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**Filing Date - 2023-08-25 12:49:24 PM**

**Control Number - 54634**

**Item Number - 453**

SOAH DOCKET NO. 473-23-14020
DOCKET NO. 54634

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| **APPLICATION OF SOUTHWESTERN PUBLIC SERVICE COMPANY FOR AUTHORITY TO CHANGE RATES** | **§ § §** | **BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS** |

**REBUTTAL TESTIMONY**
***of***
**TODD A. SHIPMAN**

***on behalf of***

**SOUTHWESTERN PUBLIC SERVICE COMPANY**

(*Filename*: ShipmanRRRebuttal.docx; *Total Pages*: 19)

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## GLOSSARY OF ACRONYMS AND DEFINED TERMS

| Acronym/Defined Term | Meaning |
|---|---|
| AXM | Alliance of Xcel Municipalities |
| EFH | Energy Futures Holdings Corporation |
| Moody's | Moody's Investor Service |
| PUCT | Public Utility Commission of Texas |
| ROE | return on common equity |
| ROR | rate of return |
| SACP | stand-alone credit profile |
| S&P | Standard & Poors Global Ratings |
| SPS | Southwestern Public Service Company, a New Mexico corporation |
| Staff | Rate Regulation Staff of the Public Utility Commission of Texas |
| TIEC | Texas Industrial Energy Consumers |
| Xcel Energy | Xcel Energy Inc. |

**REBUTTAL TESTIMONY**
**OF**
**TODD A. SHIPMAN**

## I. WITNESS IDENTIFICATION

**Q. Please state your name and business address.**

A. My name is Todd A. Shipman. I am a Principal in Utility Credit Consultancy, LLC, which has its headquarters at 51 Woodsneck Road, Orleans, Massachusetts 02653.

**Q. On whose behalf are you submitting this rebuttal testimony?**

A. I am testifying on behalf of Southwestern Public Service Company, a New Mexico corporation ("SPS").

**Q. Are you the same Todd A. Shipman who filed direct testimony on behalf of SPS in this docket?**

A. Yes.

## II. SUMMARY OF TESTIMONY AND RECOMMENDATIONS

**Q. What is the scope of your rebuttal testimony?**

A. I address several credit ratings-related issues in response to the direct testimonies of Charles S. Griffey on behalf of the Texas Industrial Energy Consumers ("TIEC"), Christopher C. Walters of TIEC, J. Randall Woolridge on behalf of Alliance of Xcel Municipalities ("AXM"), and Mark Filarowicz of the Rate Regulation Division ("Staff") of the Public Utility Commission of Texas ("PUCT").

**Q. Please summarize your recommendation in this case.**

A. The PUCT should adopt a return on common equity ("ROE") of 10.65% and a capital structure consisting of a common equity component of 54.68%, as supported by SPS witnesses Dylan D'Ascendis and Patricia Martin to stabilize its credit ratings and create momentum for future ratings improvement for the benefit of customers. The rate of return ("ROR") recommendations of Staff and intervenors do not follow prudent risk management practice to support current credit ratings with the requisite cushion necessary to ensure ratings stability under stress and position SPS for future ratings improvement. The additional "ringfencing" provision proffered by Staff should be rejected as ineffective and in fact potentially harmful to SPS and its ratepayers.

## III. RATE OF RETURN SHOULD BE SET TO PROMOTE RATINGS STABILITY

**Q. Are the ROR recommendations of Staff and intervenors in the best interests of ratepayers?**

A. No. If unforeseen events in the current ratings and capital market environment[1] do not abate, acceptance of their recommendations would stall the positive trend to SPS's credit metrics and risk deterioration in SPS's credit ratings. Which would yield higher long-term costs for SPS customers and leave customers at risk of much higher capital costs and reduced access to capital on the part of SPS. The Commission's goal in this case should be to help sustain the positive trend in the SPS credit ratings and achieve ratings stability, forming a foundation to improve ratings over the long-term for the benefit of ratepayers.

**Q. Would the Staff and intervenor ROR recommendations be sufficiently credit-supportive?**

A. No. The recommendations of Messrs. Filarowicz[2], Walters[3], Griffey[4], and Dr. Wooldrige[5] on ROE and capital structure would reinforce the marginal standing of the SPS ratings because of existing concerns about the Company's regulatory risk. They would not advance the Company's credit profile and would keep it vulnerable to downgrades in the future if unexpected developments erode the insufficient buffer in the current ratings. Recall that in my direct testimony in this

[1] Shipman Direct, p. 25-30.

