepared testimony for the Office of Regulatory Staff in South Carolina: South Carolina Electric and Gas Company (Docket No. 2005-113-G), Carolina Water Service Co. (Docket No. 2006-87-WS), Tega Cay Water Company (Docket No. 2006-97-WS), United Utilities Companies, Inc. (Docket No. 2006-107-WS).

Missouri: Dr. Woolridge prepared testimony for the Department of Energy in Missouri: Kansas City Power & Light Company (CASE NO. ER-2006-0314). Dr. Woolridge prepared testimony for the Office of Attorney General of Missouri: Union Electric Company (CASE NO. ER-2007-0002).

Kentucky: Dr. Woolridge prepared testimony for the Office of Attorney General in Kentucky: Kentucky-American Water Company (Case No. 2004-00103), Union Heat, Light, and Power Company (Case No. 2004-00042), Kentucky Power Company (Case No. 2005-00341), Union Heat, Light, and Power Company (Case No. 2006-00172), Atmos Energy Corp. (Case No. 2006-00464), Columbia Gas Company (Case No. 2007-00008), Delta Natural Gas Company (Case No. 2007-00089), Kentucky-American Water Company (Case No. 2007-00143).

Washington, D.C.: Dr. Woolridge prepared testimony for the Office of the People's Counsel in the District of Columbia: Potomac Electric Power Company (Formal Case No. 939).

Washington: Dr. Woolridge consulted with trial staff of the Washington Utilities and Transportation Commission on the following cases: Puget Energy Corp. (Docket Nos. UE-011570 and UG-011571); and Avista Corporation (Docket No. UE-011514).

Kansas: Dr. Woolridge prepared testimony on behalf of the Kansas Citizens' Utility Ratepayer Board in the following cases: Western Resources Inc. (Docket No. 01-WSRE-949-GIE), UtiliCorp (Docket No. 02-UTCG701-CIG), and Westar Energy, Inc. (Docket No. 05-WSEE-981-RTS).

FERC: Dr. Woolridge has prepared testimony on behalf of the Pennsylvania Office of Consumer Advocate in the following cases before the Federal Energy Regulatory Commission: National Fuel Gas Supply Corporation (RP-92-73-000) and Columbia Gulf Transmission Company (RP97-52-000).
Vermont: Dr. Woolridge prepared testimony for the Department of Public Service in the Central Vermont Public Service (Docket No. 6988) and Vermont Gas Systems, Inc. (Docket No. 7160).

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Recommended Rate of Return
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Exhibit JRW-1

Tampa Electric Company
Cost of Capital

Weighted Average Cost of Capital - Regulatory Capital Structure

Capital Source	Capitalization Ratio	Cost Rate	Weighted Cost Rate
Long Term Debt	43.80%	6.80%	2.98%
Short Term Debt	0.60%	2.33%	0.01%
Customer Deposits	2.82%	6.07%	0.17%
Common Equity	42.48%	9.75%	4.14%
Tax Credits - Weighted Cost	0.33%	8.21%	0.03%
Deferred Income Taxes	9.97%	0.00%	0.00%
Total	100.00%		7.33%

Weighted Average Cost of Capital - Conventional Capital Structure

Capital Source	Capitalization Ratio	Cost Rate	Weighted Cost Rate
Long Term Debt	50.42%	6.80%	3.43%
Short Term Debt	0.69%	2.33%	0.02%
Common Equity	48.89%	9.75%	4.77%
Total	100.00%		8.21%

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Interest Rates
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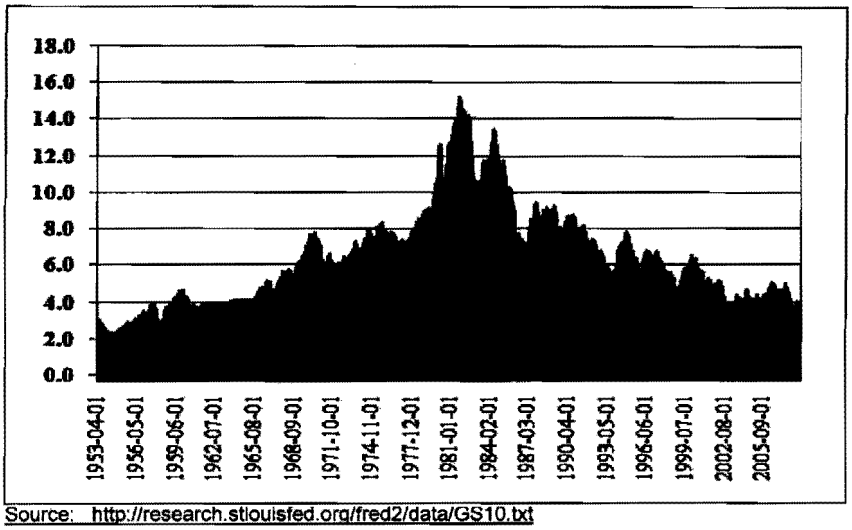
Exhibit JRW-2
Ten-Year Treasury Yields
1953-Present



Source: http://research.stlouisfed.org/fred2/data/GS10.txt

Attachment B

Exhibit JRW-3
Tampa Electric Company
Summary Financial Statistics for Electric Proxy Group

Electric Proxy Group

Company	Operating Revenue ($mil)	Percent Elec Revenue	Net Plant ($mil)	Moody's Bond Rating	S&P Bond Rating	Long-Term Interest Coverage	Primary Service Area	Common Equity Ratio	Return on Equity	Market to Book Ratio
ALLETE, Inc. (NYSE-ALE)	816.3	88	1,224.3	NR	A-	6.0	MN, WS	57	11.7	1.41
Ameren Corporation (NYSE-AEE)	7,671.0	82	15,566.0	Baa2	BBB	4.2	IL, MO	46	10.4	0.93
Central Vermont Public Serv. Corp. (NYSE-CV)	340.7	100	327.6	NR	BBB+	4.1	VT	50	8.8	1.13
Cleco Corporation (NYSE-CNL)	1,042.7	95	1,877.6	Baa1	BBB	2.5	LA	49	12.5	1.24
DPL Inc.(NYSE-DPL)	1,587.8	100	2,821.8	A2	A-	6.2	OH	39	NM	2.77
Empire District Electric Co. (NYSE-EDE)	504.9	87	1,261.5	Baa1	BBB+	2.1	MO,KS,OK,AR	44	6.7	1.07
Hawaiian Electric Industries, Inc. (NYSE-HE)	2,885.3	83	2,480.0	Baa2	BBB	2.7	HI	38	8.2	1.57
IDACORP, Inc. (NYSE-IDA)	902.6	100	2,687.8	A3	A-	2.4	ID,OR	45	6.6	0.94
Northeast Utilities (NYSE-NU)	5,571.2	84	7,721.7	Baa1	BBB+	2.8	CT,NH,MA	40	8.3	1.09
NSTAR (NYSE-NST)	3,191.6	78	4,243.1	A1	AA-	3.3	MA	40	5.6	1.79
Pinnacle West Capital Corp. (NYSE-PNW)	3,628.0	86	8,570.9	Baa2	BBB-	3.2	AZ	52	8.8	0.82
Progress Energy Inc. (NYSE-PGN)	8,723.0	100	17,501.0	A2	A-	2.9	NC,SC,FL	43	8.2	1.10
UIL Holdings Corporation (NYSE-UIL)	941.5	100	969.6	Baa2	NR	4.2	CT	44	10.5	1.80
Mean	2,908.2	91	5,173.3	Baa1		3.6		45	8.9	1.36

Data Source: AUS *Utility Reports*, November, 2008; Service Area and Long-Term Interest Coverage are from *Value Line Investment Survey*, 2008.

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Exhibit JRW-4
Capital Structure Ratios and Debt Cost Rate
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Exhibit JRW-4
Tampa Electric Company
Capital Structure Ratios

Panel A - Tampa's Recommended Capitalization Ratios - Investor Provided Capital

Capital	Capitalization Ratios	Capitalization Ratios
Short-Term Debt	1,397,566	42.11%
Long-Term Debt	8,001.99	0.24%
Common Equity*	1,835,985	55.32%
Total Capital*	3,318,553	100.00%

* Includes $77,000 adjustment for PPAs
Source: Testimony of Dr. Murry

Panel B - Tampa's Average Capitalization Ratios - 2005-2007

	2005	2006	2007	Average
Short-Term Debt	47.36%	48.27%	52.16%	49.26%
Long-Term Debt	1.79%	2.76%	0.60%	1.72%
Common Equity*	50.85%	48.97%	47.24%	49.02%
Total*	100.00%	100.00%	100.00%	100.00%

* Excludes adjustments for PPAs
Source: Page 2 of Exhibit JRW-4

Panel C - Average Common Equity Ratio of Electric Proxy Group - 2008

	2008
Average Common Equity Ratio	45.7

Source: Page 3 of Exhibit JRW-4

Panel D - Tampa Electric Capital Structure

	2007		2008	
Source	Amount	Ratio	Amount	Ratio
Long Term Debt	$1,638,241	45.57%	$1,603,286	42.03%
Short Term Debt	17,324	0.48%	27,462	0.72%
Customer Deposits	99,885	2.78%	109,307	2.87%
Common Equity	1,460,034	40.62%	1,691,387	44.34%
Tax Credits - Weighted Cost	13,228	0.37%	11,293	0.30%
Deferred Income Taxes	366,044	10.18%	372,209	9.76%
Total	$3,594,756	100.00%	$3,814,944	100.00%
Capital Structure Investor Sources Only:				
Long Term Debt	$1,638,241	52.58%	$1,603,286	48.26%
Short Term Debt	17,324	0.56%	27,462	0.83%
Common Equity	1,460,034	46.86%	1,691,387	50.91%
	3,115,599	100.00%	3,322,135	100.00%

Source: MFR D-1a

Panel E - OPC Recommended Capital Structure Ratios

Source	
Long Term Debt	43.80%
Short Term Debt	0.60%
Customer Deposits	2.82%
Common Equity	42.48%
Tax Credits - Weighted Cost	0.33%
Deferred Income Taxes	9.97%
Total	100.00%
Capital Structure Investor Sources Only:	
Long Term Debt	50.42%
Short Term Debt	0.69%
Common Equity	48.89%
Total	100.00%

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Tampa Electric Company
Thirteen Month Jurisdictional Capital Structure

	2005				2005				
	Mar	**June**	**Sept**	**Dec**	**Mar**	**June**	**Sept**	**Dec**	**Average**
Long-term Debt	$ 1,195,913,100	$ 1,196,774,848	$ 1,190,478,376	$ 1,189,711,165	47.47%	47.46%	47.40%	47.11%	47.36%
Short-term Debt	39,852,417	39,823,462	41,625,969	59,614,202	1.58%	1.58%	1.66%	2.36%	1.79%
Common Equity	1,283,446,175	1,285,126,390	1,279,654,494	1,276,298,423	50.95%	50.96%	50.95%	50.53%	50.85%
Total	2,519,211,692	2,521,724,700	2,511,758,839	2,525,623,790	100.00%	100.00%	100.00%	100.00%	100.00%
	2006				**2006**				
	Mar	**June**	**Sept**	**Dec**	**Mar**	**June**	**Sept**	**Dec**	**Average**
Long-term Debt	$ 1,189,101,961	$ 1,206,085,095	$ 1,242,404,168	$ 1,276,549,822	46.89%	47.62%	48.79%	49.77%	48.27%
Short-term Debt	78,774,665	75,761,170	66,398,305	60,352,489	3.11%	2.99%	2.61%	2.35%	2.76%
Common Equity	1,267,827,147	1,250,899,637	1,237,395,037	1,227,968,563	50.00%	49.39%	48.60%	47.88%	48.97%
Total	2,535,703,773	2,532,745,902	2,546,197,510	2,564,870,874	100.00%	100.00%	100.00%	100.00%	100.00%
	2007				**2007**				
	Mar	**June**	**Sept**	**Dec**	**Mar**	**June**	**Sept**	**Dec**	**Average**
Long-term Debt	$ 1,314,986,187	$ 1,367,068,720	$ 1,382,565,969	$ 1,404,913,615	51.12%	52.42%	52.55%	52.54%	52.16%
Short-term Debt	25,699,498	7,821,490	14,726,750	14,856,944	1.00%	0.30%	0.56%	0.56%	0.60%
Common Equity	1,231,805,024	1,233,100,824	1,233,737,707	1,254,250,601	47.88%	47.28%	46.89%	46.91%	47.24%
Total	2,572,490,709	2,607,991,034	2,631,030,426	2,674,021,160	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Tampa response to OPC POD 3-90.

