BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF SOUTHWESTERN PUBLIC SERVICE COMPANY'S APPLICATION FOR: (1) REVISION OF ITS RETAIL RATES UNDER ADVICE NOTICE NO. 292; (2) AUTHORIZATION AND APPROVAL TO ABANDON ITS PLANT X UNIT 3 GENERATING STATION; AND (3) OTHER ASSOCIATED RELIEF,	)	**CASE NO. 20-00238-UT**
SOUTHWESTERN PUBLIC SERVICE COMPANY,	)	
APPLICANT.	)	

DIRECT TESTIMONY

of

TODD A. SHIPMAN, CFA

on behalf of

SOUTHWESTERN PUBLIC SERVICE COMPANY

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GLOSSARY OF ACRONYMS AND DEFINED TERMS

Acronym/Defined Term	Meaning
Commission or PRC	New Mexico Public Regulation Commission
CFO	cash flow from operations
CRA	comparable ratings analysis
CTA	Carbon Transition Assessment
Moody’s	Moody’s Investor Service
ROE	return on common equity
SACP	stand-alone credit profile
S&P	S&P Global Ratings
SPS	Southwestern Public Service Company, a New Mexico corporation
Xcel Energy	Xcel Energy Inc.

LIST OF ATTACHMENTS

Attachment	**Description**
TAS-1	Todd A. Shipman Statement of Qualifications
TAS-2	Filings by Todd A. Shipman
TAS-3	Ratings Scales of S&P and Moody's

Case No. 20-00238-UT
Direct Testimony
of
Todd A. Shipman

I. WITNESS INDENTIFICATION AND QUALIFICATIONS

Q. Please state your name and business address.

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

Q. On whose behalf are you submitting this testimony?

A. I am filing testimony on behalf of Southwestern Public Service Company, a New Mexico corporation ("SPS"). SPS is a wholly-owned electric utility subsidiary of Xcel Energy Inc. ("Xcel Energy").

Q. What is your education and business experience?

A. I graduated from Texas Christian University with a Bachelor of Business Administration (B.B.A.) degree with a major in economics and from Texas Tech University School of Law with a Juris Doctor (J.D.) degree. I was awarded the Chartered Financial Analyst (C.F.A.) designation in 1989. I have over 34 years of experience in the financial and utility industries. I began in the financial industry as an analyst with a research firm that specialized in analyzing and reporting the investment implications of the actions and behavior of utility regulators. Subscribers to the research included investment bankers and analysts at major Wall

Street firms, large institutional investors such as insurance companies and mutual funds, utilities, and regulators.

I then joined an independent power producer. My primary responsibility was in regulatory affairs, where I coordinated the company's participation in state regulatory proceedings.

I spent the last 21 years of that stage of my career at S&P Global Ratings ("S&P"), a major ratings agency that has been in business over 150 years and issues more than one million ratings on over $47 trillion of debt across all global capital markets. I performed credit surveillance of utilities, pipelines, midstream energy, and diversified energy companies. In the final ten years at S&P, I was the Sector Specialist on the North American utilities team. I was the lead analyst on the team, charged with ensuring ratings quality, assisting in the training and development of new analysts, and creating the criteria used to establish ratings on utilities. I also led outreach efforts to investors and the regulatory community and performed a lead analytical role in the development and application of global ratings criteria for hybrid capital securities such as preferred stock.

Q. What are your current professional activities?

A. After retiring from S&P, I became a management consultant specializing in advising utilities and other entities on credit and ratings issues, balance sheet management, and capital markets strategies. I was also an adjunct faculty member at Boston University's Questrom School of Business, where I taught advanced undergraduate courses in corporate finance and capital markets. My resume is provided as Attachment TAS-1.

Q. Have you previously sponsored testimony before regulatory authorities?

A. Yes. I filed rebuttal testimony before the New Mexico Public Regulation Commission ("Commission") in Case No. 19-00170-UT. I have also submitted testimony to the Federal Energy Regulatory Commission, the Hawaii Public Utilities Commission, the Wisconsin Public Service Commission, the California Public Utilities Commission, the New York Public Service Commission, the Virginia State Corporation Commission, the Mississippi Public Service Commission, the New Mexico Public Regulation Commission, the Texas Public Utility Commission, and the Arizona Corporation Commission. A list of the proceedings and filings is provided as Attachment TAS-2.

II. ASSIGNMENT AND SUMMARY OF TESTIMONY AND RECOMMENDATIONS

Q. What is the purpose of your testimony?

A. Credit ratings are an important consideration for investors as an independent measure of a utility's overall risk. SPS's current issuer credit ratings at the two primary rating agencies, 'Baa2' (Moody's) and 'A-' with a 'bbb+' stand-alone credit assessment (S&P), are several notches below what I believe to be the optimal ratings that SPS and the Commission should be targeting. In order to ensure access to capital at reduced rates through all economic conditions, which will inure to the benefit of customers, the Commission should place SPS on a path toward achieving a single issuer 'A' credit rating.