[2] Direct Testimony of Mark Filarowicz, Aug. 11, 2023, p. 33.

[3] Direct Testimony of Christopher C. Walters, Aug. 4, 2023.

[4] Direct Testimony of Charles S. Griffey, Aug. 4, 2023.

[5] Direct Testimony of J. Randall Wooldridge, Ph.D., Aug. 4, 2023.

case, I pointed to the importance of constructive regulatory outcomes to the rating agencies and investors[6] to ratings stability and the importance of ROE and capital structure on investor and rating agency perceptions of regulatory risk.[7] While the financial metrics alone would not produce a downgrade trigger, the imposition of a hypothetical capital structure would likely be seen as increasing SPS's business risk. As discussed in my direct testimony, business risk, and in particular regulatory risk, is the single most important factor in utility ratings. I think adopting the Company's supported ROE and capital structure would send a strong message to investors and rating agencies that the determination of the Company to improve its financial performance to support a strong credit profile will be facilitated by the Commission. Staying the course will firm up the current ratings and position SPS for future ratings improvement to the benefit of customers.

**Q. If none of the ROR recommendations would immediately result in any ratings downgrades, should the Commission regard them as merely mediocre or harmless to ratepayers?**

A. No. Ratings are among other things a *long-term* measure of risk[8], and as I argued in direct testimony, making decisions with the long-term benefit to ratepayers should be the top priority to maintain credit quality and ratings over time. For instance, succombing to the kind of myopic, short-term thinking that permeates

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[6] Shipman Direct at 20.

[7] *Id.* at 16-17.

[8] Shipman Direct at 14-16.

the testimony of Mr. Griffey,[9] risks unnecessary negative rating actions in the future.

**Q. Staff dismisses the size premium for ROE recommended by Mr. D'Ascendis. Does the risk analysis performed by rating agencies suggest that risk is affected by the size of the issuer?**

A. Yes. I can add more color from the perspective of a risk professional with extensive credit ratings experience. While my focus is on credit analysis, it applies to how equity investors attribute greater risk because of size because credit ratings equate to the overall risk of a firm.

**Q. How does size play a role in the credit analysis of a utility?**

A. Size factors into the credit analyses performed by rating agencies in several important areas. It first appears in the fundamental analysis as a factor called diversity: "[t]here is no minimum size criterion, although size often provides a measure of diversification. Size and scope of operations is important relative to those of industry peers.."[10] Standard & Poors ("S&P") criteria includes the analysis in a sub-factor called "Scale, Scope, and Diversity."[11] As described in its utility methodology:

> "We consider the key factors ... to be primarily operational scale and diversity of the geographic, economic, and regulatory foot prints. We focus on a utility's markets, service territories, and diversity and the extent that these

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[9] For example, Griffey dismisses "meaningful savings [that] can only be achieved years from now", as if the Commision should not be striving to save customers money unless the benefit materializes right away. Griffey Direct at 32.

[10] S&P, *Criteria | Corporates | General: Corporate Methodology*, Dec. 15, 2021, paragraph 212.

[11] *Id.* at 18 (Table 9).

> attributes can contribute to cash flow stability while dampening the effect of economic and market threats."[12]

S&P analyzes the size and diversity of the customer base (including customer concentration risk among residential, commercial, and industrial classes), the number of service territories and regulators, and the number of assets and suppliers that can affect operating risk. We can see the application of this criteria in the S&P analysis of SPS, which notes "the company's limited geographic diversity."[13] Moody's Investor Service ("Moody's") also refers to this aspect of the analysis as diversity, making it evident that size is relevant and can sometimes play a prominent role in the analysis.[14]

**Q. Where else does size enter into the credit analysis?**

A. Size affects the all-important area of liquidity. The analysis centers on the company's liquidity, not on the market liquidity that also affects smaller entities more than larger ones. For S&P, liquidity is one of several "modifiers" to the preliminary result of the basic business risk/financial risk outcome of the credit analysis.[15] The main element of the analysis is a comparison of the company's sources and use of liquidity, but several qualitative and relative elements interact with that quantitative analysis in a way that can constrain liquidity. Those factors (the ability of an issuer to absorb high-impact, low-probability events without refinancing, the relationships it has with banks, and its standing in credit markets)

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[12] *Id.* at para. 31.

[13] S&P, *Southwestern Public Service Co.*, Sept. 20, 2022, p. 4.