Tampa Electric Company
Common Equity Ratios of Electric Proxy Group

Electric Proxy Group

Company	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov	Mean
ALLETE, Inc. (NYSE-ALE)	62.0	62.0	63.0	63.0	63.0	60.0	60.0	60.0	60.0	57.0	57	60.7
Ameren Corporation (NYSE-AEE)	49.0	49.0	49.0	47.0	47.0	47.0	47.0	47.0	46.0	46.0	46	47.2
Central Vermont Public Serv. Corp. (NYSE-CV)	59.0	59.0	59.0	60.0	60.0	51.0	51.0	51.0	50.0	50.0	50	54.6
Cleco Corporation (NYSE-CNL)	56.0	56.0	56.0	54.0	54.0	51.0	51.0	51.0	49.0	49.0	49	52.4
DPL Inc.(NYSE-DPL)	34.0	34.0	34.0	35.0	35.0	35.0	36.0	36.0	36.0	39.0	39	35.7
Empire District Electric Co. (NYSE-EDE)	45.0	45.0	45.0	48.0	48.0	45.0	45.0	45.0	45.0	44.0	44	45.4
Hawaiian Electric Industries, Inc. (NYSE-HE)	27.0	27.0	27.0	27.0	27.0	29.0	29.0	29.0	29.0	38.0	38	29.7
IDACORP, Inc. (NYSE-IDA)	48.0	48.0	48.0	47.0	47.0	46.0	46.0	46.0	46.0	46.0	46	46.7

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Capital Structure Ratios and Debt Cost Rate
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Tampa Electric Company
2007 - 2009 Capital Structure Comparison

2007 Actual Weighted Cost of Capital:	Total Company Per Books Per MFR D-1a	Specific Adjustments: Common Dividends	Deferred Tax / Pro rata	Deferred Tax / STD	PPA Equity Adjustment	Other	Pro rata Adjustments	Jurisdictional Capital Structure	Jurisdictional Adjusted Separation Factor	(Mid-pt.) Capital Structure	Weighted Cost Rate
			0	0							
Long Term Debt	$1,638,241	$0	$0	$0	$0	($24)	($191,866)	$1,448,351	0.973348	$1,407,803	6.43%
Short Term Debt	17,324		0	0		0	-2,029	15,295	0.973325	14,887	3.68%
Customer Deposits	99,885		0	0		0	-11,698	88,187	0.973352	85,837	6.04%
Common Equity	1,460,034	2,540	0	0	0	-39	-171,290	1,291,245	0.973347	1,256,830	11.75%
Tax Credits - Weighted Cost	13,228		0	0		-2	-1,549	11,677	0.973366	11,366	8.94%
Deferred Income Taxes	366,044		0	0		11,733	-44,245	333,532	0.973349	324,643	0.00%
Total	$3,594,756	$2,540	$0	$0	$0	$11,668	($422,677)	$3,186,287		$3,101,366	
Capital Structure Investor Sources Only:											
Long Term Debt	$1,638,241	52.6%						$1,448,351	52.5%	$1,407,803	52.5%
Short Term Debt	17,324	0.6%						15,295	0.6%	14,887	0.6%
Common Equity	1,460,034	46.9%						1,291,245	46.9%	1,256,830	46.9%
	3,115,599	100.0%						2,752,891	100.0%	2,679,520	100.0%
2008 Weighted Cost of Capital:											
Long Term Debt	$1,603,286	$0	$0	$0	$0	($26)	($183,276)	$1,419,984	0.975386	$1,385,032	6.66%
Short Term Debt	27,462		0	0		0	-3,139	24,323	0.975373	23,724	5.73%
Customer Deposits	109,307		0	0		0	-12,495	96,812	0.975385	94,429	6.27%
Common Equity	1,891,387	11,713	0	0	0	-27	-194,686	1,508,387	0.975386	1,471,259	11.75%
Tax Credits - Weighted Cost	11,293		0	0		-2	-1,291	10,000	0.975400	9,754	9.38%
Deferred Income Taxes	372,209		0	0		432	-42,598	330,043	0.975385	321,919	0.00%
Total	$3,814,944	$11,713	$0	$0	$0	$377	($437,485)	$3,389,549		$3,306,117	
Capital Structure Investor Sources Only:											
Long Term Debt	$1,603,286	48.3%						$1,419,984	48.1%	$1,385,032	48.09%
Short Term Debt	27,462	0.8%						24,323	0.8%	23,724	0.82%
Common Equity	1,691,387	50.9%						1,508,387	51.1%	1,471,259	51.09%
	3,322,135	100.0%						2,952,694	100.0%	2,880,015	100.00%
2009 Test Year Weighted Cost of Capital:			Note 1	Note 2	Note 3		Note 4				
Long Term Debt	$1,841,637	$0	$76,352	$0	$0	$0	($282,725)	$1,455,264	0.960352	$1,397,566	6.80%
Short Term Debt	49,170		185	-39,498		0	-1,504	8,332	0.960352	8,002	4.63%
Customer Deposits	121,838		5,667	0		0	-19,499	108,006	0.960352	103,724	6.07%
Common Equity	2,075,341	7,677	86,908	0	77,000	0	-345,142	1,911,784	0.960352	1,835,985	12.00%
Tax Credits - Weighted Cost	10,795		0	0		-2	-1,650	9,142	0.960352	8,780	9.75%
Deferred Income Taxes	396,055		454	-24,805		452	-56,912	315,243	0.960352	302,744	0.00%
Total	$4,294,835	$7,677	$179,546	($64,304)	$77,000	$450	($687,432)	$3,807,772		$3,656,800	
Capital Structure Investor Sources Only:											
Long Term Debt	$1,641,637	43.6%						$1,455,264	43.1%	$1,397,566	43.1%
Short Term Debt	49,170	1.3%						8,332	0.2%	8,002	0.2%
Common Equity	2,075,341	55.1%						1,911,784	56.6%	1,835,985	56.6%
	3,766,147	100.0%						3,375,381	100.0%	3,241,552	100.0%

Source: Tampa Response to OPC POD 3-58.

Note 1: Includes the following proforma adjustments that impact only 2009. Deferred tax impact separately identified and remaining adjustment prorated over other sources of capital; Annualization of CTs and rail project, Amortization of Rate Case Expense, Amortization of Dredging O&M, Storm Reserve, IRS Adjustment to Deferred Taxes.

Note 2: Adjustment for Under recovery of Fuel, which reflects appropriate treatment for establishing permanent base rates. 2007 and 2008 fuel underrecoveries are included in pro rata adjustments.

Note 3: Adjustment to equity to offset off balance sheet obligations for purchased power. This adjustment is not included in 2007 and 2008.

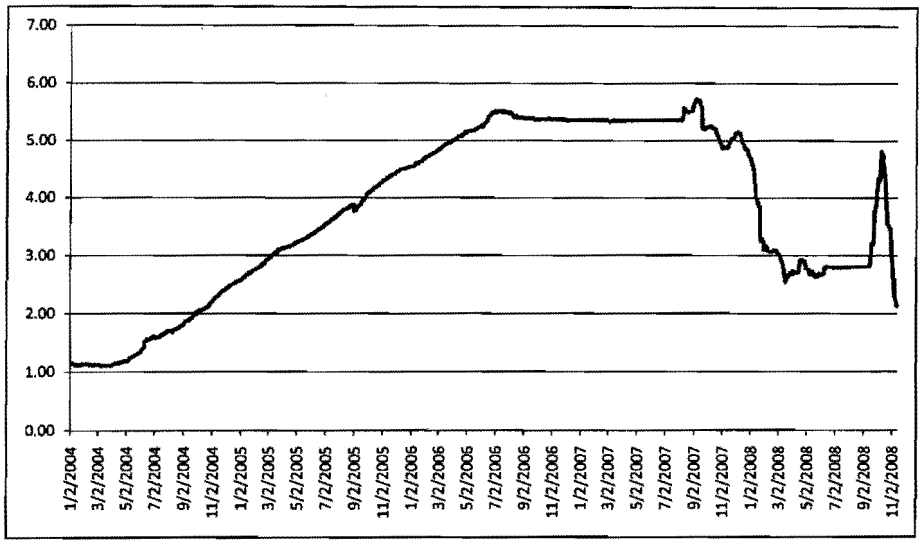
Note 4: Pro rata adjustment detail for all three years is included in MFR D-1b.

Attachment B

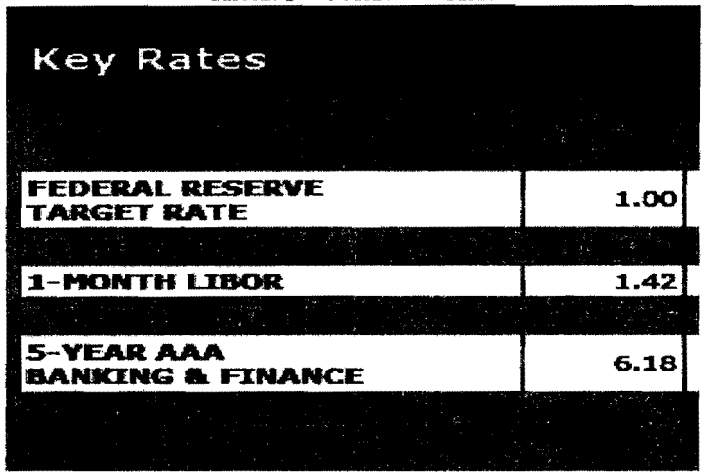
Docket No. 080317-EI
Exhibit JRW-4
Capital Structure Ratios and Debt Cost Rate
Page 5 of 6

Tampa Electric Company
Short-Term Debt Cost Rate

Three-Month LIBOR Rates



Current Three-Month LIBOR Rate



Source: Bloomberg

Attachment B

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Exhibit JRW-4
Capital Structure Ratios and Debt Cost Rate
Page 6 of 6

Tampa Electric Company
Long-Term Debt Cost Rate

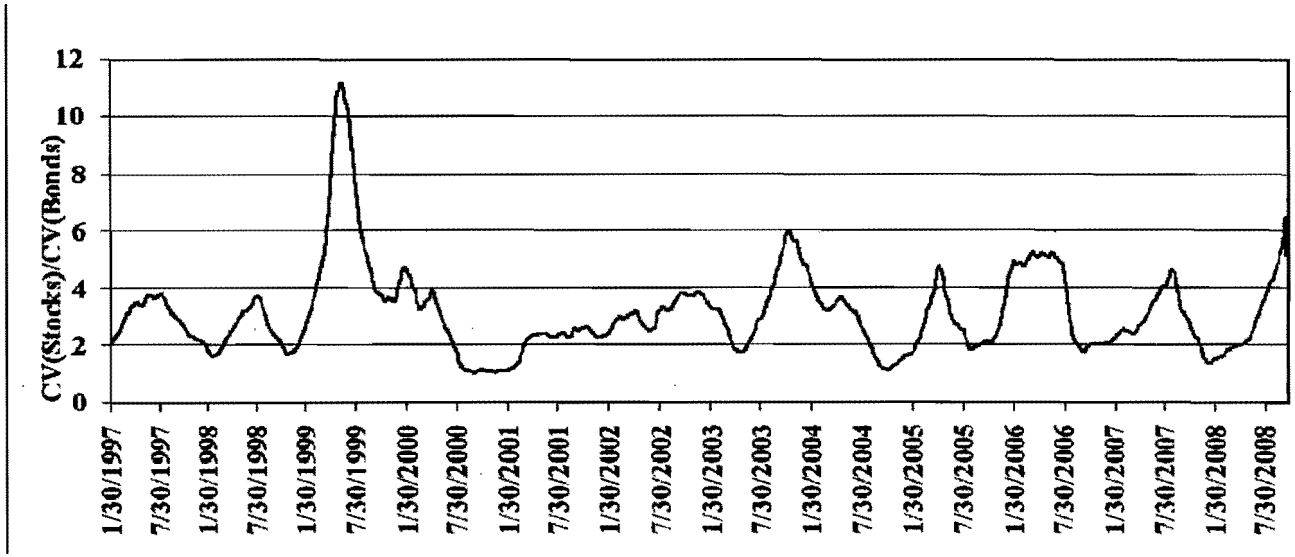
(1) Description, Coupon Rate	(2) Issue Date	(3) Maturity Date	(4) Principal Amount Sold (Face Value)	(5) 13-Month Average Principal Amt. Outstanding	(6) Discount (Premium) on Principal Amount Sold	(7) Issuing Expense On Principal Amount Sold	(8) Life (Years)	(9) Annual Amortization (6+7)/(8)	(10) Interest Expense (Coupon Rate) (1) x (5)	(11) Total Annual Cost (9)+(10)	(12) Unamortized Discount (Premium) Associated With (5)	(13) Unamort. Issuing Expense & Loss on Reacquired Debt Associated With (5)
6.875% Due 2012	8/25/2001	6/15/2012	$ 210,000	$ 210,000	$ 886	$ 1,506	10.96	$ 218	$ 14,438	$ 14,656	$ 240	$ 408
5.10% Due 2013	8/11/2002	10/1/2013	80,685	80,685	(1,098)	800	11.32	(41)	3,095	3,054	(401)	226
5.50% Due 2023	8/11/2002	10/1/2023	86,400	86,400	1,076	854	21.32	91	4,752	4,843	719	571
6.375% Due 2012 (a)	8/26/2002	8/15/2012	330,000	330,000	2,850	13,498	9.96	1,618	21,038	22,656	830	4,227
6.25% Due 2016	4/11/2003	4/11/2016	250,000	250,000	-	1,945	13.01	149	15,625	15,774	-	1,014
6.550% Due 2036	5/12/2006	5/15/2036	250,000	250,000	1,583	4,142	30.03	190	16,375	16,565	1,399	3,710
6.150% Due 2037 (b)	5/25/2007	5/15/2037	190,000	190,000	1,077	1,099	30.00	73	11,685	11,758	1,002	1,024
5.00% Due 2034	1/19/2006	12/1/2034	85,950	85,950	-	3,264	28.89	215	4,298	4,513	-	2,778
5.65% Due 2018	7/25/2007	5/15/2018	54,200	54,200	-	1,401	10.82	130	3,062	3,192	-	1,150
5.15% Due 2025	7/25/2007	9/1/2025	51,600	51,600	-	1,293	18.12	115	2,657	2,772	-	1,112
6.10% Due 2018 (c)	5/13/2008	5/15/2018	100,000	100,000	-	8,571	10.00	857	6,100	6,957	-	7,807
8.90% Due 2019 (d)	11/1/2009	11/1/2019	125,000	19,231	-	1,250	10.00	21	1,438	1,459	-	190
Unamortized loss on reacquired debt								2,630	869	3,499	-	18,623
Total				$ 1,686,066	$ 6,185	$ 39,421		$ 6,486	$ 105,232	$ 111,698	$ 3,790	$ 42,639
											Total Long-Term Debt Average	1,641,857
											Total Interest Average	111,698
											Long-Term Debt Cost Rate	6.80%

Source: Tampa Response to OPC 3-60, part 2.

