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APPLICATION OF EL PASO ELECTRIC	§	BEFORE THE STATE OFFICE
COMPANY TO CHANGE RATES	§	OF
	§	ADMINISTRATIVE HEARINGS

REBUTTAL TESTIMONY

OF

LISA D. BUDTKE

FOR

EL PASO ELECTRIC COMPANY

NOVEMBER 19, 2021

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I. Introduction and Qualifications

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Lisa D. Budtke. My business address is 100 North Stanton Street, El Paso, Texas 79901.

Q. HOW ARE YOU EMPLOYED?

A. I am employed by El Paso Electric Company ("EPE" or "Company") as Director of Treasury Services and Investor Relations.

Q. ARE YOU THE SAME LISA D. BUDTKE WHO SUBMITTED DIRECT TESTIMONY?

A. Yes, I am.

II. Purpose of Rebuttal Testimony

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my testimony is to rebut Direct Testimony filed by the following witnesses (i) Office of Public Utility Counsel ("OPUC") witness Constance T. Cannady on the subject of the Company's capital structure and cost of debt; (ii) Texas Industrial Energy Consumers ("TIEC") witness Kevin C. Higgins and the United States Department of Defense and all other Federal Executive Agencies ("DoD/FEA") witness Felipe A. Salcedo on the subject of the Company's Revolving Credit Facility ("RCF") commitment fees; and (iii) Texas Industrial Energy Consumers ("TIEC") witness Michael P. Gorman and the City of El Paso, Texas ("CEP") witness Daniel J. Lawton on the subject of the application of appropriate rating agency methodologies and credit metrics.

III. Capital Structure and Cost of Debt

Q. DID ALL PARTIES TO THIS PROCEEDING AGREE WITH THE COMPANY'S REQUESTED CAPITAL STRUCTURE AND COST OF DEBT THAT WAS REQUESTED IN THIS PROCEEDING?

A. All parties in this case supported the Company's requested capital structure (i.e., a 51% equity ratio) and cost of debt except for OPUC witness Constance T. Cannady. OPUC witness Cannady proposes a capital structure of 49.878% equity, 45.108% long-term debt, and 5.014% short-term debt. Alternatively, she includes an adjustment to the cost of debt to reflect the inclusion of short-term debt. OPUC witness Cannady argues that the incremental debt and/or cost of debt reflects the Company's average amount of non-nuclear RCF borrowings during the period spanning January 2019 through June 2021.

Q. WOULD YOU SUMMARIZE YOUR UNDERSTANDING OF WITNESS CANNADY'S RECOMMENDATION REGARDING THE ADJUSTMENTS TO THE COMPANY'S CAPITAL STRUCTURE AND COST OF DEBT?

A. The Company requested a capital structure comprised of 51% equity and 49% long-term debt and with a cost of debt of 5.576%. This resulted in the Company requesting an overall weighted average cost of capital of 7.985%. However, OPUC witness Cannady argues that the Company's cost of capital should include an average amount of short-term debt not related to nuclear fuel financing for the period spanning January 2019 through June 2021. OPUC witness Cannady recommends a capital structure of 49.878% equity, 45.108% long-term debt, and 5.014% short-term debt. The short-term debt is comprised of $140,450,000 of non-nuclear fuel related short-term RCF borrowings at a cost of 2.227%. This addition of short-term debt to the capital structure lowers the Company's (1) requested equity layer from 51% to 49.878% and its (2) total cost of debt from 5.576% to 5.241%. The effect of witness Cannady's recommendation would lower the Company's requested weighted average cost of capital from 7.985% to 7.76%. Cannady's alternative approach, which maintains EPE's capital structure and lowers the cost debt from 5.576% to 5.241%, results in a weighted average cost of capital of 7.82%.