III. WHY CREDIT RATINGS MATTER

Q. What is a credit rating, and how does it differ from other measures of the financial condition of a utility?

A. A credit rating summarizes credit risk, which is reflected by the ability and willingness of an issuer to fulfill its financial obligations in full and on time.[1] Ratings address the relative probability that an issuer or an issue will experience default, i.e., the failure to pay either the required periodic payment or the principal when it matures under the terms of the security.

Credit ratings encapsulate a longer-term view of a company's financial health than other common financial markers, such as the latest quarterly financial results, earnings-per-share, rate of return for a particular reporting period, and the market prices of a company's securities at any given time. Ratings are also an independent opinion offered by firms that have no direct financial stake in the outcome of their analyses. The long-term and independent nature of credit ratings make them an ideal benchmark to help utility regulators navigate through the many decisions they must make in the course of balancing the various stakeholder interests before them. As disinterested observers with a long-term mindset, rating

[1] In rating agency parlance, an issuer is the entity that is being rated.

agencies may be viewed as more closely aligned with ratepayers than other utility industry stakeholders.

Credit ratings are a function of two risk assessments: financial risk (i.e. quantitative) and business risk (i.e. qualitative). Business risk and financial risk can be viewed as complementary sides of the total risk of an entity. A particular rating thus reflects a balance of each type of risk, so that where there is an increasing level of one risk there must be a corresponding reduction of the other risk to maintain a particular rating. It therefore follows that entities seeking to improve their rating should strive to improve both business risk and financial risk in tandem.

Q. Please briefly describe the purpose and types of ratings produced by credit rating agencies.

A. Credit rating agencies assess the creditworthiness of a company or a financial instrument issued by a company to facilitate better access to fixed income capital markets at the most efficient cost. Access to capital, or simply the ability to raise ample funds needed to operate and invest in a business, is improved with a rating because it offers investors high-quality information from a third party regarding the risk of investing in or doing business with the issuer. The agencies publish analyses of the issuers and issuances to explain the ratings to the capital markets. Ratings are expressed in a series of letters, numbers, and/or symbols to summarize the relative creditworthiness of the entity or issue. The ratings scales of the two major rating agencies appear in Attachment TAS-3.

Ratings in the BBB/Baa category and above are considered "investment-grade" by market participants. Ratings below BBB-/Baa3 are known as "speculative-grade," or colloquially "junk," securities. Because some investors are precluded from holding speculative-grade issues, the difference between investment-grade and speculative-grade ratings is profound and is recognized as such by rating agencies and market participants.

Q. Are credit ratings a useful and accurate measure of a company's risk profile and financial strength?

A. Yes. The default experience of issuers validates the usefulness of credit ratings as a measure of risk. According to Moody's Investor Service ("Moody's"), in the 1994 through 2019 time period the five-year average, volume-weighted corporate bond default rate increases from one rating category to the next lower one in the ratings scale, from a low of 0.4% for the Aaa category to 39.6% for the combined "Caa-C" categories.[2] Thus, experience shows that lower ratings do in fact correspond to higher default risk and lower financial health.

[2] *See* Exhibit 54 in Moody's Investor Service, *Annual Default Study*, January 30, 2020.

Q. Who uses credit ratings?

A. Investors use credit ratings to assist their investment decisions: which companies to invest in and the price that they will charge to lend to or invest in a company. Ratings are helpful because they are based on a consistent approach to assessing risk across time. Investors generally fall into two basic categories with distinct risk characteristics: fixed-income investors (e.g. lenders or bondholders) that furnish capital to a company in exchange for a fixed return and the right to be repaid the original investment, and equity investors that receive only a residual return after all expenses are paid. Fixed-income investors use ratings as one consideration when deciding whether and at what cost to lend capital to a utility. Both fixed-income and equity investors use the credit analyses performed by rating agencies to better understand the overall risk of an issuer.

Q. How does a ratings agency establish a credit rating?

A. Ratings are established by a committee that specializes in the industry or industries of the rated entity, rather than by individual analysts. Ratings conform to common standards of credit risk across all issuers, industries, and markets by employing consistently applied ratings criteria. The basic analysis is two-fold. The quantitative side of the analysis examines financial ratios and other metrics to analyze the financial risk of a particular issuer. The qualitative side is the assessment of business risk, which is built up from the broad macro risks at the country and industry level. The issuer's more specific risk within its business and economic environment is then determined. For a utility, the major business risks are regulatory risk, operating risk, and cash-flow diversity. The first, regulatory risk, is a major factor in the analysis.

Business risk and financial risk can be viewed as complementary sides of the total risk of an entity, so that more of one risk must be offset by less of the other risk to arrive at a particular rating. Because utilities are tightly regulated on financial matters that limit how much financial metrics can vary over time, it is often the qualitative analysis that drives ratings outcomes.