Attachment B

Exhibit JRW-5

Coefficient of Variation
S&P 500 Price CV/Bear Sterns Bond Price Index CV



Data Source: Bloomberg

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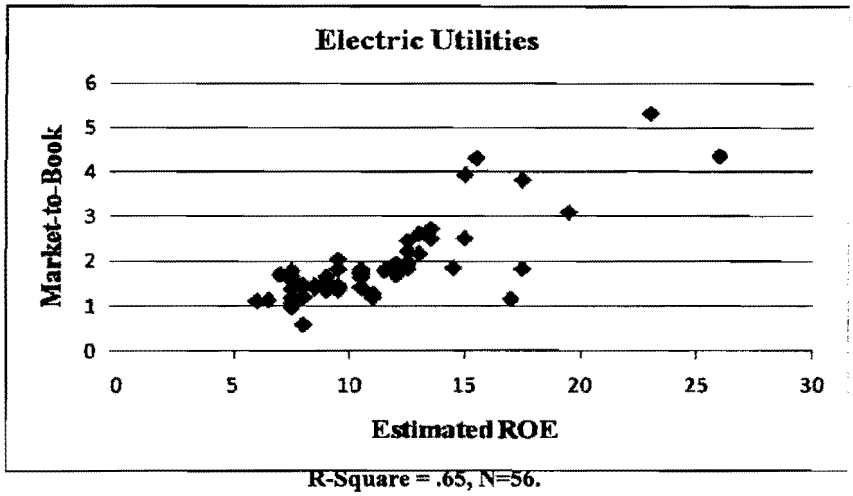
Exhibit JRW-6
The Relationship Between Estimated ROE and Market-to-Book Ratios
Page 1 of 2

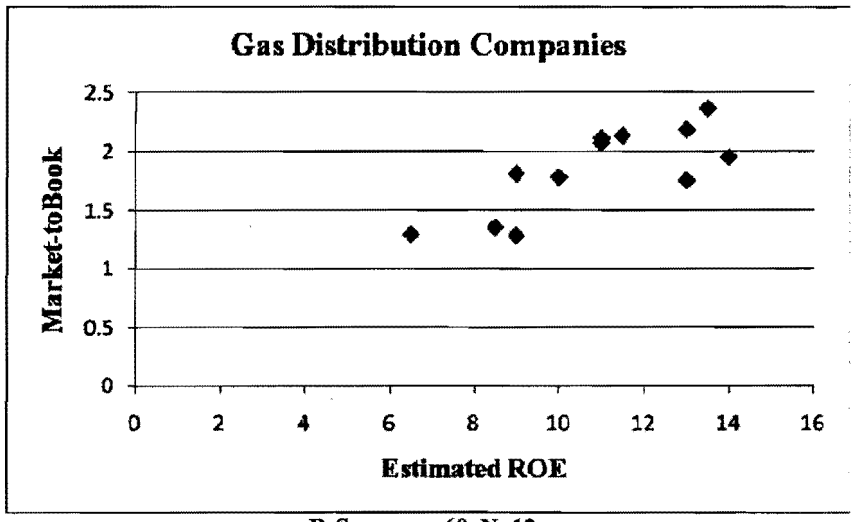
Exhibit JRW-6

Panel A



R-Square = .65, N=56.

Panel B



R-Square = .60, N=12.

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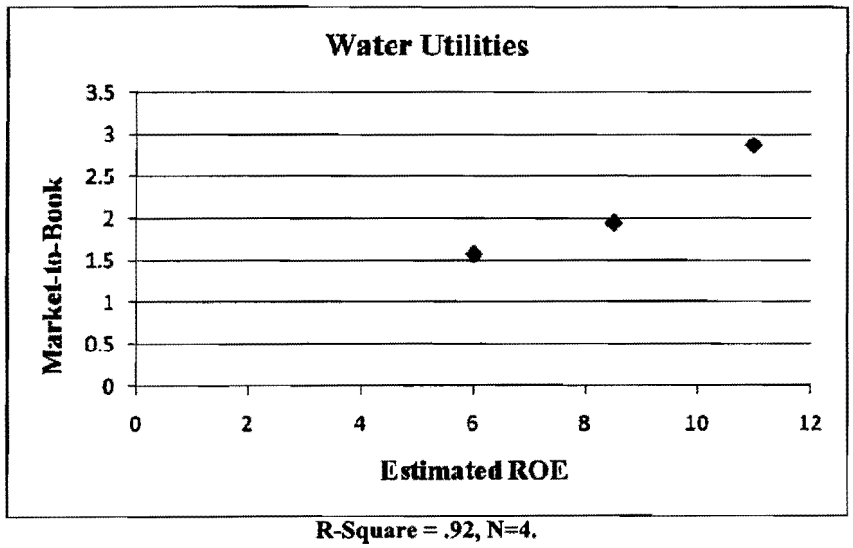
Exhibit JRW-6
The Relationship Between Estimated ROE and Market-to-Book Ratios
Page 2 of 2

Exhibit JRW-6

Panel C



R-Square = .92, N=4.

Attachment B

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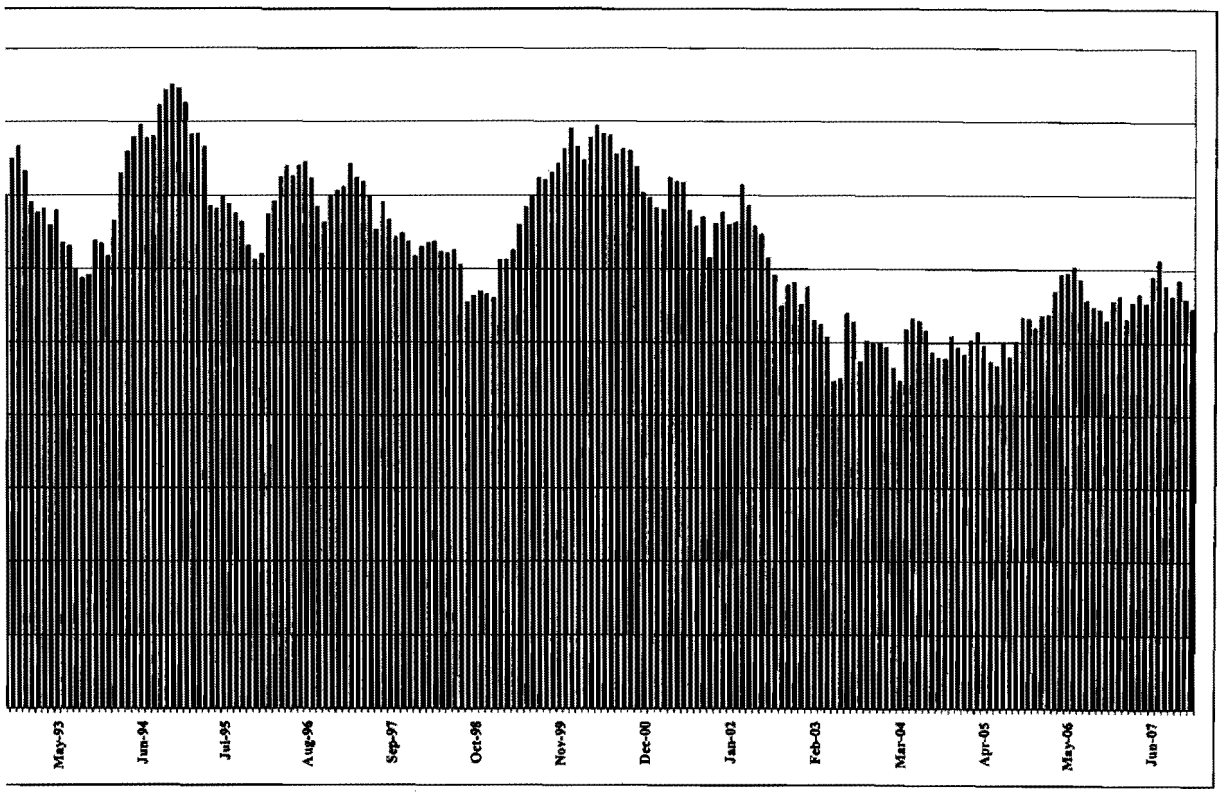
Exhibit JRW-7
Public Utility Capital Cost Indicators
Page 1 of 3

Exhibit JRW-7
Long-Term 'A' Rated Public Utility Bonds

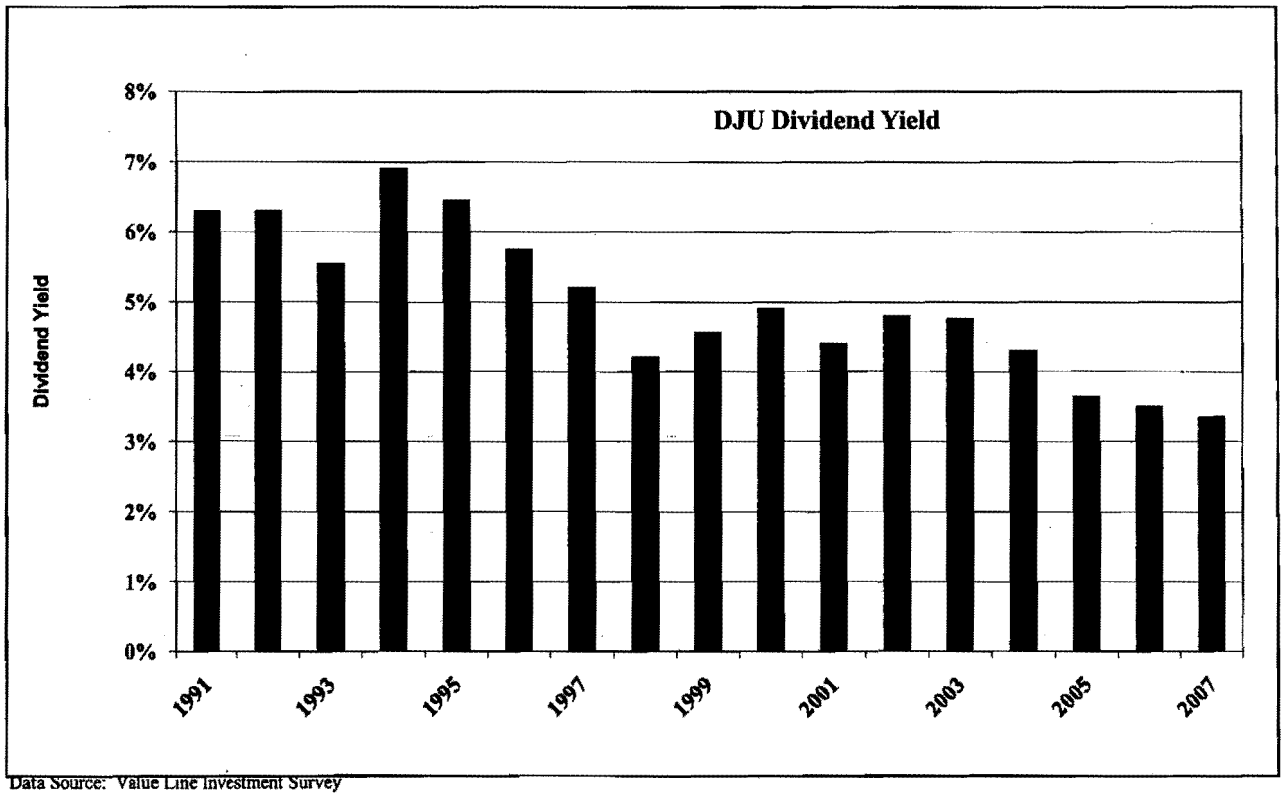


Attachment B

Docket No. 080317-EI
Exhibit JRW-7
Public Utility Capital Cost Indicators
Page 2 of 3

