BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

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IN THE MATTER OF ADVICE NO. 993-GAS OF PUBLIC SERVICE COMPANY OF COLORADO TO REVISE ITS COLORADO PUC NO. 6-GAS TARIFF TO INCREASE JURISDICTIONAL BASE RATE REVENUES, IMPLEMENT NEW BASE RATES FOR ALL GAS RATE SCHEDULES, AND MAKE OTHER PROPOSED TARIFF CHANGES EFFECTIVE FEBRUARY 24, 2022	)	**PROCEEDING NO. 22AL-_____G**

DIRECT TESTIMONY AND ATTACHMENTS OF PAUL A. JOHNSON

ON

BEHALF OF

PUBLIC SERVICE COMPANY OF COLORADO

January 24, 2022

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO**

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DIRECT TESTIMONY AND ATTACHMENTS OF PAUL A. JOHNSON

I. INTRODUCTION, QUALIFICATIONS, PURPOSE OF TESTIMONY, AND RECOMMENDATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Paul A. Johnson. My business address is 401 Nicollet Mall, Minneapolis, Minnesota 55401.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?

A. I am employed by Xcel Energy Services Inc. ("XES") as Vice President, Treasurer and Investor Relations. XES, which is a wholly-owned subsidiary of Xcel Energy Inc. ("Xcel Energy"), provides an array of support services to Public Service

Company of Colorado ("Public Service" or the "Company") and the other utility operating company subsidiaries of Xcel Energy on a coordinated basis.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THE PROCEEDING?

A. I am testifying on behalf of Public Service.

Q. PLEASE SUMMARIZE YOUR RESPONSIBILITIES AND QUALIFICATIONS.

A. As Vice President of Investor Relations and Treasurer, I am responsible for recommending and implementing the financing required to achieve target capital structure objectives at each of the regulated utility operating companies and at Xcel Energy. I am also responsible for corporate cash forecasting and management, pension plan management, hazard risk insurance, treasury services, and financial policies. In addition, I am responsible for developing and maintaining relationships with investors, investor analysts, and internal and external stakeholders to ensure that investors have accurate and appropriate information to ensure that they are well informed to make financial or investment decisions. I also am responsible for working with the various credit rating agencies and providing timely updates as required. A description of my qualifications, duties, and responsibilities is set forth after the conclusion of my testimony in my Statement of Qualifications.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my testimony is to support Public Service's forecasted Weighted Average Cost of Capital ("WACC") for the test year ending December 31, 2022

("Current Test Year" or "CTY"), as shown in Table PAJ-D-1, below. The requested Return on Equity ("ROE") of 10.25 percent for the CTY is further supported by Company witness Ms. Ann E. Bulkley in her Direct Testimony.

TABLE PAJ-D-1: Requested WACC

		As of December 31, 2022[1]	
	Ratio	**Rate**	**Wtd Cost**
Long-Term Debt	43.13%	3.73%	1.61%
Short-Term Debt	1.21%	0.79%	0.01%
Equity	55.66%	10.25%	5.71%
		Total Cost	**7.33%**

The 13-month average equity ratio included in the requested WACC is consistent with the settled equity ratio authorized by the Commission in the Company's most recent gas rate case, its 2020 Phase I and Phase II Gas Rate Case (Proceeding No. 20AL-0049G) ("2020 Combined Gas Rate Case").[2] The equity ratio authorized in the 2020 Combined Gas Rate Case is within four basis points of what the Company is requesting in this proceeding (i.e., 55.66 percent as requested as compared to the currently authorized equity ratio of 55.62 percent). Additionally, the 55.66 percent equity ratio requested in this proceeding is the Company's forecasted actual equity ratio for the CTY. Based on current

[1] Forecasted 13-month average equity, long-term debt, and short-term debt balances, as well as 13-month average cost of long-term and short-term debt as of the proposed CTY ending December 31, 2022.
[2] Proceeding No. 19AL-0268E, Decision No. C20-0096 (mailed date Feb. 11, 2020), Ordering Paragraph 118.

information and assumptions, the Company expects to continue to manage to this capital structure for the foreseeable future as it supports our current credit rating and financing integrity. It is based on a tested, data-driven, and market-based approach and reflects the capital structure that the Company will actually manage to in order to continue to provide long-term benefits to Colorado customers in the form of safe, reliable and affordable gas service over time.

The 13-month average cost of debt included in the requested WACC appropriately aligns with the composition of the capital structure by using the 13-month average costs of long-term and short-term debt as of December 31, 2022.

Most importantly, the Company is requesting a capital structure and overall WACC that positions it to continue to attract capital at favorable rates, lowering the overall cost of debt ultimately paid by customers and to help support and maintain the Company's credit metrics and overall financial integrity.

Q. WHAT TOPICS DO YOU DISCUSS IN SUPPORT OF THOSE RECOMMENDATIONS?

A. I discuss numerous topics related to the Company's cost of capital in my Direct Testimony. In particular, I:

1. Discuss the importance of financial integrity to Public Service, its customers and its other stakeholders, and the need for Public Service to maintain stable financial health in order to access capital markets and raise capital in varied economic conditions and at reasonable costs;

2. Discuss the criteria that the credit rating agencies use to measure financial integrity;

3. Provide a current assessment of Public Service's financial integrity and describe the impact that regulatory decisions, changes in cash flow, and the timely recovery of prudent utility costs have on Public Service's financial integrity;

4. Present and support the use of a 13-month average capital structure, a 13-month average cost of long-term debt, and 13-month average cost of short-term debt for the Gas Department for CTY ending December 31, 2022;

5. Present and support the recommended 7.33 percent WACC for the Gas Department for the CTY ending December 31, 2022.

I also present and support the 13-month average capital structure, 13-month average cost of long-term debt, and 13-month average cost of short-term debt for the Gas Department for the informational 2021 historical test year consisting of the 12-month period ending June 30, 2021 ("HTY"). All of these averages are based on actuals, and result in the 7.67 percent WACC for the Gas Department that Company witness Mr. Arthur P. Freitas uses in the 2021 HTY.