[14] Moody's, *Rating Methodology, Regulated Electric and Gas Utilities*, Sept. 10, 2022, pp. 26-27.

[15] S&P, , *Corporate Methodology*, para. 31.

all relate closely to an issuer's size. For Moody's, liquidity is highlighted in the methodology as a "key element in the financial analysis."[16] They also note that when it is lacking, liquidity can dominate the analysis and rating outcome.[17]

**Q. Do you agree with TIEC witness Griffey that using a hypothetical capital structure for SPS rather than its actual capital structure is inconsequential?**

A. No. He proposes a capital structure with less common equity than what SPS actually employs and vaguely opines that the practice "does not violate any financial principles."[18] He also alleges that SPS's cost of capital is unrelated to the Commission's actions on its authorized ROR.[19] Mr. Griffey is mistaken, mostly because his recommendation ignores the significance of the qualitative (i.e. business risk) side of the credit quality equation. As I discuss in my direct testimony, the actions of regulators have far-reaching and lasting effects on a utility and its credit ratings, and thus its cost of capital.[20] Mr. Griffey's attempt to understate the impact of the PUCT's influence on SPS, its management of its balance sheet, and its cost of capital is unrealistic.

Based on observing utility management behavior over more than three decades, few if any utility managers will continue to maintain an equity layer over an extended period that does not correspond to the level that it is allowed to earn a return on. If regulators continually impose a lower equity component in the

[16] Moody's, *Utility Methodology*, page 25.

[17] *Ibid.*, page 26.

[18] Griffey Direct at 19.

[19] *Ibid.*

[20] Shipman Direct at 15-17.

capital structure used to set rates and expect the utility to eat the difference by keeping a thicker equity ratio to support credit quality, they put that credit quality at risk and will eventually result in lower credit ratings and higher costs to ratepayers.

**Q. Are Mr. Griffey's references to the capital structure of SPS's parent relevant to the determination of the capital structure in this case?**

A. No. Mr. Griffey invokes Xcel Energy Inc.'s ("Xcel Energy") financial policies and activities to try to bolster his support of a weaker SPS balance sheet.[21] This is a distraction to what is relevant in determining capital structure. The PUCT is setting rates for SPS, not Xcel Energy, so the appropriate focus is on the SPS financials. The parent's use of leverage does not affect SPS or its credit ratings, which is verified by the fact that Xcel Energy's credit profile is stronger than its subsidiary. Moreover, Xcel Energy's stronger business risk profile shows that it can tolerate higher leverage than SPS

**Q. Are Mr. Griffey's references to the large capital expenditure plans of SPS's parent relevant to the issue of SPS's cost of capital?**

A. No. That, too, is irrelevant. Mr. Griffey posits that Xcel Energy's willingness to commit substantial capital to its utility operations shows that regulatory risk has abated over time.[22] However, Mr. Griffey is mistaken. Investor opinion of the PUCT has worsened over time. Mr. Griffey's general discussion of regulatory

[21] Griffey Direct at 20-21.

[22] *Id.* at 23.

risk, devoid of any analysis, consists of alleged reductions in regulatory lag and recent legislation related to purchased power agreements and employee compensation.[23] Regulatory risk depends on much more than just regulatory lag and procurement of generation resources, and Mr. Griffey's simple recitation of certain recovery mechanisms is a poor substitute for a careful analysis of the many factors rating agencies evaluate when assessing regulatory risk.[24]

**Q. Have cost recovery mechanisms lowered regulatory risk for SPS?**

A. Not materially. While any use of recovery mechanisms that operate outside the long and cumbersome rate case process is a helpful antidote to regulatory lag and aids a utility's ability to consistently earn its authorized return, it takes more than a recitation of acronyms to analyze a company's risk. SPS and its risk profile do not especially benefit from flexible recovery mechanisms. As the table below shows, almost 90% of SPS's revenues rely on base rates and not other types of recovery.

**Table TAS-RR-R1**[25]

| | | |
|---|---|---|
| Base Rates | $ 761,917,412 | 87.19% |
| Fuel | $ 106,861,536 | 12.23% |
| EECRF Rider | $ 5,121,695 | 0.59% |
| Total | $ 873,900,643 | 100.00% |

[23] Griffey Direct at 11-12.

[24] For a comprehensive discussion on regulatory risk, *see* Moody's, "*Rating Methodology, Regulated Electric and Gas Utilities,*" pp. 6-15, Jun. 23, 2017; and S&P, "*Assessing U.S. Investor-Owned Utility Regulatory Environments,*" May 18, 2015.