Q. DO YOU AGREE WITH WITNESS CANNADY'S RECOMMENDATION OR THE ALTERNATIVE COMPUTATION?

A. No, witness Cannady's proposed adjustment to the Company's capital structure and overall requested return on capital is incorrect for a number of reasons. First, the Company does not utilize the RCF borrowings to fund its rate base, as OPUC witness Cannady argues. Therefore, the Company's requested capital structure and cost of debt is only reflective of the amount of long-term debt that was used to fund the rate base additions that are being requested in this case. Second, the Company's RCF borrowings are primarily used to fund amounts excluded from rate base, including construction work in progress ("CWIP"). The Company's Allowance for Funds Used During Construction ("AFUDC") rate reflects the cost of borrowed and equity funds to be charged to projects that are capital in nature until the project is placed in-service. The AFUDC rate calculation assumes that CWIP is financed with short-term debt before any financing by long-term debt or equity. As such, Ms. Cannady's recommendation improperly double counts this short-term debt in the ratemaking process. Third, OPUC witness Cannady ignores the fact that increasing the amount of debt and lowering EPE's requested equity could potentially lead to a downgrade. EPE's proposed capital structure included a reduction in common stock equity from the test year-end amount to the minimum (51%) equity required to maintain its current bond ratings. A downgrade would limit EPE's access to capital and increase its borrowing costs. Lastly, the exclusion of short-term RCF borrowings from the Company's requested cost of debt is consistent with current Commission precedent. In PUCT Docket No. 43695, Southwestern Public Service Company's ("SPS") application for authority to change its Texas retail rates, the Department of Energy witness in that case argued that SPS should include short-term borrowings in its capital structure like the argument OPUC witness Cannady is making in this case. However, the Commission rejected that argument, finding that it was both inconsistent with Commission precedent and unreasonable.[1]

Q. WHY ARE SHORT-TERM RCF BORROWINGS NOT INCLUDED IN THE COMPANY'S REQUESTED CAPITAL STRUCTURE AND COST OF DEBT?

A. The short-term RCF borrowings are excluded from the capital structure since the borrowings are used to fund amounts excluded from rate base, including CWIP, nuclear fuel financing obligations, non-nuclear fuel purchases, and to meet short-term funding requirements (including the funding of fuel under-recoveries). The RCF borrowings are temporary and will be replaced with long-term or permanent financing including both common equity and long-term debt. EPE generally refinances CWIP with permanent capital prior to its completion and inclusion in electric plant in service. EPE is not requesting CWIP in rate base so its requested return on rate base only reflects plant in

[1] *Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 43695, Order on Rehearing at 25, Finding of Fact No. 71 (Feb. 23, 2016).

service financed with permanent capital. It is clear that EPE's rate base is only financed with long-term capital when its requested rate base at test year-end of $2.61 billion is compared to its capital structure of common equity and long-term debt at test year-end of $2.66 billion. Ms. Cannady's inclusion of short-term debt in the capital structure is not only inconsistent with Commission policy and accounting for CWIP and non-rate base assets, but also with the facts of this case.

Q. WHAT OTHER DETAILS OF WITNESS CANNADY'S RECOMMENDATION ARE YOU OPPOSED TO?

A. I also disagree with the amount of non-nuclear short term RCF borrowings calculated by Witness Cannady. Again, Witness Cannady proposes to add $140,450,000 of non-nuclear fuel related short-term RCF borrowings to the Company's requested capital structure using an average amount of short-term debt outstanding during the period spanning January 2019 through June 2021. However, even if it were proper to consider short-term debt in the Company's capital structure, this amount is arbitrary. Ms. Cannady has not explained how or why the average non-nuclear fuel related short-term borrowings over a 30-month period is an appropriate amount to utilize in the development of an adjustment to the Company's capital structure and her recommendation should be rejected.

IV. RCF Commitment Fees

Q. DID ANY PARTY PROPOSE AN ADJUSTMENT TO THE COMPANY'S REQUEST FOR RECOVERY OF COSTS ASSOCIATED WITH HAVING UNUSED CAPACITY AVAILABLE ON THE COMPANY'S REVOLVING CREDIT FACILITY?

A. Yes, TIEC witness Kevin C. Higgins and DoD/FEA witness Felipe A. Salcedo propose to remove the entirety of the $571,211 in RCF commitment fees from Company's requested revenue requirement.

Q. DO YOU AGREE WITH WITNESSES HIGGINS AND SALCEDO REGARDING THEIR RECOMMENDATION TO REMOVE ALL RCF COMMITMENT FEES FROM THE COMPANY'S REQUESTED REVENUE REQUIREMENT?