Exhibit JRW-4

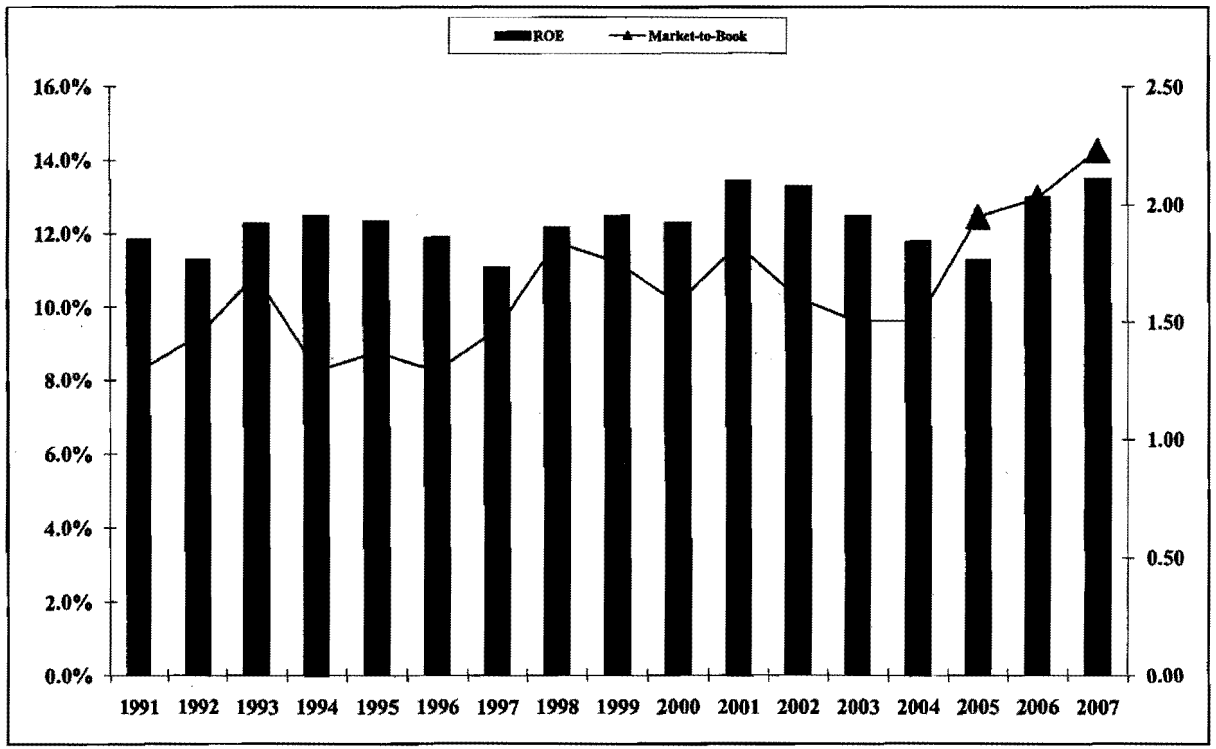
Dow Jones Utilities Dividend Yield



Data Source: Value Line Investment Survey

Attachment B

Exhibit JRW-7
Dow Jones Utilities - Market to Book and ROE



Data Source: Value Line Investment Survey

Attachment B

Docket No. 080317-EI
Exhibit JRW-8
Industry Average Betas
Page 1 of 1

Exhibit JRW-8

Industry Average Betas

Industry Name	Number of Firms	Beta	Industry Name	Number of Firms	Beta	Industry Name	Number of Firms	Beta
Semiconductor	138	2.59	Telecom. Services	152	1.34	Utility (Foreign)	6	1.01
Semiconductor Equip	16	2.51	Electronics	179	1.32	Petroleum (Producing)	186	1.00
Wireless Networking	74	2.20	Investment Co.(Foreign)	15	1.31	Environmental	89	1.00
E-Commerce	56	2.08	Educational Services	39	1.27	Grocery	15	0.99
Entertainment Tech	38	2.06	Retail (Special Lines)	164	1.26	Home Appliance	11	0.95
Telecom. Equipment	124	1.98	Hotel/Gaming	75	1.25	Insurance (Life)	40	0.94
Steel (Integrated)	14	1.97	Heavy Construction	12	1.25	Electric Util. (Central)	25	0.93
Internet	266	1.97	Retail Building Supply	9	1.23	Paper/Forest Products	39	0.93
Manuf. Housing/RV	18	1.92	Railroad	16	1.23	Restaurant	75	0.93
Power	58	1.87	Industrial Services	196	1.22	Natural Gas (Div.)	31	0.93
Computers/Peripherals	144	1.86	Newspaper	18	1.21	Healthcare Information	38	0.91
Drug	368	1.78	Aerospace/Defense	69	1.19	Property Management	12	0.91
Coal	18	1.71	Metal Fabricating	37	1.19	R.E.I.T.	147	0.90
Steel (General)	26	1.71	Machinery	126	1.19	Household Products	28	0.89
Securities Brokerage	31	1.66	Chemical (Diversified)	37	1.16	Insurance (Prop/Cas.)	87	0.89
Precision Instrument	103	1.66	Financial Svcs. (Div.)	294	1.14	Beverage	44	0.89
Homebuilding	36	1.64	Office Equip/Supplies	25	1.13	Electric Utility (West)	17	0.88
Advertising	40	1.60	Packaging & Container	35	1.12	Maritime	52	0.87
Retail Automotive	16	1.58	Precious Metals	84	1.11	Apparel	57	0.87
Cable TV	23	1.56	Retail Store	42	1.11	Bank (Midwest)	38	0.85
Computer Software/Svcs	376	1.56	Furn/Home Furnishings	39	1.10	Toiletries/Cosmetics	21	0.85
Auto & Truck	28	1.54	Oilfield Svcs/Equip.	113	1.10	Electric Utility (East)	27	0.84
Recreation	73	1.54	Medical Services	178	1.10	Canadian Energy	13	0.80
Entertainment	93	1.53	Foreign Electronics	10	1.08	Food Wholesalers	19	0.79
Chemical (Basic)	19	1.52	Building Materials	49	1.07	Water Utility	16	0.78
Biotechnology	103	1.51	Pharmacy Services	19	1.07	Natural Gas Utility	26	0.78
Shoe	20	1.47	Chemical (Specialty)	90	1.06	Food Processing	123	0.77
Auto Parts	56	1.45	Metals & Mining (Div.)	78	1.05	Oil/Gas Distribution	15	0.72
Medical Supplies	274	1.43	Information Services	38	1.05	Investment Co.	18	0.71
Air Transport	49	1.40	Trucking	32	1.04	Tobacco	11	0.70
Human Resources	35	1.38	Diversified Co.	107	1.03	Bank (Canadian)	8	0.67
Publishing	40	1.35	Petroleum (Integrated)	26	1.02	Bank	504	0.63
Electrical Equipment	86	1.35	Reinsurance	11	1.01	Thrift	234	0.59
Data Source: http://pages.stern.nyu.edu/~adamodar/						Total/Average	7364	1.24

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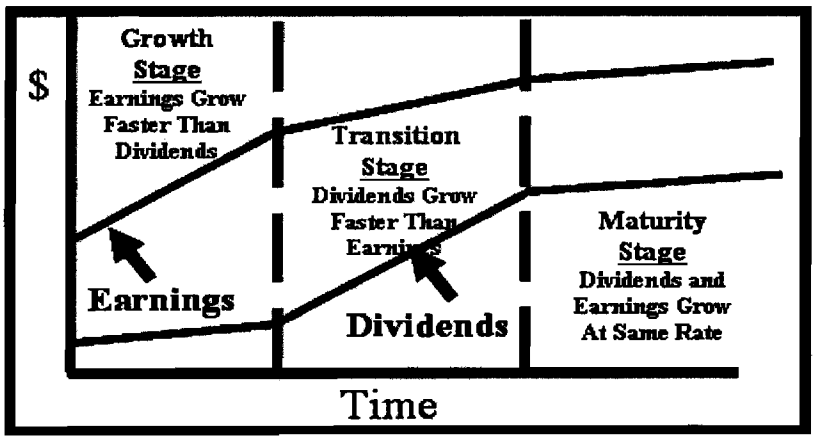
Exhibit JRW-9
Three-Stage DCF Model
Page 1 of 1

Exhibit JRW-9
Three-Stage DCF Model



Source: William F. Sharpe, Gordon J. Alexander, and Jeffrey V. Bailey, Investments (Prentice-Hall, 1995), pp. 590-91.

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Exhibit JRW-10
DCF Study
Page 1 of 6

Exhibit JRW-10

Tampa Electric Company
Discounted Cash Flow Analysis

Electric Proxy Group

Dividend Yield*	**5.2%**
Adjustment Factor	**1.0225**
Adjusted Dividend Yield	**5.3%**
Growth Rate**	**4.5%**
Equity Cost Rate	**9.8%**

*** Page 2 of Exhibit JRW-6**

**** Based on data provided on pages 3, 4, and 5 of Exhibit JRW-6**

Attachment B

Exhibit JRW-10

Tampa Electric Company
Monthly Dividend Yields
April-November 2008

Electric Proxy Group

Company	June	July	Aug	Sep	Oct	Nov	Mean
ALLETE, Inc. (NYSE-ALE)	4.0%	3.8%	4.2%	4.0%	3.8%	4.6%	4.1%
Ameren Corporation (NYSE-AEE)	5.5%	5.9%	6.3%	6.0%	6.1%	8.4%	6.4%
Central Vermont Public Serv. Corp. (NYSE-CV)	4.1%	4.7%	4.4%	3.7%	3.7%	4.4%	4.2%
Cleco Corporation (NYSE-CNL)	3.6%	3.7%	3.8%	3.5%	3.4%	4.2%	3.7%
DPL Inc.(NYSE-DPL)	3.9%	3.9%	4.1%	4.5%	4.2%	4.9%	4.3%
Empire District Electric Co. (NYSE-EDE)	6.1%	6.4%	6.7%	5.9%	5.6%	7.0%	6.3%
Hawaiian Electric Industries, Inc. (NYSE-HE)	4.7%	4.7%	5.2%	4.9%	4.4%	5.1%	4.8%
IDACORP, Inc. (NYSE-IDA)	3.8%	3.8%	4.1%	3.9%	3.8%	4.7%	4.0%
Northeast Utilities (NYSE-NU)	3.0%	3.2%	3.5%	3.1%	3.2%	4.1%	3.4%
NSTAR (NYSE-NST)	4.2%	4.1%	4.4%	4.2%	3.9%	4.8%	4.3%
Pinnacle West Capital Corp. (NYSE-PNW)	6.2%	6.5%	6.7%	6.0%	6.0%	6.9%	6.4%
Progress Energy Inc. (NYSE-PGN)	5.8%	5.8%	6.0%	5.6%	5.5%	6.8%	5.9%
UIL Holdings Corporation (NYSE-UIL)	5.5%	5.4%	5.9%	5.1%	4.9%	5.3%	5.4%
Mean	4.6%	4.8%	5.0%	4.6%	4.5%	5.5%	4.8%

Source: *AUS Utility Reports*, monthly issues.

Attachment B

Exhibit JRW-10

Tampa Electric Company
DCF Equity Cost Growth Rate Measures
***Value Line* Historic Growth Rates**

Electric Proxy Group

Company	*Value Line* Historic Growth					
	Past 10 Years			Past 5 Years		
	Earnings	Dividends	Book Value	Earnings	Dividends	Book Value
ALLETE, Inc. (NYSE-ALE)	NA	NA	NA	NA	NA	NA
Ameren Corporation (NYSE-AEE)	1.0%	0.0%	3.5%	-0.5%	0.0%	5.5%
Central Vermont Public Serv. Corp. (NYSE-CV)	-2.5%	1.0%	1.0%	-2.5%	1.0%	2.0%
Cleco Corporation (NYSE-CNL)	2.5%	1.5%	6.5%	-2.0%	0.5%	7.0%
DPL Inc.(NYSE-DPL)	1.0%	1.5%	-0.5%	-1.0%	1.0%	2.5%
Empire District Electric Co. (NYSE-EDE)	-1.0%	0.0%	2.0%	2.0%	0.0%	2.0%
Hawaiian Electric Industries, Inc. (NYSE-HE)	-0.5%	0.5%	1.5%	-3.0%	0.0%	2.0%
IDACORP, Inc. (NYSE-IDA)	-1.0%	-4.5%	3.5%	-7.0%	-8.5%	2.5%
Northeast Utilities (NYSE-NU)	11.0%	-4.5%	0.5%	8.5%	10.0%	2.5%
NSTAR (NYSE-NST)	4.5%	3.0%	3.5%	3.5%	3.5%	4.0%
Pinnacle West Capital Corp. (NYSE-PNW)	1.0%	7.0%	4.5%	-2.5%	5.5%	3.5%
Progress Energy Inc. (NYSE-PGN)	0.0%	3.0%	6.0%	-4.5%	2.5%	3.0%
UIL Holdings Corporation (NYSE-UIL)	-2.0%	0.0%	0.5%	-6.0%	0.0%	-1.0%
Mean	1.2%	0.7%	2.7%	-1.3%	1.3%	3.0%
Median	0.5%	0.8%	2.8%	-2.3%	0.8%	2.5%
Data Source: *Value Line Investment Survey, 2008.*	**Average of Mean and Median F**			1.0%		