Q. ARE YOU SPONSORING ANY ATTACHMENTS AS PART OF YOUR DIRECT TESTIMONY?

A. Yes, I am sponsoring the following attachments:

- Attachment PAJ-1, which is a description of the major credit rating agencies' credit ratings;

- Attachment PAJ-2, which is a Moody's Investors Service ("Moody's") publication entitled *Rating Methodology: Regulated Electric and Gas Utilities*;

- Attachment PAJ-3, which is a Standard & Poor's ("S&P's") publication entitled *Key Credit Factors for the Regulated Utilities Industry*;

- Attachment PAJ-4, which is an S&P publication entitled *Corporate Methodology: Ratios and Adjustments*;

- Attachment PAJ-5, which is a Moody's publication entitled *Credit Opinion: Public Service Company of Colorado.*

- Attachment PAJ-6, which presents Public Service's recommended capital structure, cost of capital, and cost of long term and short-term debt as of the CTY ending December 31, 2022, and the resulting WACC; and

- Attachment PAJ-7, which presents Public Service's capital structure, cost of capital, and cost of long term and short-term debt as of June 30, 2021, and the resulting WACC. This capital structure is for informational purposes only.

Q. ARE YOU THE ONLY PUBLIC SERVICE WITNESS SPONSORING TESTIMONY RELATED TO PUBLIC SERVICE'S COST OF CAPITAL?

A. No. Ms. Bulkley is presenting testimony regarding Public Service's required ROE, and she addresses capital structure as well.

II. FINANCIAL INTEGRITY, RATING AGENCY METHODOLOGIES, APPLICATION TO PUBLIC SERVICE

Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR DIRECT TESTIMONY?

A. In this section of my Direct Testimony, I will:

- Discuss financial integrity and the importance of maintaining it over time so the utility can serve and respond to customer needs;
- Provide a current assessment of Public Service's financial integrity and the related impact to Public Service's customers;
- Identify both how Public Service is working to maintain its financial integrity and how its financial integrity could be strengthened through a supportive regulatory decision in this case; and
- Present and support the recommended capital structure comprised of 55.66 percent equity, 43.13 percent long-term debt, and 1.21 percent short-term debt, and the 7.33 percent WACC for the CTY ending December 31, 2022.

A. Financial Integrity

Q. WHAT IS FINANCIAL INTEGRITY?

A. As used in my Direct Testimony, "financial integrity" refers to a company's financial strength and its ability to attract capital at reasonable rates to support ongoing operations and infrastructure investment in various market conditions. The ability to attract capital at a reasonable cost in varying market conditions is essential for a utility to be able to fulfill its obligation to provide safe and reliable utility service to customers. Achieving and maintaining strong financial integrity ensures that a utility will have the flexibility and liquidity needed to withstand and access the capital markets during negative unanticipated macroeconomic events outside of

its control, such as the COVID-19 pandemic, abnormal events such as Winter Storm Uri and wildfires, and economic downturns and situations when the capital markets are under financial distress.

Q. HOW DOES MAINTAINING FINANCIAL INTEGRITY BENEFIT PUBLIC SERVICE'S CUSTOMERS?

A. Financial integrity directly affects both the Company's ability to access capital to ensure liquidity for day-to-day operations and fund necessary investments on behalf of customers, and the cost of that capital ultimately included in overall rates. Attracting reasonably priced capital in all market conditions, including following unexpected macroeconomic events outside the Company's control, is critical to being able to invest in the infrastructure necessary for Public Service to provide safe and reliable utility service.

It is important to note that the question of a utility's financial integrity is not necessarily binary (i.e., does a utility have financial integrity or not?); rather, the degree of financial integrity and therefore the cost of capital available to a utility lies on a spectrum. Weaker financial integrity at a utility increases the issued cost of debt and the implied cost of equity, which increases the overall WACC and the ultimate financing costs that are paid by customers. Weaker financial integrity can also limit liquidity and access to capital markets, particularly in times of financial distress. Stronger financial integrity produces the opposite effects, which in turn benefits customers.

Q. HOW DO THESE PRINCIPLES AFFECT THIS RATE CASE?

A. This case is particularly important, as Public Service is making significant investments to make the natural gas system more resilient and to aggressively pursue important policy goals around reduced greenhouse gas emissions. The Company must raise significant outside capital to finance the investments in these customer-benefitting clean-energy initiatives. Consequently, it is important for the Company's capital structure and overall financial integrity to illustrate to credit rating agencies and investors that Public Service represents a high-quality investment. To these ends, the Commission's approval of Public Service's requested 7.33 percent WACC and requested equity ratio would support Public Service's current investment grade credit ratings and demonstrate ratemaking consistency and predictability.