A. No, I do not agree with TIEC witness Higgins and DoD/FEA witness Salcedo's recommendation to remove all RCF Commitment Fees from the Company's requested revenue requirement. The Company's recommendation for recovery of the commitment fees is based on the difference between the total line of credit of the RCF less the highest level of borrowings for nuclear fuel during the Test Year. The administrative cost of maintaining a sufficient level of liquidity in case of an emergency should be included in the Company's cost of service.

Q. WHAT ARE THE FLAWS IN TIEC WITNESS HIGGINS AND DoD/FEA WITNESS SALCEDO'S ARGUMENTS REGARDING THE REMOVAL OF ALL RCF COMMITMENT FEES FROM THE COMPANY'S REQUESTED REVENUE REQUIREMENT?

A. TIEC witness Higgins argues that since the Company's customers are not afforded the benefit of EPE's use of lower-cost short-term debt financing in its capital structure used for ratemaking, it is not appropriate for customers to fund the RCF commitment fees. However, TIEC witness Higgins is incorrect in his assessment of the utilization of the Company's short-term RCF borrowings and why they are excluded from the Company's requested capital structure and the weighted cost of debt. The mechanics and reasons for the exclusion of RCF borrowings from the Company's capital structure are described below. DoD/FEA witness Salcedo's primary argument is that the RCF commitment fees are borrowing fees or financing costs such as interest expense. However, this argument is inaccurate. The commitment fee is assessed on the undrawn balance of the RCF and not on a specific amount of loans outstanding. To the contrary, interest costs on the short-term RCF borrowings are actually reflected in the Company's AFUDC capitalization rate, which reflects the cost of short-term debt and equity funds used to fund CWIP.

Q. WHY SHOULD THE COMPANY'S REQUEST FOR RECOVERY OF THE COMMITMENT FEES BE ALLOWED IN THS PROCEEDING?

A. The Company's request should be approved in this proceeding because the commitment fees are only assessed on the undrawn portion of the RCF and are incurred to ensure that the Company has an available source of liquidity, if necessary, and to help support and maintain its investment grade credit ratings. Having available and unused liquidity is critical for the Company's operations, including the provision of reliable electric service, and there is no other means of recovering the cost associated with this liquidity. As discussed in my direct testimony on pages 17, the rating agencies consider a company's liquidity as an essential element in its credit ratings. The RCF is EPE's primary means of liquidity and is closely reviewed by rating agencies. Having these funds available as needed is an essential business practice and supports our obligation to serve our customers. In addition, as discussed in my direct testimony on pages 17-18, the RCF is essential to EPE to meet unexpected cash fluctuations. Therefore, the commitment fees should not be disallowed on the basis that the Company does not include short-term debt in its capital structure. The commitment fees associated with the unused credit facility are a necessary cost of doing business and are just and reasonable and should be approved as requested.

V. Rating Agency Methodology and Credit Metrics

Q. ARE THERE ANY ADDITIONAL ISSUES THAT WERE RAISED BY ANY PARTY THAT YOU WOULD LIKE TO ADDRESS?

A. Yes, TIEC witness Michael P. Gorman argues that the Company's requested Return on Equity ("ROE") should be lowered to the range of 9.00% to 9.40%, with a point estimate of 9.20% from its requested ROE of 10.30% as proposed by El Paso Electric Company ("EPE") witness Jennifer Nelson. One of the supporting reasons to lower the Company's ROE that was cited by TIEC witness Gorman, was that EPE's credit rating would not be impacted if a lower ROE was ordered in this proceeding. TIEC witness Gorman argues this point by relying on S&P's credit rating agency methodology and credit metrics.

In addition, City of El Paso, Texas witness Daniel J. Lawton also argues that his recommended 9.0% equity return will provide sufficient financial metrics for the Company as calculated by Moody's, Fitch, and Standard and Poor's.

Q. IS THE COMPANY'S DEBT CURRENTLY RATED BY S&P?

A. No, the Company's debt is currently rated by Moody's and Fitch. S&P has not rated the Company's debt since the Company's rating was withdrawn on September 18, 2020.

Q. IS IT APPROPRIATE TO UTILIZE THE S&P METHODOLOGY TO ASSESS THE COMPANY'S FINANCIAL INTEGRITY IN THE MANNER THAT TIEC WITNESS GORMAN EMPLOYED?