Attachment B

Exhibit JRW-10

Tampa Electric Company
DCF Equity Cost Growth Rate Measures
***Value Line* Projected Growth Rates**

Electric Proxy Group

Company	*Value Line* Projected Growth Est'd. '05-'07 to '11-'13			*Value Line* Internal Growth		
	Earnings	Dividends	Book Value	Return on Equity	Retention Rate	Internal Growth
ALLETE, Inc. (NYSE-ALE)	2.5%	5.5%	6.5%	9.5%	36.0%	3.4%
Ameren Corporation (NYSE-AEE)	3.5%	0.0%	3.0%	9.5%	28.0%	2.7%
Central Vermont Public Serv. Corp. (NYSE-CV)	7.5%	0.0%	3.5%	7.5%	43.0%	3.2%
Cleco Corporation (NYSE-CNL)	10.5%	9.5%	6.0%	11.0%	37.0%	4.1%
DPL Inc.(NYSE-DPL)	11.0%	5.0%	9.0%	19.0%	43.0%	8.2%
Empire District Electric Co. (NYSE-EDE)	10.0%	1.5%	3.5%	10.5%	29.0%	3.0%
Hawaiian Electric Industries, Inc. (NYSE-HE)	5.0%	1.0%	2.5%	11.0%	31.0%	3.4%
IDACORP, Inc. (NYSE-IDA)	2.0%	0.0%	2.0%	7.5%	47.0%	3.5%
Northeast Utilities (NYSE-NU)	11.5%	6.0%	5.5%	8.5%	52.0%	4.4%
NSTAR (NYSE-NST)	7.5%	7.0%	5.5%	14.5%	38.0%	5.5%
Pinnacle West Capital Corp. (NYSE-PNW)	2.0%	1.0%	2.0%	8.0%	29.0%	2.3%
Progress Energy Inc. (NYSE-PGN)	5.0%	1.0%	1.5%	9.5%	25.0%	2.4%
UIL Holdings Corporation (NYSE-UIL)	4.5%	0.0%	1.0%	10.5%	20.0%	2.1%
Mean	6.3%	2.9%	4.0%	10.5%	35.2%	3.7%
Median	5.0%	1.0%	3.5%	9.5%	36.0%	3.4%
Average of Mean and Median Figures =		3.8%			Average =	3.6%

Data Source: *Value Line Investment Survey, 2008.*

Exhibit JRW-10

DCF Equity Cost Growth Rate Measures
Analysts Projected EPS Growth Rate Estimates

Electric Proxy Group

Company	Zacks		Bloomberg			Average
	# Estimates	Mean	# Estimates	Mean	St. Dev	
ALLETE, Inc. (NYSE-ALE)	1	5.00%	2	7.50%	3.54%	6.25%
Ameren Corporation (NYSE-AEE)	5	5.00%	2	6.50%	2.12%	5.75%
Central Vermont Public Serv. Corp. (NYSE-CV)	0	-	0	-	-	
Cleco Corporation (NYSE-CNL)	1	14.00%	2	14.14%	4.05%	14.07%
DPL Inc.(NYSE-DPL)	3	10.67%	2	13.90%	5.52%	12.29%
Empire District Electric Co. (NYSE-EDE)	0	-	1	34.00%	-	34.00%
Hawaiian Electric Industries, Inc. (NYSE-HE)	3	4.17%	2	2.75%	0.35%	3.46%
IDACORP, Inc. (NYSE-IDA)	2	6.00%	2	6.00%	1.41%	6.00%
Northeast Utilities (NYSE-NU)	3	10.00%	5	7.02%	2.80%	8.51%
NSTAR (NYSE-NST)	4	6.75%	2	6.50%	2.12%	6.63%
Pinnacle West Capital Corp. (NYSE-PNW)	3	3.67%	3	4.67%	1.53%	4.17%
Progress Energy Inc. (NYSE-PGN)	6	5.00%	5	4.82%	1.12%	4.91%
UIL Holdings Corporation (NYSE-UIL)	1	6.00%	1	6.00%	-	6.00%
Median						6.13%

Data Sources: Bloomberg , http://quote.yahoo.com, 2008

Exhibit JRW-10

Tampa Electric Company
DCf Growth Rate Indicators

Electric Proxy Group

Growth Rate Indicator	
Historic Value Line Growth in EPS, DPS, and BVPS	1.00%
Projected *Value Line* Growth in EPS, DPS, and BVPS	3.80%
Internal Growth ROE * Retention Rate	3.60%
Projected EPS Growth from Bloomberg and Zacks	6.13%

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Exhibit JRW-11
CAPM Study
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Exhibit JRW-11

Capital Asset Pricing Model

Electric Proxy Group

Risk-Free Interest Rate	**4.50%**
Beta*	**0.82**
Ex Ante Equity Risk Premium**	**4.56%**
CAPM Cost of Equity	**8.2%**

* See page 2 of Exhibit JRW-7
** See page 3 of Exhibit JRW-7

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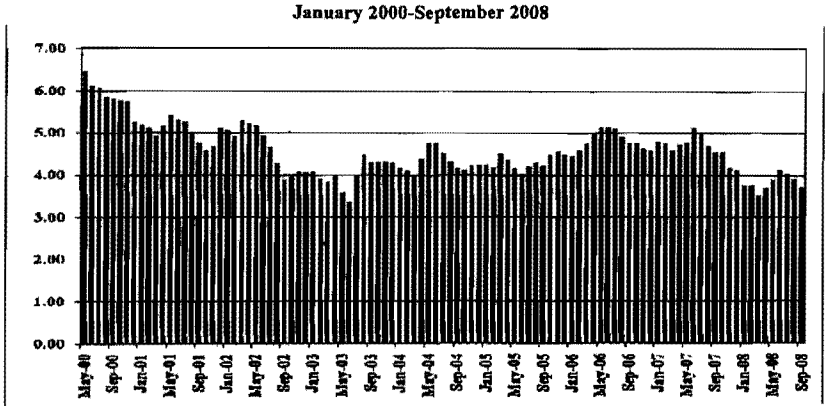
Exhibit JRW-11
CAPM Study
Page 2 of 10

Exhibit JRW-11
Ten-Year U.S. Treasury Yields
January 2000-September 2008



http://research.stlouisfed.org/fred2/series/GS10?cid=115

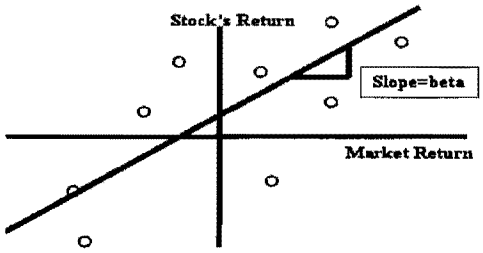
U.S. Treasury Yields
3-Nov-08

U.S. Treasuries			
3-MONTH	0.000	01/29/2009	0.44 / .45
12-MONTH	0.000	10/22/2009	1.26 / 1.29
3-YEAR	4.625	10/31/2011	108-15+ / 1.70
10-YEAR	4.000	08/15/2018	100-19 / 3.93

Source: www.bloomberg.com

Exhibit JRW-11

Calculation of Beta



Electric Proxy Group

Company	Beta
ALLETE, Inc. (NYSE-ALE)	0.85
Ameren Corporation (NYSE-AEE)	0.80
Central Vermont Public Serv. Corp. (NYSE-CV)	1.05
Cleco Corporation (NYSE-CNL)	0.90
DPL Inc.(NYSE-DPL)	0.75
Empire District Electric Co. (NYSE-EDE)	0.80
Hawaiian Electric Industries, Inc. (NYSE-HE)	0.75
IDACORP, Inc. (NYSE-IDA)	0.85
Northeast Utilities (NYSE-NU)	0.75
NSTAR (NYSE-NST)	0.80
Pinnacle West Capital Corp. (NYSE-PNW)	0.75
Progress Energy Inc. (NYSE-PGN)	0.75
UIL Holdings Corporation (NYSE-UIL)	0.80
Mean	**0.82**

Data Source: *Value Line Investment Survey, 2008.*

Exhibit JRW-11

Tampa Electric Company
Risk Premium Approaches

	Historical Ex Post Excess Returns	Surveys	Ex Ante Models and Market Data
Means of Assessing the Equity-Bond Risk Premium	Historical average is a popular proxy for the ex ante premium – but likely to be misleading	Investor and expert surveys can provide direct estimates of prevailing expected returns/premiums	Current financial market prices (simple valuation ratios or DCF-based measures) can give most objective estimates of feasible ex ante equity-bond risk premium
Problems/Debated Issues	Time variation in required returns and systematic selection and other biases have boosted valuations over time, and have exaggerated realized excess equity returns compared with ex ante expected premiums	Limited survey histories and questions of survey representativeness. Surveys may tell more about hoped-for expected returns than about objective required premiums due to irrational biases such as extrapolation.	Assumptions needed for DCF inputs, notably the trend earnings growth rate, make even these models' outputs subjective. The range of views on the growth rate, as well as the debate on the relevant stock and bond yields, leads to a range of premium estimates.

Source: Antti Ilmanen, Expected Returns on Stocks and Bonds," *Journal of Portfolio Management*, (Winter 2003).

Attachment B

Exhibit JRW-11

Tampa Electric Company
Capital Asset Pricing Model
Equity Risk Premium

Category	Study Authors	Publication Date	Time Period Of Study	Methodology	Return Measure	Range Low	Range High	Midpoint of Range	Mean	Average
Historical Risk Premium										
	Ibbotson	2008	1926-2007	Historical Stock Returns - Bond Returns	Arithmetic				6.50%	
					Geometric				4.90%	
	Bate	2008	1900-2007	Historical Stock Returns - Bond Returns	Geometric				4.50%	
	Shiller	2006	1926-2005	Historical Stock Returns - Bond Returns	Arithmetic				7.00%	
					Geometric				5.50%	
	Damodoran	2006	1926-2005	Historical Stock Returns - Bond Returns	Arithmetic				6.70%	
					Geometric				5.10%	
	Siegel	2005	1926-2005	Historical Stock Returns - Bond Returns	Arithmetic				6.10%	
					Geometric				4.60%	
	Dimson, Marsh, and Staunton	2006	1900-2005	Historical Stock Returns - Bond Returns	Arithmetic				5.50%	
	Goyal & Welch	2006	1872-2004	Historical Stock Returns - Bond Returns					4.77%	
	AVERAGE									5.56%
Ex Ante Models (Puzzle Research)										
	Claus Thomas	2001	1985-1998	Abnormal Earnings Model					3.00%	
	Arnott and Bernstein	2002	1810-2001	Fundamentals - Div Yld + Growth					2.40%	
	Constantinides	2002	1872-2000	Historical Returns & Fundamentals - P/D & P/E					6.90%	
	Cornell	1999	1926-1997	Historical Returns & Fundamental GDP/Earnings		3.50%	5.50%	4.50%	4.50%	
	Easton, Taylor, et al	2002	1981-1998	Residual Income Model					5.30%	
	Fama French	2002	1951-2000	Fundamental DCF with EPS and DPS Growth		2.55%	4.32%		3.44%	
	Harris & Marston	2001	1982-1998	Fundamental DCF with Analysts' EPS Growth					7.14%	
	Best & Byrne	2001								
	McKinsey	2002	1962-2002	Fundamental (P/E, D/P, & Earnings Growth)		3.50%	4.00%		3.75%	
	Siegel	2005	1802-2001	Historical Earnings Yield	Geometric				2.50%	
	Grabowski	2006	1926-2005	Historical and Projected		3.50%	6.00%	4.75%	4.75%	
	Maheu & McCurdy	2006	1885-2003	Historical Excess Returns, Structural Breaks,		4.02%	5.10%	4.56%	4.56%	
	Bostock	2004	1960-2002	Bond Yields, Credit Risk, and Income Volatility		3.90%	1.30%	2.60%	2.60%	
	Bakshi & Chen	2005	1982-1998	Fundamentals - Interest Rates					7.31%	
	Donaldson, Kamstra, & Kramer	2006	1952-2004	Fundamental, Dividend yld., Returns,, & Volatility		3.00%	4.00%	3.50%	3.50%	
	Campbell	2008	1982-2007	Historical & Projections (D/P & Earnings Growth)		4.10%	5.40%		4.75%	
	Best & Byrne	2001	Projection	Fundamentals - Div Yld + Growth					2.00%	
	Fernandez	2007	Projection	Required Equity Risk Premium					4.00%	
	DeLong & Magin	2008	Projection	Earnings Yield - TIPS					3.22%	
	Damodoran	2008	Projection	Fundamentals - Implied from FCF to Equity Model					4.37%	
	Social Security									
	Office of Chief Actuary		1900-1995							
	John Campbell	2001	1860-2000	Historical & Projections (D/P & Earnings Growth)	Arithmetic	3.00%	4.00%	3.50%	3.50%	
			Projected for 75 Years		Geometric	1.50%	2.50%	2.00%	2.00%	
	Peter Diamond	2001	Projected for 75 Years	Fundamentals (D/P, GDP Growth)		3.00%	4.80%	3.90%	3.90%	
	John Shoven	2001	Projected for 75 Years	Fundamentals (D/P, P/E, GDP Growth)		3.00%	3.50%	3.25%	3.25%	
	AVERAGE									4.03%
Surveys										
	Survey of Financial Forecasters	2008	10-Year Projection	About 50 Financial Forecastsers					1.96%	
	Duke - CFO Magazine Survey	2008	10-Year Projection	Approximately 500 CFOs					3.99%	
	Welch - Academics	2008	30-Year Projection	Random Academics		5.00%	5.74%		5.37%	
	AVERAGE									3.77%
Building Block										
	Ibbotson and Chen	2008	1926-2007	Historical Supply Model (D/P & Earnings Growth)	Arithmetic			6.23%	5.24%	
					Geometric			4.24%		
	Woolridge		2008	Current Supply Model (D/P & Earnings Growth)					4.55%	
	AVERAGE									4.89%
OVERALL AVERAGE										4.56%