Q. What financial considerations constitute the quantitative side of credit analysis?

A. Credit analysis is distinguished by its emphasis on cash flow. Recognizing that debt is serviced with cash, not earnings, credit analysts strive to understand the cash-flow dynamics of a company's financial results as much as or more than the accounting-derived earnings. The most recent example of this dichotomy is the effect of tax reform on utilities, which placed downward pressure on utility ratings because of its negative cash-flow impact despite relatively neutral earnings implications. The primary measure that rating agencies use as a base for most cash-flow metrics is cash flow from operations ("CFO") or some derivation.[3] The other major element of financial risk to a credit analyst is the total amount of debt or debt-like obligations on the issuer's balance sheet and from other activities. Items that the rating agency regards as debt-like are lease liabilities, long-term power purchase obligations, and deferred taxes.

Credit metrics are calculated for both historical periods and future forecasts and fall into two basic types: leverage and coverage ratios. Since ratings are forward-looking, the analysis places greater weight on the forecast period than on the historical period. Leverage metrics attempt to assess the relative burden of debt and other fixed-income obligations compared to the financial responsibility being carried by shareholders. Coverage metrics are something of the opposite, gauging the more immediate question of how cash flow compares to the need to service the fixed-income obligations in the near term.

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[3] Moody's refers to this as "CFO pre-working capital-to-debt." S&P has a similar measure, referred to as funds-from-operations," or FFO, which S&P also compares to an entity's overall debt burden.

Q. What business risk considerations constitute the qualitative side of credit analysis for utilities?

A. Evaluating business risk for utilities is predominantly a matter of regulatory risk. Even for areas that do not explicitly touch on regulatory behavior, the evaluation almost invariably circles back to the central question of whether utility regulation provides sufficient cost recovery, including full recovery of a utility's cost of capital through a reasonable authorized return on equity ("ROE"). The nature and pace of the process of recognizing an incurred cost as recoverable through rates is the paramount business-risk factor for a utility credit analyst. The other elements of regulatory risk, such as the political influences on regulation, are analyzed to discern the risk surrounding the ultimate factor of covering all costs sufficiently to earn a reasonable return on investment.

Q. How is regulatory risk analyzed?

A. For Moody's regulatory risk constitutes over 80% of business risk, and for S&P it is 60%.[4] Both rating agencies focus on the basic regulatory framework, including:

[4] Moody's, *Rating Methodology, Regulated Electric and Gas Utilities*, Sept. 10, 2020, p. 4; S&P, *Criteria | Corporates | General: Corporate Methodology*, April 30, 2020, p.22.

(1) the legal foundation for utility regulation, (2) the ratemaking policies and procedures that determine how well the utility is afforded the opportunity to earn a reasonable return with a reasonable cash component, and (3) the history of regulatory behavior by the governing bodies applying those laws, policies, and procedures.

Q. After the broad framework is analyzed, how is regulatory risk determined?

A. Rating agencies examine the mechanics of regulation, particularly the rate-setting process, as they refine their analyses of regulatory risk. Rate cases take up much of the analysis, but the totality of a utility's tariff schedule is assessed to capture the effect on business risk of revenues generated outside base rates. Creditors, and therefore rating agencies, attribute less risk to tariff provisions that operate outside the rate case cycle and that adjust rates automatically or with some flexibility to match revenues with expenses, thereby minimizing regulatory lag. Fuel clauses and increasingly other varieties of riders are almost universal across the utility industry and are the most common of these kinds of rate mechanisms that stabilize earnings and cash flows, which enhances utilities' business risk profiles.

Q. Are the framework and the mechanics of regulation the only considerations that go into determining regulatory risk?

A. No. Rating agencies also look holistically at the consistency and transparency displayed in a regulatory jurisdiction.[5] Rating agencies rate many types and tenors of fixed income securities, but they regard debtholders who extend credit over long periods as their primary audience and strive to rate long-term debt as accurately as possible over the longest possible timeframe. Utilities ultimately fund capital expenditures with long-dated maturities to match the long-lived assets they are supporting, and utility investors value ratings that are forward-looking and stable. Regulatory frameworks and practices that allow rating agencies to confidently project future cash flows and debt leverage will naturally be accorded a better business risk profile. This predictability offers creditors the ability to accurately assess risk over most of the debt's term and improves the ability of the company to manage its business activities and capital program for the long-term benefit of ratepayers.

[5] Moody's, *Rating Methodology*, p. 4; S&P, *Assessing U.S. Investor-Owned Utility Regulatory Environments*, May 18, 2015, p.2.

Q. How do credit ratings and actions directly affect a utility and its customers?

A. The most straightforward effect is on a utility's cost of capital. Fixed-income investors and other creditors consult ratings to assist them in determining the "price" they will charge the utility for the use of their money. The total price is the combination of the interest rate of the instrument and its initial value in relation to the stated amount on the instrument. There is an inverse relationship between debt cost and ratings: the higher the rating, the lower the cost. Equity investors, i.e. stockholders, also use credit ratings as a risk guide to help them decide the terms that they will offer their capital to a utility. The more risk they detect, the greater return they will require to compensate them for bearing that risk. The effect is not as direct or precisely quantifiable as it is with fixed-income instruments, but in my experience equity investors often take notice of and react to credit ratings.