B. Factors Impacting Financial Integrity

Q. WHAT FACTORS CONTRIBUTE TO A UTILITY'S FINANCIAL INTEGRITY?

A. The financial integrity of a regulated utility is largely a function of its capital structure, ROE, and cash flow, but other factors can also affect it. To maintain strong financial health, a utility needs to have the opportunity to recover all prudently-incurred utility costs in a timely manner, which includes not only the costs of capital investments and operations and maintenance expense, but also the costs of servicing debt and providing a fair return for equity investors.

Q. HOW DO REGULATORY OUTCOMES IMPACT FINANCIAL INTEGRITY AND INFLUENCE INVESTOR DECISIONS?

A. Regulatory outcomes affect both a utility's financial integrity and investor decisions in multiple ways. A commission's decisions about the costs a utility may recover and the timing in which they are able to recover, its revenues, and the components of its WACC affect the utility's cash flows and debt levels, which in turn affect both the utility's financial health and the metrics against which rating agencies specifically measure a utility's financial integrity and establish its credit ratings. In turn, these credit ratings – combined with the returns on equity investments authorized by a commission's decisions – affect investors' willingness to provide capital to the utility ultimately used to support its business and provide service to customers. Additionally, rating agencies' stated perceptions of a commission's decisions further impact investors' willingness to invest in a utility.

Q. PLEASE EXPLAIN IN MORE DETAIL HOW CREDIT RATINGS ARE RELATED TO FINANCIAL INTEGRITY.

A. Credit ratings are an independent assessment and indicate a utility's financial integrity. Rating agencies determine credit ratings, which investors use to assist in making investment decisions, including 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 over time. A utility's credit ratings become an indicator of that utility's financial integrity to the

investor community. Thus, a utility's credit ratings impact its ability to access capital on reasonable terms. This is especially true at times when the capital markets are under financial distress.

Q. CAN YOU PROVIDE MORE DISCUSSION OF HOW A UTILITY'S CREDIT RATINGS AFFECT ITS ABILITY TO ACCESS CAPITAL ON REASONABLE TERMS?

A. Yes. More specifically, a credit rating measures credit risk, which is the ability and willingness of an issuer to fulfill its financial obligations in full and on time. Ratings address the relative probability that an issuer or an issue will experience default, i.e. the failure to pay either the required periodic interest payment or the principal when it comes due.

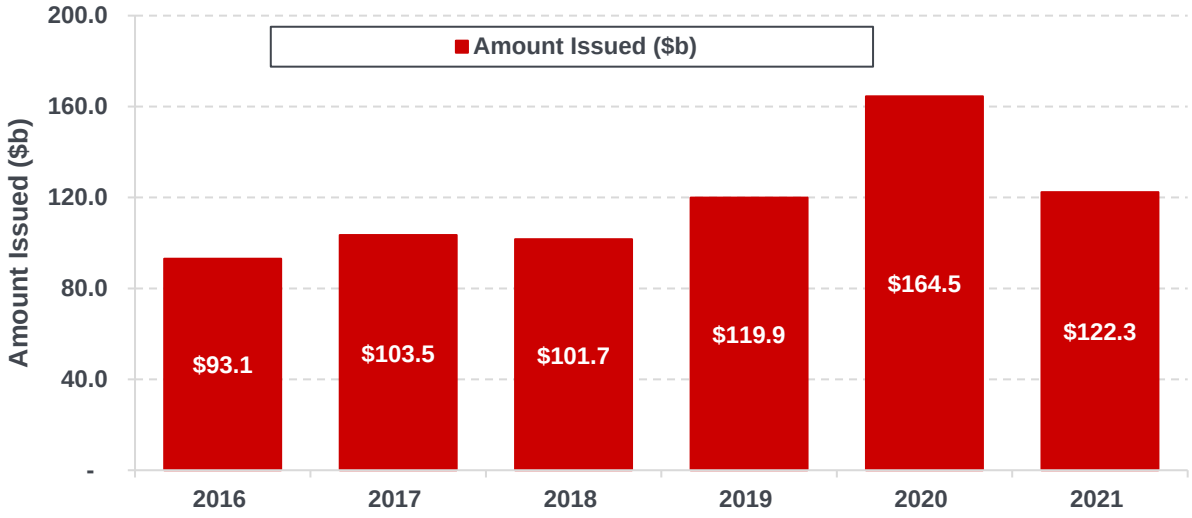
Credit ratings project a long-term view of a company's financial health. Ratings are also an independent opinion offered by firms that have no direct financial stake in the outcome of their analyses. The long-term and independent nature of credit ratings make them an ideal benchmark to help utility regulators navigate through the many decisions they must make in the course of reaching balanced and constructive outcomes.

Q. HOW DOES THIS RELATE TO THE UTILITY SECTOR?

A. Utilities must not only compete for capital with other utilities, but also with non-utility companies. Additionally, utilities tend to require significant amounts of capital to fund capital infrastructure investments that are critical to providing safe and reliable gas service to customers.

During the period 2016 to 2021[3], debt investors have provided approximately $676 billion of capital investment to the U.S. utility sector. See Chart PAJ-D-1 below.

CHART PAJ-D-1:
2016 – 2021 Debt Amount Issued to the U.S. Utility Sector



In order to attract capital at favorable rates in such a competitive environment, protecting and maintaining Public Service's credit ratings is critical.

[3] Source: Bloomberg.