Attachment B

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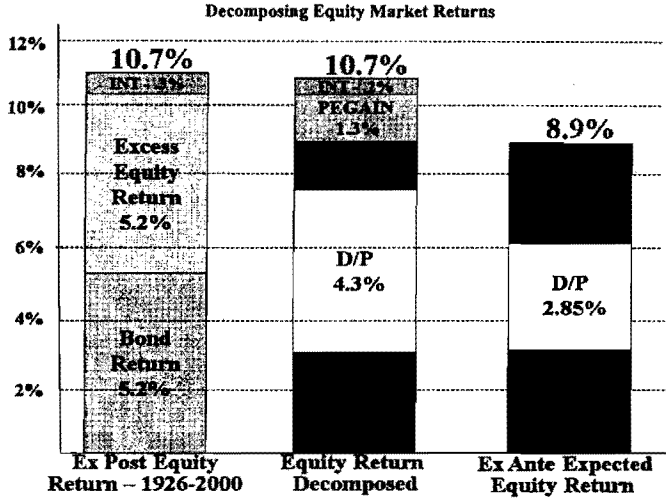
Exhibit JRW-11
CAPM Study
Page 6 of 10

Exhibit JRW-11

Tampa Electric Company
Decomposing Equity Market Returns

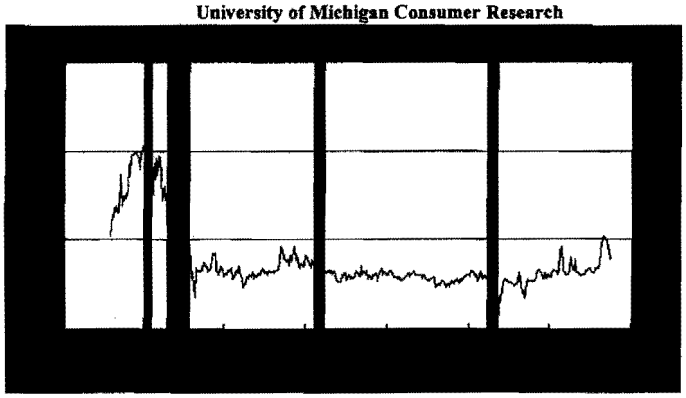


Source: Antti Ilmanen, Expected Returns on Stocks and Bonds," *Journal of Portfolio Management*, (Winter 2003).

Exhibit JRW-11

Tampa Electric Company
Decomposing Equity Market Returns
The Building Blocks Methodology

Expected Inflation Rate
University of Michigan Consumer Research



(Data Source: http://research.stlouisfed.org/fred2/series/MICH/98)

Exhibit JRW-11

Tampa Electric Company

Survey of Professional Forecasters
Philadelphia Federal Reserve Bank
Long-Term Forecasts

Table Seven
LONG-TERM (10 YEAR) FORECASTS

SERIES: CPI INFLATION RATE	
STATISTIC	
MINIMUM	1.600
LOWER QUARTILE	2.200
MEDIAN	2.500
UPPER QUARTILE	2.750
MAXIMUM	4.200
MEAN	2.520
STD. DEV.	0.520
N	45
MISSING	5

SERIES: REAL GDP GROWTH RATE	
STATISTIC	
MINIMUM	2.200
LOWER QUARTILE	2.500
MEDIAN	2.750
UPPER QUARTILE	2.800
MAXIMUM	3.100
MEAN	2.700
STD. DEV.	0.230
N	43
MISSING	7

SERIES: PRODUCTIVITY GROWTH	
STATISTIC	
MINIMUM	0.900
LOWER QUARTILE	1.800
MEDIAN	2.000
UPPER QUARTILE	2.200
MAXIMUM	3.000
MEAN	2.000
STD. DEV.	0.390
N	39
MISSING	11

SERIES: STOCK RETURNS (S&P 500)	
STATISTIC	
MINIMUM	2.700
LOWER QUARTILE	6.000
MEDIAN	6.500
UPPER QUARTILE	8.000
MAXIMUM	9.000
MEAN	6.800
STD. DEV.	1.300
N	31
MISSING	19

SERIES: BOND RETURNS (10-YEAR)	
STATISTIC	
MINIMUM	3.200
LOWER QUARTILE	4.500
MEDIAN	5.000
UPPER QUARTILE	5.200
MAXIMUM	5.800
MEAN	4.840
STD. DEV.	0.590
N	38
MISSING	12

SERIES: BILL RETURNS (3-MONTH)	
STATISTIC	
MINIMUM	2.400
LOWER QUARTILE	3.000
MEDIAN	4.000
UPPER QUARTILE	4.250
MAXIMUM	5.300
MEAN	3.840
STD. DEV.	0.680
N	38
MISSING	12

Source: Philadelphia Federal Reserve Bank, Survey of Professional Forecasters, February 12, 2008.
http://www.phil.frb.org/files/spf/spfq107.pdf

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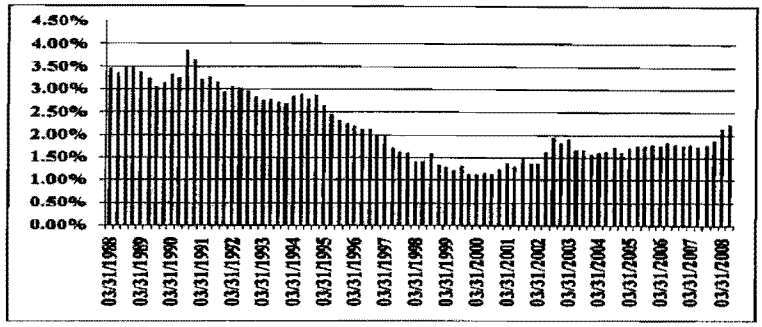
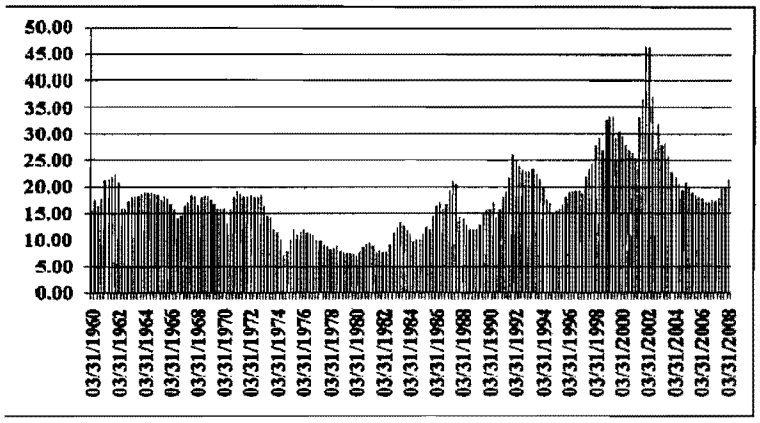
Exhibit JRW-11

Tampa Electric Company
Decomposing Equity Market Returns
The Building Blocks Methodology

S&P 500 Dividend Yield



S&P 500 PE Ratios



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Tampa Electric Company
CAPM
Real S&P 500 EPS Growth Rate

Year	S&P 500 EPS	Annual Inflation CPI	Inflation Adjustment Factor	Real S&P 500 EPS	
1960	3.10	1.48		3.10	
1961	3.37	0.07	1.01	3.35	
1962	3.67	1.22	1.02	3.59	
1963	4.13	1.65	1.04	3.99	
1964	4.76	1.19	1.05	4.55	
1965	5.30	1.92	1.07	4.97	
1966	5.41	3.35	1.10	4.90	
1967	5.46	3.04	1.14	4.80	
1968	5.72	4.72	1.19	4.81	
1969	6.10	6.11	1.26	4.83	10-Year
1970	5.51	5.49	1.34	4.13	2.89%
1971	5.57	3.36	1.38	4.04	
1972	6.17	3.41	1.43	4.33	
1973	7.96	8.80	1.55	5.13	
1974	9.35	12.20	1.74	5.37	
1975	7.71	7.01	1.86	4.14	
1976	9.75	4.81	1.95	4.99	
1977	10.87	6.77	2.08	5.22	
1978	11.64	9.03	2.27	5.13	
1979	14.55	13.31	2.57	5.66	10-Year
1980	14.99	12.40	2.89	5.18	2.30%
1981	15.18	8.94	3.15	4.82	
1982	13.82	3.87	3.27	4.23	
1983	13.29	3.80	3.40	3.91	
1984	16.84	3.95	3.53	4.77	
1985	15.68	3.77	3.66	4.28	
1986	14.43	1.13	3.70	3.90	
1987	16.04	4.41	3.87	4.15	
1988	22.77	4.42	4.04	5.64	
1989	24.03	4.65	4.22	5.69	10-Year
1990	21.73	6.11	4.48	4.85	-0.65%
1991	19.10	3.06	4.62	4.14	
1992	18.13	2.90	4.75	3.81	
1993	19.82	2.75	4.88	4.06	
1994	27.05	2.67	5.01	5.40	
1995	35.35	2.54	5.14	6.88	
1996	35.78	3.32	5.31	6.74	
1997	39.56	1.70	5.40	7.33	
1998	38.23	1.61	5.48	6.97	
1999	45.17	2.68	5.63	8.02	10-Year
2000	52.00	3.39	5.82	8.93	6.29%
2001	44.23	1.55	5.92	7.48	
2002	47.24	2.38	6.06	7.80	
2003	54.15	1.88	6.17	8.77	
2004	67.01	3.26	6.37	10.51	5-Year
2005	68.32	3.42	6.60	10.35	3.00%
2006	81.96	2.54	6.77	12.11	
2007	87.51	4.08	7.04	12.43	
Data Source: http://pages.stern.nyu.edu/~adamodar/				Real EPS Growth	3.0%

Attachment B

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Exhibit JRW-12
Summary of Tampa's Equity Cost Rate Approaches and Results
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Panel A
Summary of Dr. Murry's Equity Cost Rate Approaches and Results

	TECO Energy, Inc.		Comparable Electric Companies	
Approach	**Low**	**High**	**Low**	**High**
CAPM	**12.27%**	**13.65%**	**11.24%**	**12.42%**
Earnings Growth DCF	**10.08%**	**11.90%**	**10.05%**	**11.12%**
Projected Growth DCF	**8.21%**	**11.40%**	**10.38%**	**13.27%**

Panel B
Summary of Dr. Murry's DCF Results

	TECO Energy, Inc.		Comparable Electric Companies	
Approach	**Low**	**High**	**Low**	**High**
52 Week DCF				
Using DPS Growth	2.19%	4.00%	9.14%	10.21%
Using VL EPS Growth	10.08%	11.90%	10.05%	**11.12%**
Using VL-Yahoo Growth	8.21%	11.40%	10.38%	**13.27%**
Current DCF				
Using DPS Growth	2.32%	2.44%	9.67%	9.73%
Using VL EPS Growth	10.22%	10.34%	10.58%	10.64%
Using VL- Yahoo Growth	8.34%	9.84%	10.90%	12.80%

Panel C
Summary of Dr. Murry's CAPM Results

Size Adjusted CAPM

	TECO Energy	**Comparable Electric Companies**
Risk-Free Rate	4.60%	4.60%
Beta	0.95	0.81
Equity Risk Premium	7.10%	7.10%
CAPM Equity Cost Rate	11.35%	10.32%
Size Adjustment Premium	0.92%	0.92%
CAPM Equity Cost Rate	**12.27%**	**11.24%**

Historical CAPM

	TECO Energy	**Comparable Electric Companies**
Market Return	14.70%	14.70%
L-T Bond Return	6.20%	6.20%
Risk Premium	8.50%	8.50%
Weighting	0.95	0.81
Adjusted Risk Premium	8.08%	6.85%
Aaa Corporate Bond Return	5.57%	5.57%
CAPM Equity Cost Rate	13.65%	12.42%