Q. How does regulation influence credit ratings?

A. Regulatory behavior acts on both sides of the credit rating equation. The manner of establishing rates and the level and timing of cost recovery has a direct effect on a utility's ability to earn its authorized ROE and produce enough earnings and cash flow to support its credit metrics and ratings. A fully compensatory rate of return, including a capital structure that offers more risk protection to bondholders and other creditors, are features of a credit-supportive regulatory environment. Further, the same regulatory actions that affect a utility's ability to earn a competitive ROE also have a compounding effect on business risk, magnifying the ratings impact of regulatory decisions and behavior that fall outside expectations or norms.

Q. Why are the authorized ROE and the capital structure strong influences on a utility's credit rating?

A. These elements are important for two reasons. From the standpoint of credit metrics, the authorized ROE and capital structure have a clear impact. More supportive determinations of those inputs give a utility a better chance of earning its cost of capital and provide more cash flow for operations. Secondly, investors and rating agencies view these two items as indicators of a regulator's attitude toward the utility's providers of capital.

From the financial market perspective, the authorized ROE is the most prominent feature of a rate case decision after the amount of the rate increase or decrease. The authorized ROE reveals, among other things, the regard that the regulator has toward the investors that are furnishing the capital needed to maintain safe and reliable utility service and achieve other public policy goals. An in-depth analysis of all aspects of the rate decision is required to fully understand the ratings implications of the outcome and assess the utility's ability to earn its return in the wake of the order, but the authorized return is widely used by investors to make preliminary judgments about the relative supportiveness of a regulatory jurisdiction. As such, it is an important signaling device to the investment community and can affect the cost of capital and customer utility rates over the long term.

For fixed-income investors, the equity component in the approved capital structure takes on added importance, as the utility will be constrained in managing its balance sheet by the regulatory capital structure. The utility has no incentive to inject more equity capital to support credit quality and improve ratings than the amount the regulator deems sufficient for ratemaking purposes. In fact, doing so would produce additional, uncompensated capital costs for the utility. The ROE/equity ratio combination is an effective communication tool to underscore a regulator's interest in attracting capital to provide safe, reliable, and innovative utility service in its state.

Q. Are other considerations gaining significant attention by credit rating agencies?

A. Yes. Investors and the rating agencies are increasingly incorporating elements like the state's clean energy initiatives into their analyses and investment decisions. Grouped under an umbrella of risks known as "Environmental, Social, and Governance", or ESG, they were cited as a material credit consideration by

Moody's in a third of its rating actions on private-sector issuers in 2019 and are expected to increase in materiality.[6] More recently Moody's has adopted a carbon transition assessment ("CTA") tool that will be applied to electric utilities.[7] While it is unclear how the CTA scores will be incorporated into the overall credit analyses of electric utilities, it is clear that these considerations will play a larger role as the rating agencies become more comfortable with tools such as the CTA. The near-term stress on balance sheets and credit metrics cannot be ignored, but if well-managed can assist in improving the credit profile of issuers like SPS in the long run.

[6] Moody's, *ESG Focus: Special Coronavirus Edition, Coronavirus Effects 2Q 2020*, July 23, 2020, p. 30.

[7] Moody's, *Assessment Framework, Electric Utilities and Power Generators – Global, Carbon transition assessment framework for electric utilities and power generators*, Nov. 3, 2020.

IV. SPS'S CREDIT RATINGS

Q. What are SPS's credit ratings?

A. My testimony focuses the primary global rating agencies, Moody's and S&P, as they issue ratings that investors rely on the most. I address the basic long-term and short-term credit ratings, the *issuer* ratings, because they measure the risk of default and preserve comparability without introducing ancillary matters that affect individual issue ratings such as recovery and seniority. Default risk is the fundamental risk of an entity. Recovery and seniority affect the degree of an investor's losses only if default occurs and thus are not relevant for this discussion.

Moody's carries an issuer rating of 'Baa2' for SPS.[8] S&P's issuer rating on the Company is 'A-', two notches higher than the Moody's rating due to perceived support from parent company Xcel Energy Inc. (Xcel).[9] S&P also publishes a stand-alone credit profile ("SACP") of bbb+ that is comparable to the Moody's approach to rating an issuer with less emphasis on the influence of the parent.[10] In

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[8] This was recently reviewed and affirmed. Moody's, *Announcement of Periodic Review: Moody's announces completion of a periodic review of ratings of Xcel Energy Inc.*, October 16, 2020.

[9] S&P, *Southwestern Public Service Co.*, Oct. 19, 2020.

[10] The SACP is an intermediate determination in S&P's ratings methodology that signifies what an issuer's rating would be absent extraordinary parental support. S&P, *General Criteria: Stand-Alone Credit Profiles: One Component of a Rating*, September 25, 2020.

my experience, investors look to both evaluations when making investment decisions but tend to place more value on the stand-alone credit quality of the entity they are considering lending money to. The S&P short-term rating is 'A-2'.