[25] Update Filing, Schedule Q-U7, page 26, line 236.

**Q. Is Mr. Griffey's portrayal of SPS's credit ratings and the dynamics of how they could change accurate?**

A. No. In a review of credit ratings that is intended to help the Commission "understand how credit rating agencies currently set ratings for SPS and what might cause the agencies to increase or lower the rating,"[26] Mr. Griffey commits numerous errors. His testimony on ratings should therefore be ignored. Mr. Griffey thinks S&P applies the group rating methodology to SPS because it is a "core" subsidiary.[27] That is backward: SPS is determined to be "core" under the S&P group rating methodology, which applies to all subsidiaries, "core" or not. Mr. Griffey states that as long as SPS is a "core" subsidiary, "S&P is unlikely to alter SPS's credit rating to be different from Xcel's rating."[28] Under the S&P criteria, in fact, SPS could be rated higher than Xcel Energy if its own stand-alone credit profile ("SACP") justified it.[29] Mr. Griffey also states only Moody's "performs a SPS-specific evaluation."[30] However, he omits that S&P does as well (the SACP that I have highlighted as an important gauge of SPS's creditworthiness[31]), and thus, he misunderstands the implications of his recommendations and mine on SPS.

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[26] Griffey Direct at 24.

[27] *Ibid.*

[28] *Id.* at 25

[29] S&P, *General Criteria: Group Rating Methodology*, Aug 27, 2020, para. 64.

[30] Griffey Direct at 25.

[31] Shipman Direct at 19

**Q. Does the AXM-recommended capital structure make sense?**

A. No. The proposed hypothetical 50.57% capital structure fails to support SPS's current credit ratings, as I just demonstrated. What little basis given for the recommendation seems to rest mainly on a discussion of holding company debt,[32] but Dr. Woolridge's analysis is flawed. Citing a 2015 Moody's commentary, he seems to suggest that SPS parent Xcel Energy employs "double leverage" as defined by Moody's.[33] He misconstrues Moody's on this point, as the concept only applies when, as Moody's states,

> "[i]n a simple operating-company / holding company structure, this practice results in a consolidated debt-to-capitalization ratio that is higher at the parent than at the subsidiary because of the additional debt at the parent."[34]

Double leverage only applies when a linear relationship between a single subsidiary and the holding company prevails. With no other assets or other credit-enhancing elements like diversification to offset the additional debt, the holding company debt does indeed affect the credit profile. That linear relationship does not exist between SPS and Xcel Energy, and the fact that the parent has a stronger credit profile than SPS is proof that the parent debt does not negatively affect SPS. The only debt the PUCT should account for when setting the capital structure in this case is SPS's. Dr. Woolridge's recommendation, and Mr. Griffey's similar claims, should be disregarded.

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32 *Id.*, pp. 22-24.

33 *Id.* at 23. Mr. Griffey makes a similar claim.

34 *Ibid.*, citing the Moody's commentary.

**Q. Is the assertion that parent Xcel Energy has "greater financial risk"[35] than SPS due to a more balance-sheet leverage accurate?**

A. No. Balance sheet leverage is not the primary measure of financial risk used by rating agencies and investors. As I explained in my direct testimony, the preferred gauge of financial risk is a credit metric that compares total debt to operating cash flow. S&P designates the same financial risk profile, denoted "Significant" in its methodology, to both SPS and parent Xcel Energy.[36] Moody's scores the two companies identically on the most impactful financial metrics as well.[37] Financial risk is equivalent despite the difference in debt ratios because there are other, more important considerations that illuminate the degree of financial risk to an investor. This, along with the fact that Xcel Energy's overall credit profile is stronger than SPS's, illustrates the fallacy of considering so-called double leverage when setting a utility's rates. The only relevant capital structure in this proceeding is SPS's actual capital structure.

**Q. Are there other shortcomings in the AXM ROR recommendation?**

A. Yes. Dr. Woolridge attempts to refute the size premium adjustment advocated by Mr. D'Ascendis.[38] My response, *supra*, in rebutting the Staff recommendations applies as well to Dr. Woolridge's treatment of the proposed adjustment.

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[35] *Id.* at 22.

[36] S&P, *Southwestern Public Service Co.*, Sept. 20, 2022, p. 1; S&P, *Research Update: Xcel Energy Inc. Outlook Remains Stable; PSCo Outlook Now Negative Amid Increasing Wildfire Risks; Ratings Affirmed.*, July 28, 2023.