Attachment B

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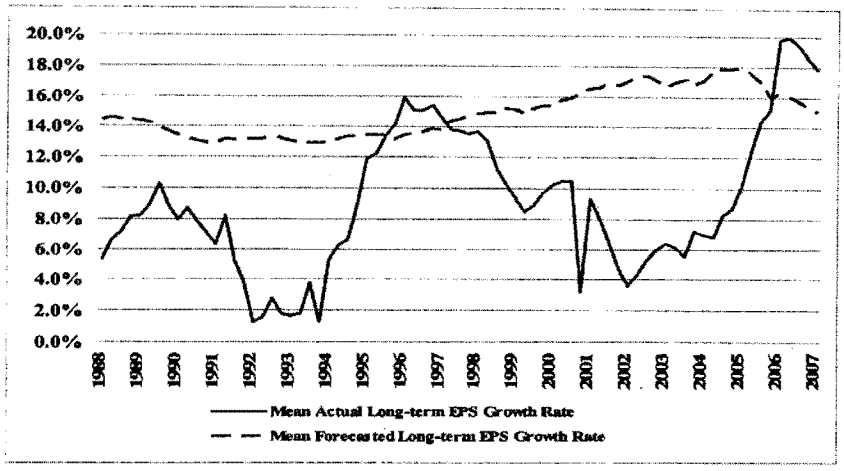
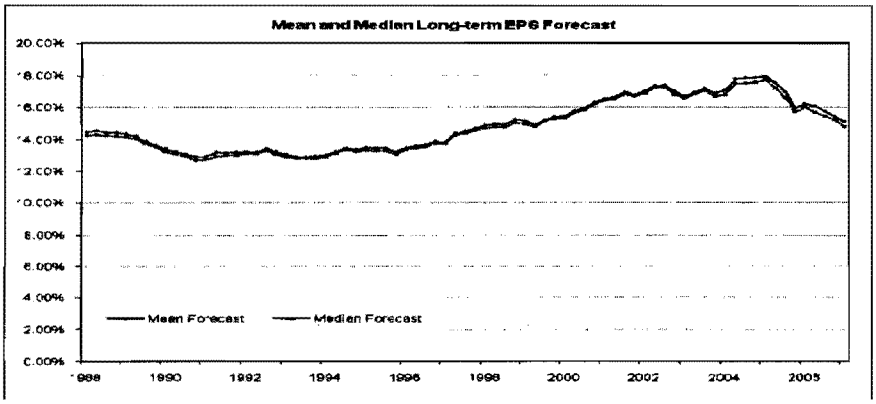
Exhibit JRW-13
Analysis of Analysts' EPS Growth Rate Forecasts
Page 1 of 3

Panel A
Long-Term Forecasted Versus Actual EPS Growth Rates
1988-2007



Panel B
Long-Term Forecasted EPS Growth Rates
1988-2007



Source: Patrick J. Cusatis and J. Randall Woolridge, "The Accuracy of Analysts' Long-Term Earnings Per Share Growth Rate Forecasts," (July, 2008).

THE WALL STREET JOURNAL.

Study Suggests Bias in Analysts' Rosy Forecasts

By ANDREW EDWARDS
March 21, 2008; Page C6

Despite an economy teetering on the brink of a recession -- if not already in one -- analysts are still painting a rosy picture of earnings growth, according to a study done by Penn State's Smeal College of Business.

The report questions analysts' impartiality five years after then-New York Attorney General Eliot Spitzer forced analysts to pay $1.5 billion in damages after finding evidence of bias.

"Wall Street analysts basically do two things: recommend stocks to buy and forecast earnings," said J. Randall Woolridge, professor of finance. "Previous studies suggest their stock recommendations do not perform well, and now we show that their long-term earnings-per-share growth-rate forecasts are excessive and upwardly biased."

The report, which examined analysts' long-term (three to five years) and one-year per-share earnings expectations from 1984 through 2006 found that companies' long-term earnings growth surpassed analysts' expectations in only two instances, and those came right after recessions.

Over the entire time period, analysts' long-term forecast earnings-per-share growth averaged 14.7%, compared with actual growth of 9.1%. One-year per-share earnings expectations were slightly more accurate: The average forecast was for 13.8% growth and the average actual growth rate was 9.8%.

"A significant factor in the upward bias in long-term earnings-rate forecasts is the reluctance of analysts to forecast" profit declines, Mr. Woolridge said. The study found that nearly one-third of all companies experienced profit drops over successive three-to-five-year periods, but analysts projected drops less than 1% of the time.

The study's authors said, "Analysts are rewarded for biased forecasts by their employers, who want them to hype stocks so that the brokerage house can garner trading commissions and win underwriting deals."

They also concluded that analysts are under pressure to hype stocks to generate trading commissions, and they often don't follow stocks they don't like.

Write to Andrew Edwards at andrew.edwards@dowjones.com

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Exhibit JRW-13
Analysis of Analysts' EPS Growth Rate Forecasts
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Panel C
Long-Term Forecasted Versus Actual EPS Growth Rates
Electric Utility Companies
1988-2007

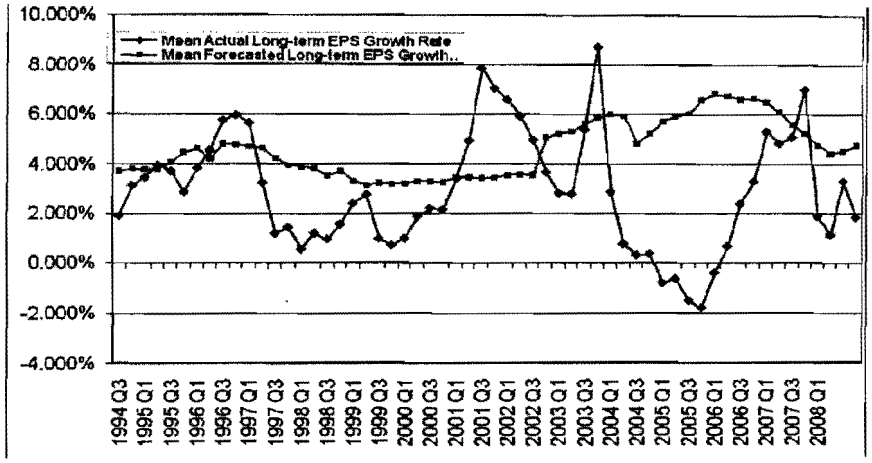

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Exhibit JRW-14
Analysis of Value Line's EPS Growth Rate Forecasts
Page 1

Panel A
Value Line 3-5 year EPS Growth Rate Forecasts

	Average Projected EPS Growth rate	Number of Negative EPS Growth Projections	Percent of Negative EPS Growth Projections
2,453 Companies	14.60%	47	1.90%

Panel B
Historical Five-Year EPS Growth Rates for Value Line Companies

	Average Historical EPS Growth rate	Number with Negative Historical EPS Growth	Percent with Negative Historical EPS Growth
2,371 Companies	12.90%	476	20.10%

Attachment B

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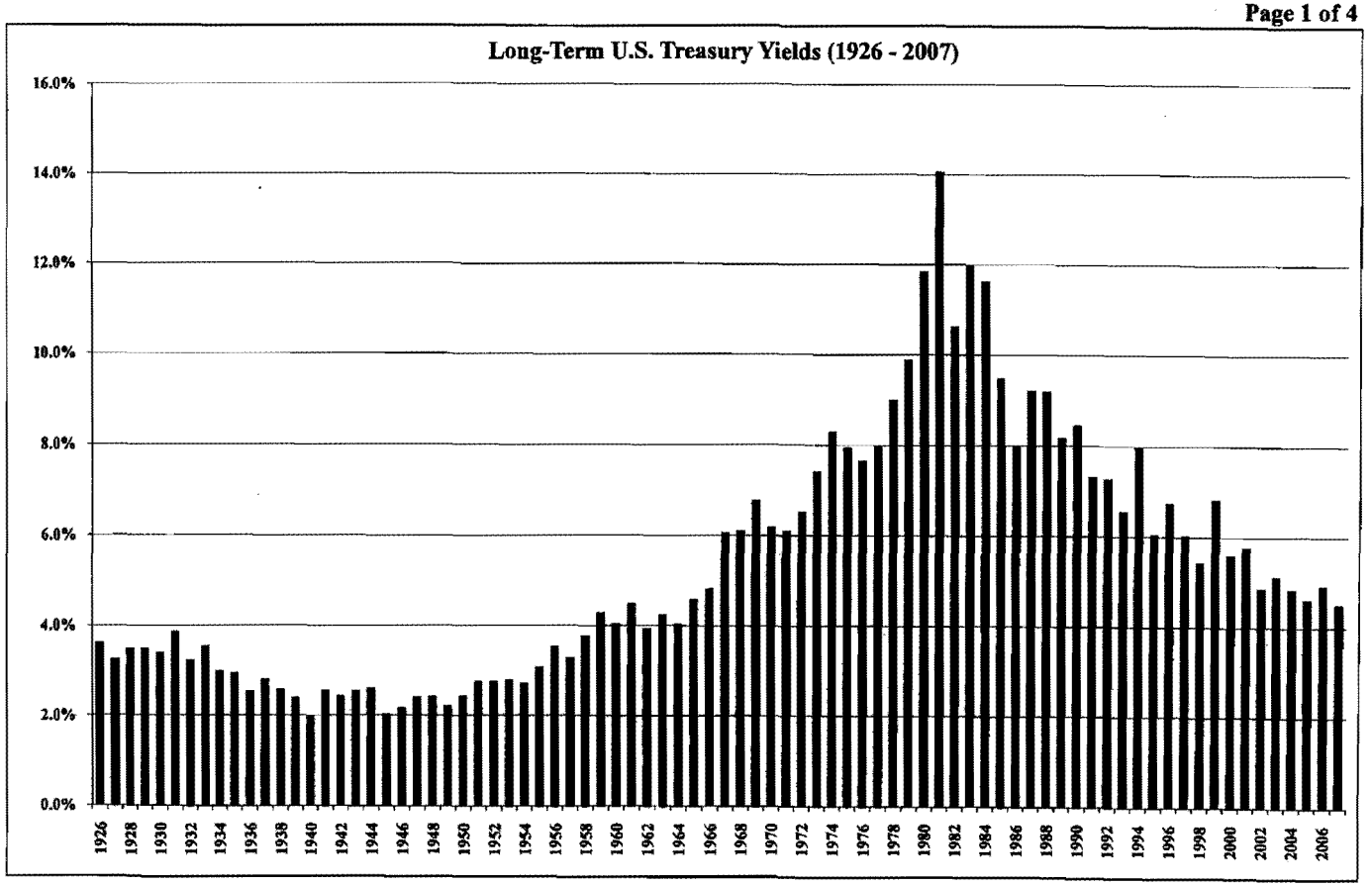
Exhibit JRW-15
Historical Risk Premium Evaluation
Page 1 of 4



Data Source: Morningstar, *SBBI Yearbook*, 2008.

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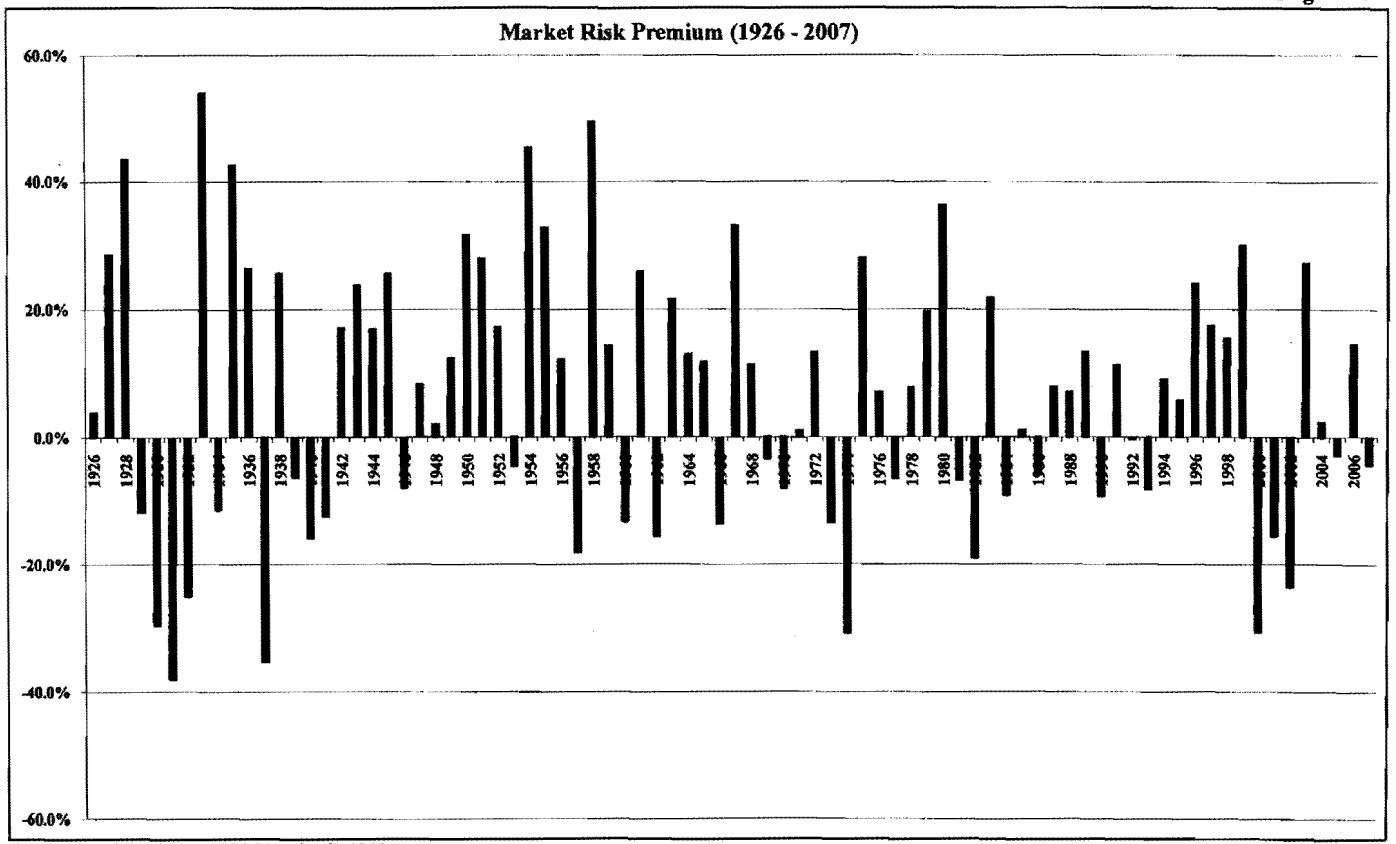
Exhibit JRW-15
Historical Risk Premium Evaluation
Page 2 of 4



Data Source: Morningstar, *SBBI Yearbook*, 2008.