A. No, TIEC witness Gorman has not appropriately utilized S&P's methodology to calculate and evaluate the Company's credit metrics and overall credit rating. S&P utilizes quantitative and qualitative information in its credit evaluations and focuses such matters on both a prospective and historical basis. TIEC witness Gorman admits in his testimony that his assessment of the Company's financial integrity is not the same as the method employed by S&P, but nonetheless relies heavily on this incomplete assessment to argue that lowering the Company's ROE will not harm the Company financially. It appears that TIEC witness Gorman's calculation of the Company's S&P core credit metrics in Exhibit MPG-19 only represents a single point in time, which is inconsistent with the rating agencies' methodology utilized in the evaluation and assignment of issuer credit ratings. In addition, TIEC witness Gorman's analysis in Exhibit MPG-19 does not reflect various adjustments commonly made to values throughout an issuer's financial statements such as lease and pension related debt adjustments. Although TIEC witness Gorman indicates he is following the S&P methodology to evaluate the Company's credit metrics, all rating agencies make a number of different adjustments to each issuers financial statements to get a complete view of the issuers obligations and ability to pay. This is clearly evident by reviewing the Company's Credit Opinion issued by Moody's on October 1, 2021. The Company's adjusted debt as calculated by Moody's at December 31, 2020, which is the same as the Test Year in this proceeding, was $1.6 billion. However, the Company's level of debt at December 31, 2020, as reflected in Schedule K-01, was approximately $1.3 billion. The October 2021 Moody's report also shows the decline of the Company's CFO Pre WC/Debt (Cash Flow from Operations pre-working capital/Debt) ratio from 18.3% in 2017 to as low as 13.7% in June 2021. This demonstrates that TIEC witness Gorman's conclusion that lowering the Company's ROE will support and, in this instance, improve the Company's current credit metrics is incorrect. In the Moody's credit opinion published on September 21, 2020, Moody's indicated that if EPE's cash coverage ratio (Cash Flow Operations pre-working capital/Debt) declines below 15% on a sustained basis and if a contentious political or regulatory environment emerges in Texas or New Mexico, it could result in a downgrade in credit ratings.[2] Mr. Gorman is also reliant upon a credit opinion issued by S&P on May 21, 2018. As Mr. Gorman points out, the Company's overall structure as well the S&P defined business and financial risk profiles have changed considerably since publication of the May 2018 report. The state of the credit markets have also changed significantly since publication of the May 2018 report, due to various global events such as the COVID-19 pandemic. Therefore, the Commission should reject TIEC witness Gorman's assessment of the financial impact that a lower ROE would have on the Company's credit ratings.

Q. IS IT APPROPRIATE TO UTILIZE THE METHODOLOGY USED BY CEP WITNESS MR. LAWTON TO ASSESS THE COMPANY'S FINANCIAL INTEGRITY?

A. No, Mr. Lawton claims that the Company will be able to maintain its financial integrity and creditworthiness if awarded a 9.0% ROE based on his calculation of the Company's credit metrics as defined by Moody's, Fitch, and Standard and Poor's. However, Mr. Lawton's analysis is incomplete and, similar to TIEC witness Gorman's analysis, only represents a single point in time, which is inconsistent with the rating agencies' methodology utilized in the evaluation and assignment of issuer credit ratings. Mr. Lawton's analysis also neglects to reflect the various adjustments commonly made to values throughout an issuer's financial statements such as lease and pension related debt adjustments. CEP witness Lawton provides four credit metric calculations in Schedule DJL-11 but does not describe how or which methodology was used to perform such calculations. The ratings process is a comprehensive evaluation of a Company's business profile and credit position over a historical and prospective period of time, which also includes an assessment of the stability and predictability of a regulatory environment in which it operates. Therefore, Mr. Lawton's simple assessment of the impact to the Company's credit worthiness should be rejected.

Q. ARE YOU THE WITNESS SPONSORING THE COMPANY'S REQUESTED ROE IN THIS PROCEEDING?

[2] Moody's Investors Service, *Credit Opinion: El Paso Electric Company, Update to credit analysis,* October 1, 2021 at 2.

A. No, I am not. The Company's ROE witness is Jennifer Nelson. My comments are meant to address Messrs. Gorman's and Lawton's arguments regarding the Company's credit ratings and metrics. Ms. Nelson directly addresses the witnesses' ROE calculations and methodology.

VI. Conclusion

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.