Q. HOW DO RECENT ECONOMIC CONDITIONS UNDERSCORE A UTILITY'S NEED FOR FINANCIAL INTEGRITY?

A. The need for access to capital becomes even more relevant in a volatile market environment, as recently evidenced during the COVID-19 pandemic and its impact on capital markets, as discussed later in this testimony. Utilities with higher credit ratings are associated with reduced risk, which generally attracts investors at a lower cost of debt (i.e., lower average credit spreads) and favorably positions a utility relative to lower-rated comparable companies. Generally, the stronger the Company's credit ratings, the larger the pool of investors willing to consider investing in Public Service's debt and a larger pool of investors leads to increased investor demand during a bond issuance. More demand can place added pressure on investors to accept a lower interest rate, which can ultimately lead to a lower overall cost of long-term debt paid by Public Service's customers. Investment-grade credit ratings are crucial because the cost of debt increases very rapidly – and the number of potential investors decreases substantially – for those companies rated near the bottom of or below investment grade.

Further, credit ratings take on greater importance when economic conditions worsen and credit becomes more difficult to obtain. As credit availability tightens, investors become increasingly more selective regarding which companies qualify for their investment dollars. Therefore, lower credit ratings

reduce or eliminate access to capital markets and increase the expense of obtaining capital.

Q. HOW CAN CREDIT RATINGS AFFECT PUBLIC SERVICE COMPANY'S COST OF CAPITAL?

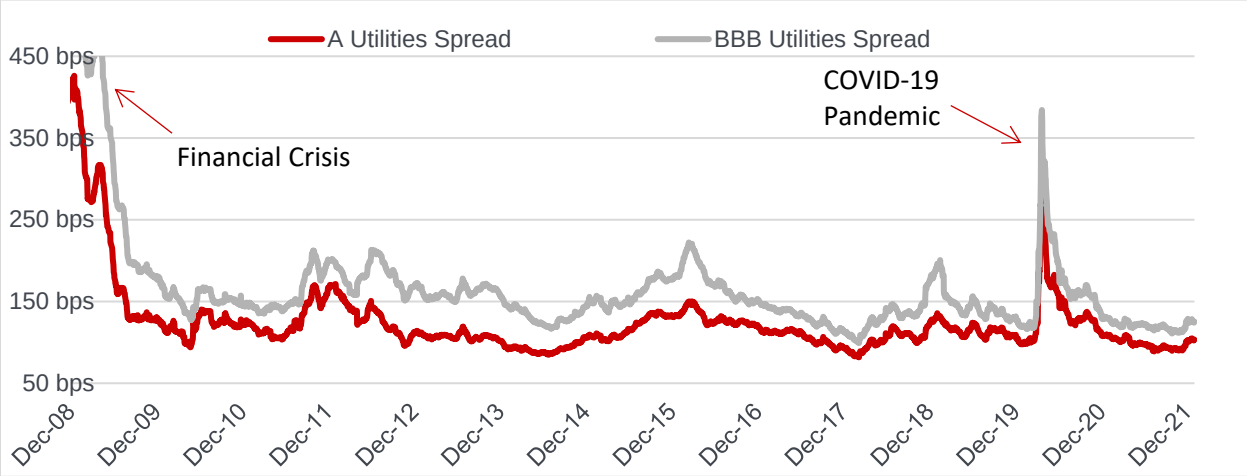
A. Long-term debt is priced based on the underlying Treasury rate plus a credit spread, which is primarily based on Public Service's credit rating and investors perception of the Company, including its regulatory environment. In general, the lower the credit rating, the higher the credit spread. Issuing debt at a higher rate will increase the cost of long-term debt for Public Service, which is ultimately paid by Public Service's customers.

Equity investors also look at credit ratings. Because the income available to common equity holders is subordinate to debt obligations, the weakening of a company's creditworthiness also increases the cost of equity. Bond and credit ratings are reflective of the types of risks faced by debt holders, and lower credit ratings generally correspond to higher required returns on equity to compensate for higher risk.

Q. DO CREDIT SPREADS DIFFER BASED ON CREDIT RATINGS?

A. Yes. Lower credit ratings are seen as riskier and therefore investors demand a higher spread. Chart PAJ-D-2 below shows that in general, the credit spreads of BBB rated utility companies are historically wider than those of A rated utility companies, especially in times of market volatility.

CHART PAJ-D-2: A vs. BBB Rated Utility Spreads
December 2008 – December 2021



Source: Bloomberg

For example, the average difference in credit spreads between A and BBB rated utilities over the course of December 2008 to December 2021 is approximately 40 basis points. However, in periods of market volatility, the credit spread difference between A and BBB rated utilities can increase dramatically. For example, in June 2009, the average difference in credit spreads between A and BBB rated utilities was approximately 100 basis points. More recently, In the month following March 2020, due to the market volatility related to the COVID-19 pandemic, the difference in credit spreads was approximately 75 basis points.

Q. CAN YOU GIVE OTHER EXAMPLES OF THE IMPORTANCE OF STRONG CREDIT METRICS TO PROTECT CUSTOMERS AGAINST PERIODS OF VOLATILITY AND PRESERVE ACCESS TO FINANCIAL MARKETS?

A. Yes. By way of further example, the COVID-19 pandemic introduced volatility into the market and made it challenging for companies to access capital, regardless of credit rating. Due to this market volatility, the investment grade markets were inaccessible the week of February 24, 2020, with no issuances coming to market.

During this time, investment grade issuers were not willing to issue given market volatility and pricing risk. The following week, while some issuers were able to access the markets and issue $31 billion of debt, the cost to issue that debt was elevated. As discussed above, in March 2020, the credit spread increased at an average spread of approximately 75 basis points due to the pandemic. This illustrates the importance of maintaining financial integrity in order to manage through all market conditions, and that companies with higher credit ratings will have more financial flexibility to fund operations at lower costs.