Attachment B

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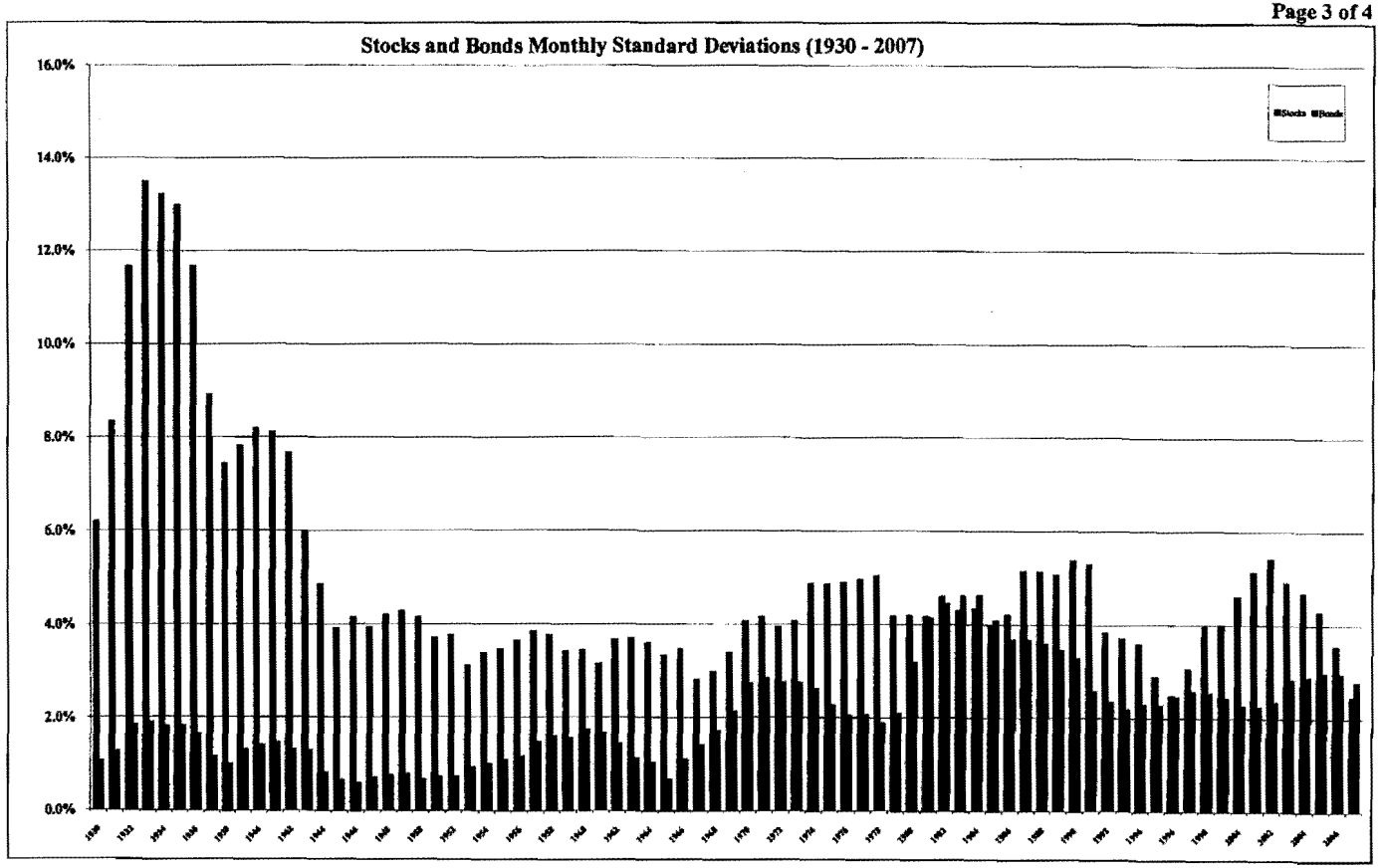
Exhibit JRW-15
Historical Risk Premium Evaluation
Page 3 of 4



Data Source: Morningstar, *SBBI Yearbook*, 2008.

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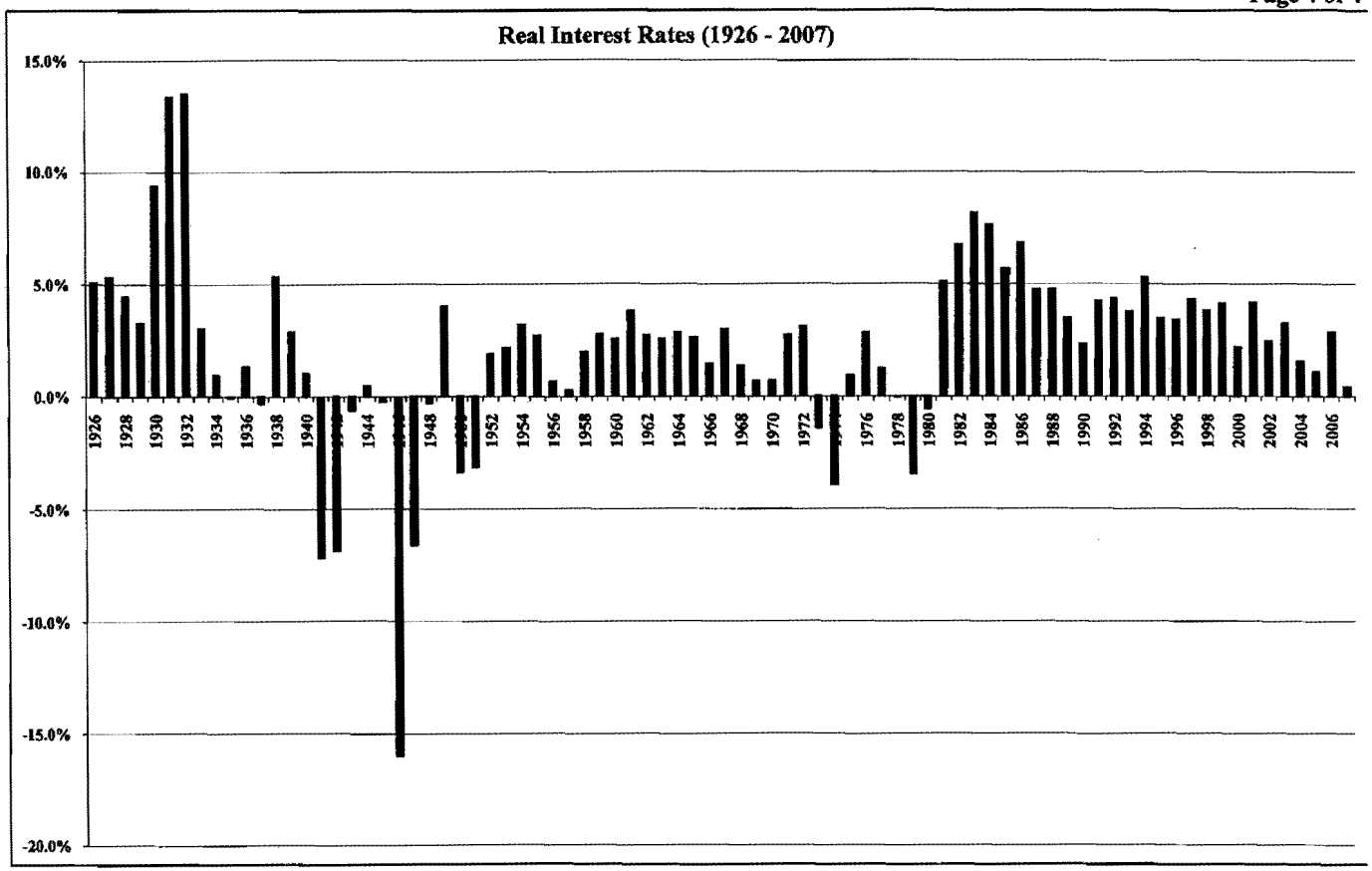
Exhibit JRW-15
Historical Risk Premium Evaluation
Page 4 of 4



Data Source: Morningstar, *SBBI Yearbook*, 2008.

Attachment B

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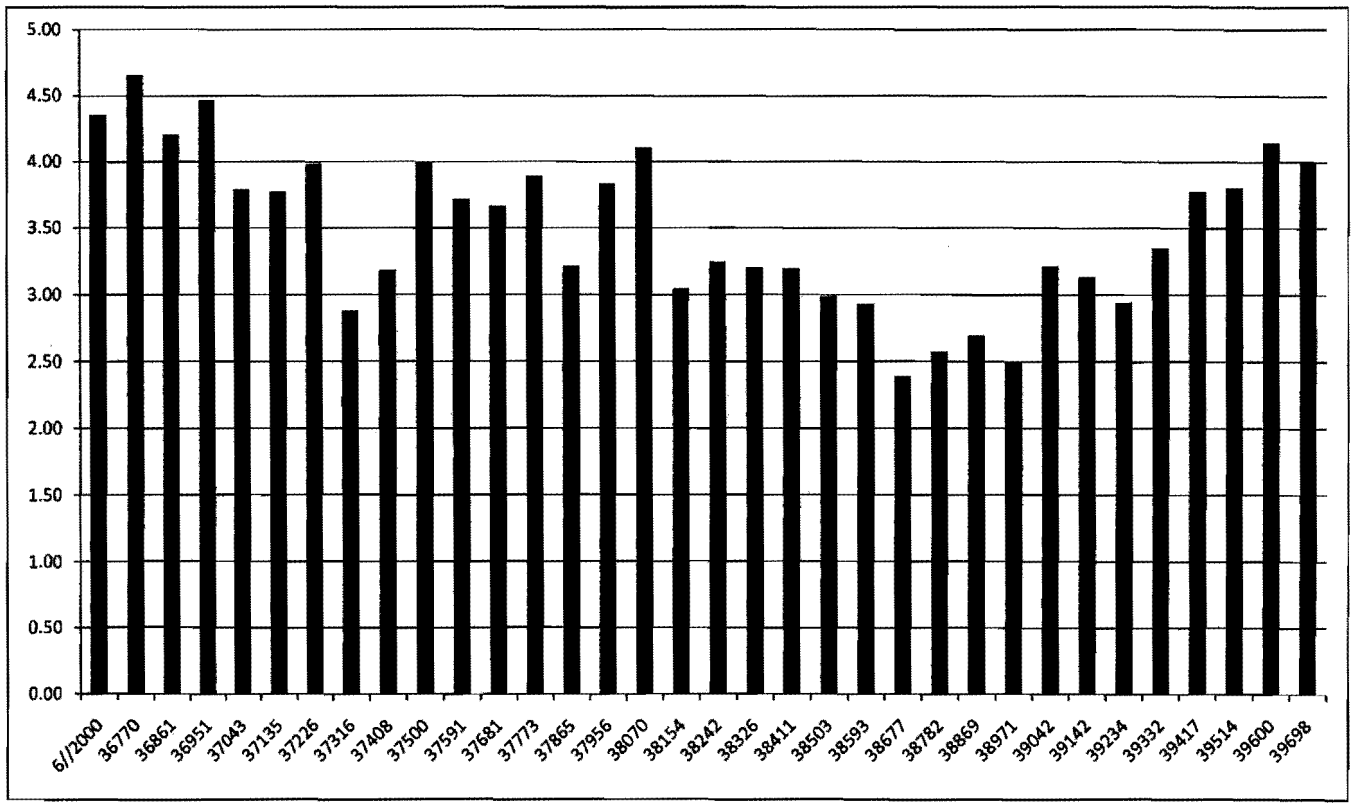
Exhibit JRW-16
CFO's Equity Risk Premium
Page 1 of 1

CFO's Equity Risk Premium
2000-2008



Data Source: John Graham and Campbell Harvey, "The Equity Risk Premium in 2008: Evidence from the Global CFO Outlook Survey."