Q. How would you describe the general attitude of Moody's and S&P to the SPS credit profile?

A. The specifics of how the SPS-specific credit assessment is determined suggest that the agencies view the Company's risk as slightly below (i.e. more risky) than the average U.S. utility. In parsing the scores assigned to SPS and the commentary surrounding the analysis, I believe one of the drivers of the Company's position among its peers is the agencies' consideration of the regulatory environment in New Mexico. S&P considers New Mexico to be among the most risky jurisdictions in the U.S.[11] The bright spot is that I think the rating agencies and the investment community have begun to see improvement and are open to reconsidering the risk level of New Mexico regulation. Notably, Moody's welcomed the resolution of the Company's previous rate case in New Mexico as an improvement to its credit profile.[12]

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[11] S&P, *Updates and Insights on Regulatory Jurisdictions Shaping Policies for North American Utilities—November 2020*, Nov. 9, 2020, p.2.

[12] Moody's, *Issuer Comment, Southwestern Public Service Company, Southwestern Public Service's rate-case stipulation agreement in New Mexico is credit-positive*, Jan. 17, 2020.

Q. What are those specifics on the rating analyses?

A. For S&P, the business risk profile and financial risk profile combination places SPS roughly in the middle the U.S. utility average.[13] The scoring that brings the assessment down is a peer analysis that S&P performs to fine-tune the analysis.[14] Moody's analysis is similar, where most of its scoring falls along the A/Baa divide with a final step akin to a peer analysis that brings the rating down even further than the S&P evaluation.[15] A notable aspect of its scoring is a sub-investment-grade score for the sufficiency of the Company's rates and returns.[16]

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[13] S&P, *Southwestern Public Service Co.*, Oct. 19, 2020, p. 6.

[14] Id. at 10.

[15] Moody's, *Credit Opinion, Southwestern Public Service Company, Update to credit analysis*, Dec. 20, 2019, Exhibit 8 on page 9.

[16] Ibid.

V. OPTIMIZING THE SPS RATING

Q. What is your recommendation for the rating that should be targeted for SPS?

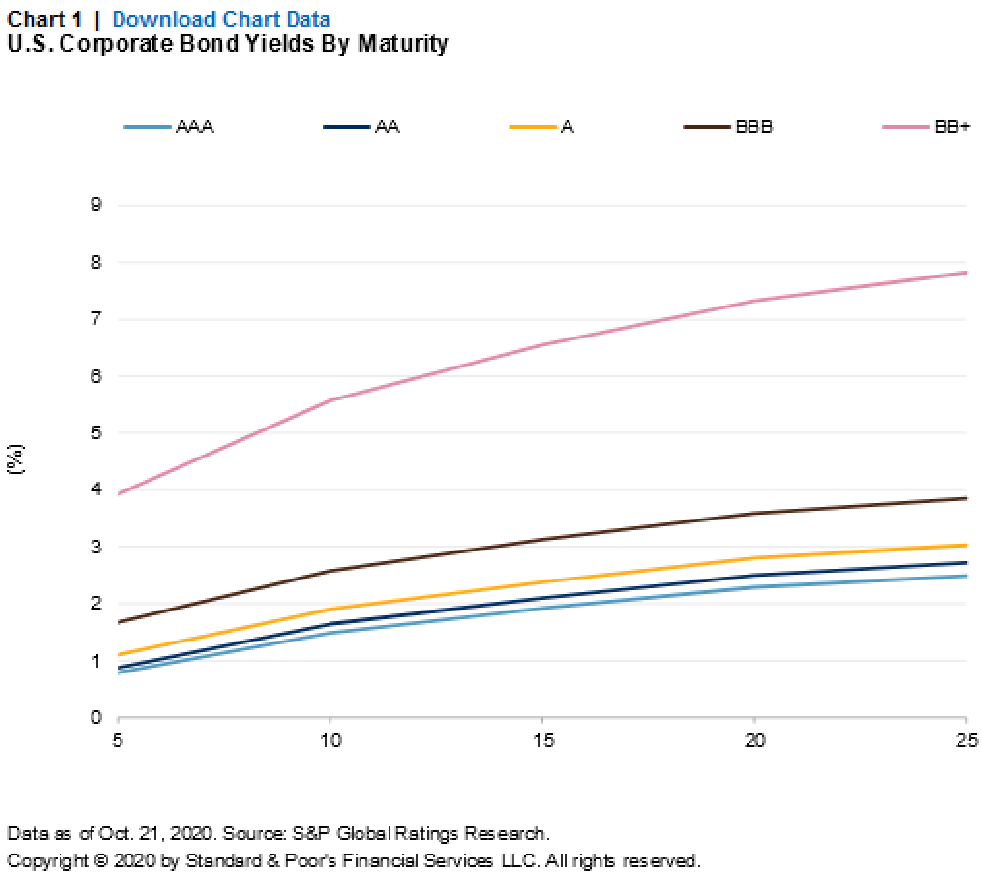
A. The Commission should set a goal of a single-A issuer credit rating for SPS to help guide future decisions that could affect credit quality. Achieving that goal and maintaining that rating would result in a lower cost of capital over time for customers and assure the Company ample access to capital through all economic and credit-market conditions. This recommendation is consistent with Dr. Roger Morin's conclusions regarding the optimal capital structure, considering the interests of the utility and ratepayers alike.[17]

Q. Please discuss in more detail some of the benefits an 'A' rating would produce.

A. The benefit of maintaining a higher credit rating to lower borrowing costs increases as an issuer moves up the rating scale, as shown in the chart below. The incremental benefit of moving up the scale appears on the chart to converge on the 'A' rating category.