While the world may have moved past the COVID-19 pandemic's initial liquidity crisis, this event is crucial for the Commission to consider because it illustrated how Public Service's financial integrity and strong credit metrics positioned the Company to deliver on its capital investments even in a time of unexpected macroeconomic crises disrupting the financial markets. Additionally, during such unexpected macroeconomic events, there typically is not meaningful

time for the Company and the Commission to discuss how to best adjust the Company's capital structure, as needed, to protect it and the customers in which it serves. As such, the Commission and the Company should continue to seek balanced and constructive outcomes that will continue to adequately insulate Public Service from these risks so that the utility can continue to serve its customers in a reliable, safe, and affordable manner no matter economic conditions.

C. Rating Agency Methodologies

Q. CAN YOU EXPLAIN CREDIT RATINGS IN MORE DETAIL?

A. Yes. A credit rating measures credit risk, which is the ability and willingness of an issuer to fulfill its financial obligations in full and on time. A portion of the analysis that goes into the credit rating includes a forward-looking forecast of operating income, internally generated cash flows, and debt burden.

Credit rating agencies publish credit analyses of the issuers and issuances to explain the ratings to the investment community. 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 major rating agencies appear in Attachment PAJ-1.

Q. HOW IS A CREDIT RATING ESTABLISHED?

A. Credit ratings are established through both qualitative and quantitative analysis. The qualitative side is the assessment of business risk, which is built up from the

broad macro-environment risks at the country and industry level. For a utility, regulatory risk is the most significant overall business risk, as I describe below. The issuer's more specific risk within its business and economic environment is then determined. The quantitative side of the analysis examines financial ratios to analyze the financial risk of the issuer.

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 specific rating. Because utilities are subject to regulation, qualitative analysis—specifically, regulatory risk—is a key consideration in ratings outcomes.[4]

Q. HOW IS REGULATORY RISK ANALYZED?

A. For Moody's, regulatory risk constitutes up to 60 percent of the credit profile, and for S&P it is up to 80 percent.[5] Both focus on the basic regulatory framework, including (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

[4] Attachment PAJ-2 at 3; Attachment PAJ-3 at 6.
[5] Attachment PAJ-2 at 4 (Regulatory Framework (25%) plus Ability to Cover Costs and Earn Returns (25%) plus Diversification (10%); Attachment PAJ-3 at 6,9 (Competitive Advantage (60%) plus Scale, Scope and Diversity (20%).

procedures. Rating agencies then examine the mechanics of regulation, particularly the rate-setting process.

Q. ARE THE FRAMEWORK AND THE MECHANICS OF REGULATION THE ONLY CONSIDERATIONS IN DETERMINING REGULATORY RISK?

A. No. Rating agencies also place high value on transparency, predictability, and consistency in regulation.[6] 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 timeframe as possible. Utilities ultimately fund capital expenditures primarily with long-dated maturities to match the long-lived assets they are supporting, and utility investors value ratings that are 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.

Q. HAVE CREDIT RATING AGENCIES COMMENTED ON THE IMPORTANCE OF THE REGULATORY FRAMEWORK IN EVALUATING A UTILITY'S FINANCIAL INTEGRITY?

A. Yes. S&P has noted that the regulatory framework "is of critical importance when

[6] Attachment PAJ-2 at 10; Attachment PAJ-3 at 6-8.

assessing regulated utilities' credit risk because it defines the environment in which a utility operates and has a significant bearing on a utility's financial performance."[7] S&P observes further that "we base our assessment of the regulatory framework's relative credit supportiveness on our view of how regulatory stability, efficiency of tariff setting procedures, financial stability, and regulatory independence protect a utility's credit quality and its ability to recover its costs and earn a timely return."[8]

Q. WHAT FINANCIAL CONSIDERATIONS CONSTITUTE THE QUANTITATIVE SIDE OF CREDIT ANALYSIS?

A. Credit analysis is distinguished by its emphasis on cash flow. Recognizing that servicing debt requires not just earnings but actual cash, credit analysts strive to understand the cash-flow dynamics of a company's financial results as much as or more than the earnings. A recent example of this was 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 of it.[9] The other major element of financial risk to a credit analyst is the total amount of debt or debt-like obligations, also referred to as off-balance sheet debt, on the issuer's balance

[7] Attachment PAJ-3 at 6.
[8] Attachment PAJ-3 at 6.
[9] For Moody's, the measurement is called "CFO pre-Working Capital-to-Debt." S&P has a similar measure, called "Funds-From-Operations" ("FFO"), which they also compare to the overall debt burden.

sheet. Items that the rating agencies regard as debt-like include lease liabilities, long-term power purchase obligations, pension obligations, and asset-retirement obligations.

Q. WHAT ARE THE PRIMARY FINANCIAL METRICS THAT CREDIT RATING AGENCIES ANALYZE?

A. The primary financial metrics evaluated by the major credit rating agencies include some version of the following coverage ratios: (i) the ratio of FFO or CFO to total debt ("FFO/Debt" or "CFO/Debt"); (ii) the ratio of FFO or CFO to interest ("FFO/Interest" or "CFO/Interest"); and (iii) the ratio of debt to earnings before interest, taxes, depreciation, and amortization ("Debt/EBITDA"). These financial metrics are a composite measure of the utility's ability to manage its debt burden over time and to meet its financial obligations as they come due. The greater the business risk of a particular company, the stronger these financial metrics must be to provide sufficient evidence to the credit rating agencies and investors that the company can withstand the financial effect of both macroeconomic and company-specific risks.