[37] Moody's, *Credit Opinion, Southwestern Public Service Company, Update to credit analysis*, Dec. 30, 2021, p.9; Moody's, *Credit Opinion, Xcel Energy Inc., Update to credit analysis*, Feb. 8, 2023, p. 16

[38] Woolridge Direct at 86-88.

## IV. THE CURRENT SPS FINANCIAL PROTECTIVE MEASURES ARE FIT FOR PURPOSE

**Q. Would the new provisions to SPS's array of financial protective measures recommended by Staff witness Filarowicz contribute to the insulation between SPS and its parent company?**

A. No.

**Q. What are the recommended additions that the Company considers problematic?**

A. According to SPS witness Martin, the Regulatory Return on Equity Commitment, the No Debt Disproportionally Dependent on SPS, and the SPS Credit Ratings proposed commitments are objectionable.

**Q. What is the basis for the proposed financial protection provisions?**

A. There are two reasons. The first is that the provisions provide "a set of safeguards against a parent (or sister) company's financial distress and potential contagiousness and, in an extreme situation, the parent's bankruptcy."[39] The second is the belief that "they are known to have worked"[40] based on the experience of Oncor Electric Delivery Company amid the bankruptcy of its parent Energy Future Holdings Corporation ("EFH") in 2014.

**Q. Do those examples provide any basis for adding the commitments mentioned above?**

A. No. Nothing about the concepts of striving to maintain ratings, proportionality of debt incurrence, or preventing a utility from citing its credit rating as part of its

[39] Filarowicz Direct at 41.

[40] *Id.* at 46.

case for a particular ROE would act to insulate the utility from its parent. Its unintended consequence would only do the opposite. For example, a provision that harms a utility's financial health by preventing full recovery of capital costs would exacerbate the impact of the financial distress that caused the ratings downgrade into a speculative-grade rating and drive it further downward. Insulating a utility involves many techniques, but the primary mechanisms are those that impede the flow of funds between a subsidiary and parent.[41] Provisions aimed at penalizing the subsidiary do not play any role in determining insulation.

In the second example, Oncor was not spared from the ratings downgrades experienced by its parent by a regulatory ROE argument provision. The Oncor provisions, which actually produced a true, legal ringfencing, were designed to create separation from its parent, which was very highly leveraged. The enhanced provisions were voluntarily adopted by Oncor and confirmed by the PUCT to support Oncor's ratings and financial integrity. Contrary to Mr. Filarowicz's understanding of the circumstances surrounding the Oncor acquisition,[42] the possibility of a future EFH bankruptcy was uppermost in the concerns of the parties. EFH was deeply speculative-grade coming out of the transaction.[43] Single-B ratings were indicative of substantial default risk. That is in stark contrast to SPS/Xcel Energy, where the opposite holds. SPS retains a higher S&P rating than its Moody's standalone rating due to its affiliation with Xcel Energy.

[41] S&P, *General Criteria, Group Rating Methodology*, Aug. 20, 2020, paragraphs 63-68.

[42] Filarowicz Direct at 46.

[43] *See*, for example, S&P, Research Update, TXU, Unregulated Subs Corp. Ratings Are Lowered to B- On LBO Debt Plan; Outlook Stable, Oct. 9, 2007.

This parental support and relationship is thus a benefit not only to SPS and its customers, thus making any provisions that would cause separation not only unnecessary, but counterproductive.

**Q. Does this conclude your pre-filed rebuttal testimony?**

A. Yes.

**AFFIDAVIT**

STATE OF MASSACHUSETTS )
)
COUNTY OF BARNSTABLE )

Todd A. Shipman, first being sworn on his oath, states:

I am the witness identified in the preceding rebuttal testimony. I have read the testimony and am familiar with the contents. Based upon my personal knowledge, the facts stated in the testimony are true. In addition, in my judgment and based upon my professional experience, the opinions and conclusions stated in the testimony are true, valid, and accurate.

TODD A. SHIPMAN

Subscribed and sworn to before me this 22day of August, 2023 by Todd A. Shipman.

Notary Public, State of

My Commission Expires: 8/5/27

DAWANE M SOUZA
Notary Public, Commonwealth of Massachusetts
My Commission Expires August 05, 2027

**CERTIFICATE OF SERVICE**

I certify that on the 25th day of August 2023, notice of the filing of the foregoing rebuttal testimony with the PUCT was served on all parties of record by electronic service and was posted to SPS's file sharing platform.

/s/ Amy M. Shelhamer