[17] *See* the Direct Testimony of Patricia L. Martin, pp. 31-32 and footnote 21.

Chart 1[18]



Q. What is another major benefit to a single-A rating?

A. Getting into the 'A' category is not sufficient to obtain the full ratepayer benefit of better credit quality. Upgrading to an 'A' issuer credit rating, in the middle of the

[18] S&P, *Credit Trends: U.S. Corporate Bond Yields as of Oct. 21, 2020*, Oct. 22, 2020.

category, would raise SPS's short-term rating.[19] Short-term ratings are tied to long-term ratings. In normal markets, that provides adequate access to cost-effective, short-term debt in the commercial paper market. The motivation for 'A-1' short-term ratings is to better ensure equally unfettered access in more stressful market conditions such as those that prevailed during the 2008 financial crisis. Prudent risk management anticipates all contingencies, including infrequent but keenly disruptive markets that impede access to short-term capital for working capital needs and capital expenditures. Increasingly globalized capital and commodity markets have experienced many episodes of varying intensity in the past few decades. Weather events like polar vortexes and fiercely violent wildfires may be related to rising global temperatures. Terrorism acts aimed at the electric grid appear to be a constant threat. In living memory, capital markets have been subject to such disparate and globally dispersed incidents as the 1998 Asian Tiger phenomenon, the 2009 Euro crisis, the 2008 U.S. financial system, and the 2020 COVID-19 pandemic near-collapse that saw widespread bank failures, severe equity market volatility, and constrained capital access for all but the strongest

[19] S&P, *General Criteria: Methodology For Linking Long-Term And Short-Term Ratings,* Aug. 7, 2020.

corporations. An 'A-1' short-term rating would allow SPS to maintain greater access to short-term capital to withstand those kinds of events.

Q. What is the path to an 'A' rating for SPS?

A. Reducing the Company's regulatory risk is the key that will unlock the barrier to better ratings. That kind of effective risk management would permeate throughout the credit analysis to the benefit of the credit profile and ratepayers. As I noted in the last section, the investment community regards New Mexico regulation as less supportive than most other U.S. jurisdictions. This can be seen in the most recent S&P report on regulatory jurisdictions[20] and the regulatory evaluation by RRA.[21] Improving those rankings and New Mexico's standing with the investment community in general would benefit all stakeholders of SPS and other New Mexico utilities and their ratepayers.

The parties and Commission can build on the initial progress made in the last rate case by reaching a result in this case that furthers the Company's ability to

[20] S&P, *Updates and Insights on Regulatory Jurisdictions Shaping Policies for North American Utilities-- November 2020*, Nov. 9, 2020.

[21] S&P Market Intelligence, RRA Regulatory Focus, *State Regulatory Evaluations, Assessments of Regulatory Climate for Energy Utilities*, Aug. 19, 2020.

earn a fair return and maintain its capital structure. That will enable the Company to stabilize its credit metrics, and the Commission and other stakeholders will need to hold the Company accountable to the commitment to improve credit quality.

Q. Should the parties bear in mind any other rating agency sensibilities when gauging regulatory risk?

A. I cannot stress enough the crucial role that ***consistency*** in a regulator's decision making plays in the exercise. I referred to the concept already,[22] but changing their fundamental view of a jurisdiction depends on instilling confidence that trends indicating reduced regulatory risk will be durable. Another way of putting it, which appears in the S&P criteria on rating utilities, is predictability.[23] Consistency and predictability form the core of the first of S&P's four "pillars" of a utility regulatory framework. Given that a rating is at its heart a forward-looking measure of risk, offering the consistency and predictability that contain risk is essential.

[22] *See* Footnote 4.

[23] S&P, *Criteria | Corporates | Utilities: Key Credit Factors for the Regulated Utilities Industry*, Dec. 4, 2019, paragraph 24.

Q. Do the agency methodologies offer more specific guidance on achieving your recommended ratings target?

A. Yes. Moody's and S&P are transparent in the steps they use to establish a rating. A closer review of the scoring that they assign to SPS can provide more color on how to reach an 'A' rating.

Q. What steps would S&P need to take in order to upgrade SPS from 'A-' to 'A'?

A. Recall that the S&P methodology has essentially two basic elements, business risk and financial risk, that when combined can be further refined with a series of modifiers, the most common of which can move ratings a notch upward or downward in a peer analysis. That last step, called a comparable rating analysis ("CRA"), now used to negatively affect the SPS credit profile, must be changed progressively to neutral and then a positive rating factor. This can be altered by improving SPS's financial and business risks to address the CRA. On the financial side, higher authorized ROEs and a strong capital structure will help improve credit metrics. Business risk is a matter of regulatory risk. As discussed above, consistency in authorizing the types of supportive regulatory outcomes is critical to improving regulatory risk. Progress on both sides of the credit equation will sustain the advances made in the last rate case and continue process of making the peer analysis a positive ratings influence.