Q. WHAT TYPES OF DEBT OBLIGATIONS DO RATING AGENCIES INCLUDE IN THEIR CREDIT METRICS CALCULATIONS?

A. The total debt calculated by rating agencies includes amounts for debt and debt-like obligations, including on-balance sheet obligations such as finance and operating leases as well as off-balance sheet obligations. Off-balance sheet

obligations are payment obligations (as discussed earlier, these include items such as long-term purchase power agreements, pension obligations, and asset retirement obligations) that do not appear on the balance sheet as debt; however, rating agencies may treat them as debt because the utility has little or no discretion whether to pay for these obligations.[10] In 2020, S&P imputed significant additional debt onto Public Service's balance sheet for off-balance sheet obligations. The majority of those costs were related to PPAs and leases.

Q. WHAT IS THE SIGNIFICANCE TO THIS RATE CASE OF THE RATIOS THE CREDIT RATING AGENCIES EVALUATE?

A. This rate case outcome will affect the financial ratios. The ratios help rating agencies and investors determine whether a company will be able to service its existing debt obligations at the required level and will have the flexibility to take on incremental debt. Including existing off-balance sheet obligations in calculating a company's total debt affects many of the financial metrics the rating agencies rely upon. In general, the higher the proportion of debt in a capital structure, the more downward pressure on cash flow metrics and credit ratings, and upward pressure on cost of capital to the utility and its customers.

[10] See Attachments PAJ-2, PAJ-3 and PAJ-4 for a discussion of adjustments for off-balance sheet obligations.

Q. HOW DOES REGULATORY LAG IMPACT A REGULATED UTILITY'S CREDIT METRICS?

A. Regulatory lag reduces cash flow and increases debt levels – both of which have a negative impact on credit metrics. In order to provide safe, reliable, and clean service, utilities require significant and consistent capital investment. When a utility is unable to recover its costs through rates on a timely basis, the utility's cash flow is reduced compared to the cash it must utilize to service its obligations. To cover the shortfall, the utility is under increased pressure to issue more debt. If debt levels increase too much relative to cash flows from operations, the credit ratings will likewise deteriorate and the utility's access to capital markets can become strained. The alternative would be to reduce levels of investment, which is not supportive of economic growth and may affect the quality of service the utility can provide.

Q. PLEASE EXPLAIN THE RATING AGENCY SCALES.

A. Credit rating agencies provide ratings for both the business entity as a whole and for the various debt issuances of the entity.

The investment-grade rating categories include the High Grade (Triple-A and Double-A) and the Medium Grade category (Single-A and Triple-B ratings). The ratings are generally further delineated by S&P and Fitch Ratings ("Fitch") through the use of pluses or minuses to show a company's relative standing within

the categories.[11] The highest investment-grade rating is AAA; the lowest investment-grade rating is BBB-. Debt rated BB+ or below is considered speculative grade. Attachment PAJ-1 contains a description of the ratings used by the agencies.

D. Public Service's Financial Integrity and Credit Metrics

Q. WHAT ARE PUBLIC SERVICE'S CURRENT CREDIT RATINGS?

A. Public Service currently has a Corporate Credit Rating ("CCR") of A- or its equivalent by all three of the major rating agencies, as reflected in Table PAJ-D-2 below.

TABLE PAJ-D-2: Public Service's Current Corporate Credit Ratings

	S&P	Moody's	Fitch
Corporate Rating	A-	A3	A-
Senior Unsecured*		A3	--
Senior Secured	A	A1	A+
Commercial Paper	A-2	P-2	F-2

*Public Service currently issues only senior secured debt

Q. HAS THE COMPANY ALWAYS HAD THE SOLID CREDIT RATINGS IT HAS TODAY?

A. No. In 2002, Public Service had an unsecured credit rating of BBB- by S&P, which is one notch above non-investment grade or "junk bond" status, in large part because of its low authorized equity ratio and extensive off-balance sheet

[11] Moody's uses numbers to show a company's standing within a category.

obligations such as purchased power agreements.

It took many years to climb out of this difficult position. With the Commission's support, Public Service began taking steps to avoid a further potential downgrade and obtained Commission approval of a 60 percent regulated equity ratio in Proceeding No. 06S-234EG (combined gas and electric case), as well as a Purchased Capacity Cost Adjustment that further mitigated the imputed debt effects of purchased power agreements. In subsequent years, Public Service was also able to avail itself of similar types of recovery mechanisms, such as the Transmission Cost Adjustment (electric), the Demand-Side Management Cost Adjustment (gas/electric), the Clean Air-Clean Jobs Act Rider (electric), the Pipeline System Integrity Adjustment (natural gas), and the Renewable Energy Standard Adjustment (electric). In addition, the Commission has also approved recovery of the Company-owned wind projects through the Electric Commodity Adjustment, prior to being included in base rates. With those steps and the advent of more aggressive bonus depreciation, Public Service was able to slowly reduce its requested equity ratios while maintaining its financial integrity and improving its credit ratings.