Q. You identify credit metric improvement as a key to the rating goal. What is impeding that improvement besides the Company's financial performance?

A. In addition to better returns and a strong capital structure, it is important to understand that off-balance-sheet adjustments that rating agencies make to SPS's reported financial results have a significant impact. For instance, the three primary S&P adjustments – for lease obligations, purchased power debt equivalency, and asset retirement obligations – add a third more adjusted debt to the Company's actual debt balances.[24] Regulators should keep that in mind when gauging the level of financial support needed to achieve better ratings.

Q. How do you think Moody's would upgrade SPS from 'Baa2' to 'A'?

A. Moody's does not break out its analysis into the two constituent parts like S&P does. Instead the analysis proceeds along a series of scores that roughly correspond to the business risk/financial risk factors that we saw in the S&P analysis. The final step is not transparent but incorporates many of the refinements that appear as modifiers in the S&P methodology. That last step acts to similarly adjust the basic conclusion for the many intangibles that do not fit into the basic Moody's scorecard.

[24] Martin, Direct Testimony, pp. 29-30.

Given that the path to ‘A’ for SPS involves more notches for Moody’s than for S&P, reaching the goal is a bigger stretch and will take a more sustained effort.

Moody’s gives us a clearer pathway, however, because the transparent scoring phase of the analysis contains a glaring disparity that could lead to higher ratings addressed. Moody’s assigns a lower score in areas such as “Consistency and Predictability of Regulation” and “Sufficiency of Rates and Returns”.[25] The latter is where the scoring is especially low, a ‘Ba’ score that is below investment-grade territory. Concentrating on better authorized returns and ratemaking decisions that improve the Company’s ability to reliably earn those returns would give Moody’s the confidence to raise both scores. The resulting stronger financial performance from higher ROEs and a strong capital structure, combined with consistent improvement in regulatory risk, would allow SPS to rise into the ‘A’ category. The positive trend in both would help persuade Moody’s to assign a rating that corresponds to the indicated outcome.

[25] Moody’s, *Credit Opinion, Southwestern Public Service Company, Update to Credit Analysis*, Dec. 20, 2019, Exhibit 8 on page 9.

Q. Is SPS poised to realize that financial improvement?

A. It would take sustained improvement to reach an A rating, and a ratings upgrade in the near term is unlikely. As Ms. Martin describes, at SPS's requested capital structure, its projected financial metrics would merely begin to approach the middle to upper reaches of the ranges for the 'Baa' score category in the two prominent credit metrics (CFO pre-working capital/Debt, before and after common dividends).[26] Thus, under those assumptions, SPS's credit rating would be unlikely to immediately increase. Its current ratings are apt to be sticky because, as Moody's always notes, the 'Financial Strength' scoring is based on metrics achieved "on a sustained basis."[27] That acts as a firm reminder that the improved financial performance that a constructive decision in this case can facilitate must be accompanied by continual improvement in regulatory risk. With the previous decision having met with approbation by Moody's,[28] I think another decision consistent with it would enhance the regulatory risk factor, which would improve SPS's opportunity to receive a ratings upgrade.

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[26] Martin, Direct testimony, pp. 28-29.

[27] Moody's, *Credit Opinion*, Dec. 20, 2019, p. 2

[28] Moody's, *Issuer Comment*, Jan. 17, 2020.

Q. Does this conclude your pre-filed direct testimony?

A. Yes.

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF SOUTHWESTERN PUBLIC SERVICE COMPANY'S APPLICATION FOR: (1) REVISION OF ITS RETAIL RATES UNDER ADVICE NOTICE NO. 292; (2) AUTHORIZATION AND APPROVAL TO ABANDON ITS PLANT X UNIT 3 GENERATING STATION; AND (3) OTHER ASSOCIATED RELIEF,	**)**	**CASE NO. 20-00238-UT**
SOUTHWESTERN PUBLIC SERVICE COMPANY,	**)**	
APPLICANT.	**)**	

VERIFICATION

On this day, December 31, 2020, I, Todd A. Shipman, swear and affirm under penalty of perjury under the law of the State of New Mexico, that my testimony contained in Direct Testimony of Todd A. Shipman is true and correct.

/s/ Todd A. Shipman
TODD A. SHIPMAN

TODD A. SHIPMAN, CFA

tshipman@utility-credit.com
857.260.0656

Experience

Utility Credit Consultancy LLC **Orleans, MA**

Principal May 2018 - Present

Founded a consulting firm to provide utilities with expert witness services and advice on capital market strategies. Specialize in capital markets issues, credit rating advisory, and hybrid securities.

Boston University **Boston, MA**

Lecturer January 2017 – June 2020

Adjunct faculty member in the Questrom School of Business, Department of Finance. Taught advanced undergraduate finance courses covering capital markets, monetary and economic policy, and corporate finance.