The Company has also received decisions in their recent rate cases that have allowed Public Service to maintain its current credit rating. Most recently, in Proceeding No. 20AL-0049G, the 2020 Combined Gas Rate Case, the Commission adopted a 13-month average capital structure including short-term

debt as of September 30, 2019, which included an equity ratio of 55.62 percent.[12] Likewise, in the Company's 2020 Combined Gas Rate Case the Commission approved a settlement agreement that included an equity ratio of 55.62 percent.[13] Those equity ratios, similar to the ratio being requested in this proceeding, put the Company within S&P and Moody's credit metric guidelines to maintain its current credit ratings.

Q. HOW HAS PUBLIC SERVICE'S IMPROVED FINANCIAL STRENGTH IMPACTED CUSTOMERS TO DATE?

A. The Company's improved financial integrity exhibited in recent capital structure outcomes has resulted in a lower overall cost of debt, which is directly passed on to customers. Public Service improved from its unsecured rating from S&P of BBB- in 2002 to BBB in 2007, and to BBB+ in 2008. From 2003 through 2009, Public Service issued seven bond offerings in which the average 10- and 30-year bond coupons were 5.325 percent and 6.375 percent, respectively. Between 2010 and 2021, Public Service had an A- unsecured rating and issued seventeen bonds with average coupon rates of approximately 2.618 percent for a 10-year bond and approximately 3.800 percent for a 30-year bond. Although market conditions have changed over this period with declining U.S. Treasury yields, the differentials in

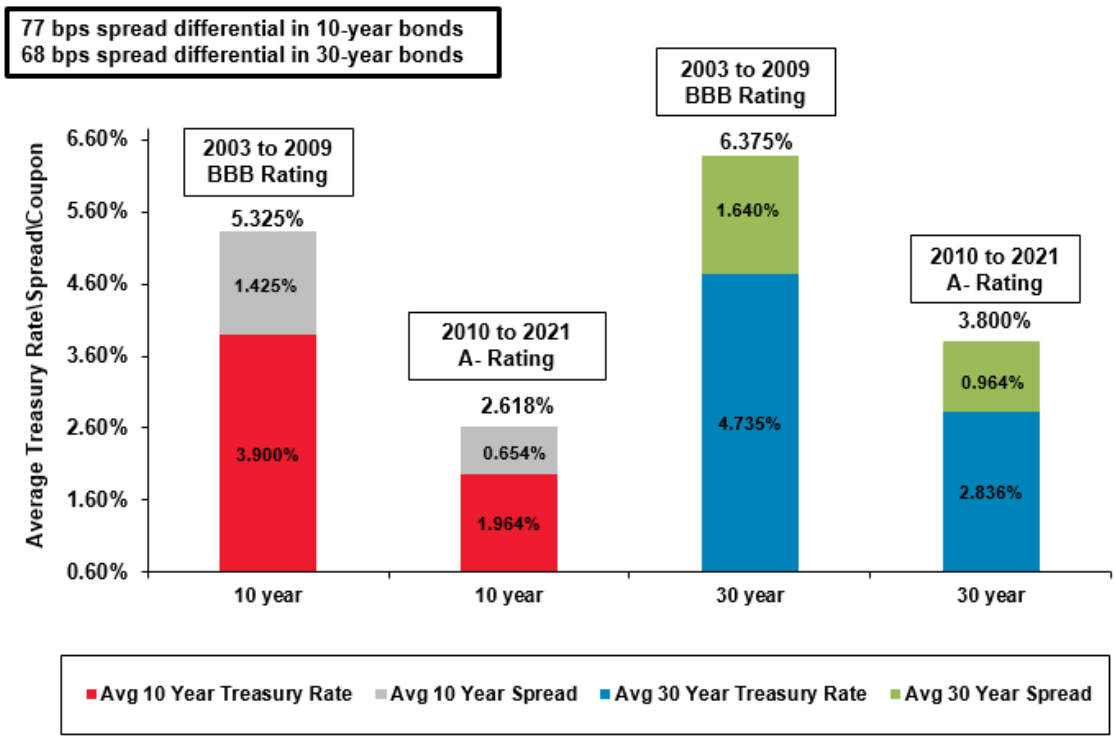
[12] Proceeding No. 20AL-0049G, Decision No. R20-0673, Ordering Paragraph 52 (mailed date Sept. 22, 2020).
[13] Proceeding No. 20AL-0049G, Decision No. R20-0673, Ordering Paragraph 52 (mailed date Sept. 22, 2020).

Public Service's average credit spreads were approximately 77 basis points on the 10-year bonds and 68 basis points on the 30-year bonds. Chart PAJ-D-3 illustrates this below. The average 30-year coupon rate declined from 6.375 percent in 2009 to 3.800 percent[14] in 2021, reflecting not only a change in market conditions but also the improvement in Public Service's financial health and credit rating. In other words, the costs of capital to the Company and ultimately its customers were substantially reduced over time as its credit rating improved.

[14] The 3.800 percent average coupon rate is based on the average of all coupon rates for bonds issued during the period 2010-2021. This is not reflective of additional bond issuance expenses as noted in the actual requested cost of debt.

CHART PAJ-D-3

PSCo: Historical S&P Credit Ratings and Average Bond Issuance Spreads



Q. HOW ELSE DO CUSTOMERS BENEFIT FROM A STRONG CREDIT RATING?

A. Strong credit ratings benefit customers in the form of access to a reasonable cost of capital. Conversely, a downgrade to a lower credit rating could affect Public Service's cost of supporting daily business. Supporting Public Service's operations requires access to funding, which can come from different sources such as commercial paper, a credit facility, and letters of credit. The cost of each of these types of funding varies and is dependent on the credit rating of the borrower. If Public Service were downgraded such that it lost its A2/P2/F2 commercial paper

rating, Public Service would no longer be able to issue commercial paper and would need to borrow directly from its $700 million credit facility. As result Public Service would pay up to 102 basis points higher than its current commercial paper rate.[15] For illustrative purposes, for each $100 million borrowed every year, that would equate to an additional $1.02 million per year in customer costs.