S&P Global Ratings **New York, NY and Boston, MA**

Senior Director April 2014 - May 2018
Director April 2000 - April 2014
Associate Director March 1997 - April 2000

Sector Specialist on the Global Infrastructure Ratings North American Utilities team. Performed credit surveillance of utilities, pipelines, midstream energy, and diversified energy companies. Chaired most team rating committees. Wrote credit reports and commentaries and led outreach efforts to investors and the regulatory community, including speeches and training seminars. Lead analytical role developing global rating criteria for utilities, master limited partnerships, and hybrid capital securities.

Electric Utility Research Inc (defunct), San Francisco, CA

Senior Vice President May 1996 - March 1997

Edited and contributed to an investor newsletter covering the electric utility industry

Sithe Energies Inc. **New York, NY**

Manager, Regulatory Affairs November 1993 - May 1996

Managed state regulatory matters for a major independent power company. Coordinated interventions in regulatory proceedings. Assisted in identifying development opportunities. Participated in investor relations activities.

Regulatory Research Associates **Jersey City, NJ**

Vice President October 1993 - November 1993
Senior Analyst August 1989 - October 1993
Analyst August 1985 - August 1989

Analyzed and reported on actions by state regulators affecting the financial status of electric, gas, and telephone utilities for a firm that provided research to the Wall St. community. Contributed to the firm's sell-side research.

Education

J.D., Texas Tech University School of Law, Lubbock, TX	May 1984
B.B.A., Texas Christian University, Fort Worth, TX	May 1981

Professional Affiliations & Other Activities

Executive Advisor, Concentric Energy Advisors, Marlborough MA

Chartered Financial Analyst

Wall Street Utility Group

Fixed Income Analysts Society Inc

Society of Utility and Regulatory Financial Analysts

Other Activities

Board of Directors, The Good Shepherd School, Charlestown, MA

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FILINGS

Unless otherwise noted, the proceeding was a rate case.

Company: Hawaiian Electric Companies
State: Hawaii
Docket/Proceeding: # 2018-0088, *Instituting a Proceeding to Investigate Performance-Based Regulation*
Date: October 25, 2018
Submittal: Regulatory Assessment Brief (Appendix: Effect of Major Regulatory Reform on Credit Quality)

Company: Wisconsin Electric Power Co. / Wisconsin Gas LLC
State: Wisconsin
Docket/Proceeding: #05-UR-109
Date: March 28, 2019 / September 17, 2019
Submittal: Direct and Rebuttal Testimony

Company: Wisconsin Public Service Corp.
State: Wisconsin
Docket/Proceeding: #6690-UR-126
Date: March 28, 2019
Submittal: Direct Testimony

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FILINGS

Company: San Diego Gas & Electric Co.
State: California
Docket/Proceeding: #A.19-04-017 (Cost of Capital)
Date: April 2019 / August 1, 2019 / August 21, 2019
Submittal: Direct, Supplemental, and Rebuttal Testimony

Company: Consolidated Edison of New York Co.
State: New York
Docket/Proceeding: #19-E-0065 & 19-G-0066
Date: June 14, 2019
Submittal: Rebuttal Testimony

Company: Roanoke Gas Co.
State: Virginia
Docket/Proceeding: #PUR-2018-00013
Date: July 30, 2019
Submittal: Rebuttal Testimony

Company: Hawaii Electric Light Co.
State: Hawaii
Docket/Proceeding: #2018-0368
Date: October 9, 2019
Submittal: Rebuttal Testimony

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FILINGS

Company: Mississippi Power Co.
State: Mississippi
Docket/Proceeding: #2019-UN-219
Date: November 26, 2019
Submittal: Direct Testimony

Company: Southwestern Public Service Co.
State: New Mexico
Docket/Proceeding: #19-00170-UT
Date: December 20, 2019
Submittal: *Rebuttal Testimony*

Company: Southwestern Public Service Co.
State: Texas
Docket/Proceeding: #49831
Date: March 11, 2020
Submittal: Rebuttal Testimony

Company: Southwest Gas Corp
State: Arizona
Docket/Proceeding: #G-01551A-19-0055
Date: March 11, 2020
Submittal: Rebuttal Testimony

Utility
Credit
Consultancy LLC

FILINGS

Company: Hawaiian Electric Companies
State: Hawaii
Docket/Proceeding: # 2018-0088, *Instituting a Proceeding to Investigate Performance-Based Regulation*
Date: June 18, 2020
Submittal: Phase 2 Statement of Position (Exhibit C2: Financial Integrity and Credit Ratings)

Company: Arizona Public Service Co.
State: Arizona
Docket/Proceeding: #E-01345A-19-0236
Date: November 6, 2020
Submittal: Rebuttal Testimony

EXHIBIT TAS-R-3

RATINGS SCALES

MOODY'S INVESTOR SERVICE	S&P GLOBAL RATINGS
Aaa	AAA
Aa1	AA+
Aa2	AA
Aa3	AA-
A1	A+
A2	A
A3	A-
Baa1	BBB+
Baa2	BBB
Baa3	BBB-
Ba1	BB+
Ba2	BB
Ba3	BB-
B1	B+
B2	B
B3	B-
Caa1	CCC+
Caa2	CCC
Caa3	CCC-
Ca	CC
C	C
D	D