Above and beyond the increased borrowing cost discussed above, the lower credit quality also impacts access to and the cost of equity, which in turn will necessitate a higher equity return. In short, maintaining strong financial metrics and credit ratings minimizes the Company's costs of capital investments and customer costs in multiple respects.

Q. ARE THERE ANY RISK FACTORS SPECIFIC TO THIS CASE THAT COULD INFLUENCE CREDIT RATINGS?

A. Yes. Rating agencies attribute less risk to tariff provisions that operate outside the rate case cycle and adjust rates automatically or with some flexibility to match revenues to expenses, thereby minimizing regulatory lag. Fuel clauses and increasingly other varieties of riders are the kinds of rate mechanisms that stabilize earnings and cash flows to the benefit of the business risk profile, which is supportive of higher credit ratings. To that end, Public Service's current rating is based to some extent on the existence of such recovery mechanisms, which were

[15] Public Service 30-day Commercial Paper rate at December 31, 2021 vs. One-Month London Inter-Bank Offered Rate ("LIBOR") as of December 31, 2021, plus credit facility drawn spread.

in existence at the time of our last gas rate case.

Since that time, the Pipeline System Integrity Adjustment ("PSIA") rider has closed (effective December 31, 2021), removing a current cost recovery mechanism for roughly one-third of Public Service Company's annual gas capital investments. Additionally, the Commission is undertaking a review of the Gas Cost Adjustment ("GCA") mechanism for recovery of gas costs.

These changes have increased Public Service's business risk and increase regulatory lag which reduces cash flow and adversely impacts credit metrics. The natural gas investment is significant and will remain significant in future years as discussed by Ms. Zich in her testimony. Recovery of this investment in base rates will cause a lag in recovery that did not exist when the PSIA rider was in place. This impact on regulatory lag is magnified with the use of a historic test year, particularly if it is a historic test year based on an average rate base while investment is growing. This will impact cash flow and credit metrics, and thus also introduces additional business risk to Public Service.

Further, as discussed by Ms. Bulkley in her Direct Testimony, Xcel Energy and Colorado have implemented relatively more aggressive greenhouse gas ("GHG") emissions reductions programs for both the natural gas and electric businesses, which increase Public Service's risk related to natural gas service as compared to the proxy group companies with respect to GHG emissions. Perceived higher business risk by the credit rating agencies could have an impact

on Public Service's overall credit rating and the return that investors demand for their investment.

Q. ARE THERE ANY OTHER RISKS FACING PUBLIC SERVICE'S GAS BUSINESS THAT CONTRIBUTE TO REGULATORY LAG AND INCREASE RISK?

A. Yes. Public Service recently reached a settlement related to Winter Storm Uri Costs.[16] While the proceeding is ongoing, Public Service has agreed to recover costs related to Winter Storm Uri over a period of up to 36 months with no financing charge. The costs incurred by Public Service for fuel were financed in March 2021. The impact of the lag in recovery of fuel costs is a reduction in cash flow and an increase in debt levels, both of which put pressure on credit metrics. The impact of the delayed recovery on the FFO/Debt and CFO pre-WC debt credit metrics is a drag of approximately 30 basis points. This will continue to be the case until all costs are recovered.

Further, as discussed by Ms. Bulkley in her Direct Testimony, the majority of operating subsidiaries of the proxy group companies did not incur extraordinary incremental costs associated with Winter Storm Uri. As a result, most proxy group companies continue to recover natural gas costs through traditional cost recovery mechanisms or have already received approval for full recovery of the storm-related gas costs. Again, the lag in recovery impacts Public Service's cash flow

[16] Proceeding No. 21A-0192EG

and debt levels negatively, thus increasing both financial and business risk.

Q. HAS THE RISK PROFILE OF PUBLIC SERVICE CHANGED OVERALL?

A. Yes. As discussed by Ms. Trammell in her Direct Testimony, the Company's risk profile has changed in multiple ways, including (1) the elimination of the PSIA rider as discussed above; (2) the potential impact of Clean Heat goals on capital spending and, absent the use of more forward test-years, regulatory lag; and (3) other natural gas investments above the Natural Gas Department's base capital budget that increase risk levels absent supportive cost recovery frameworks. The investment community has likewise recognized these risks. In a Credit Opinion dated December 24, 2021, Moody's listed several observed credit challenges for Public Service, including the delayed recovery of incremental February natural gas costs as a material drag on 2021 cash flow, the pipeline integrity rider expiration in 2021, and regulatory lag on overall investments.[17] These risk factors speak even more strongly to the need for Public Service to carry financial metrics that ensure the Company's financial strength and resilience.

[17] Attachment PAJ-5 at 2. With respect to Winter Storm Uri, for example, Moody's further states that "the long recovery period of between 24 and 30 months, without compensation for cost of carry, as well as the length of the still ongoing regulatory proceeding, temper our view of the supportiveness of the regulatory environment."

E. Maintaining and Strengthening Public Service's Financial Integrity

Q. TYING THE PIECES TOGETHER, WHY ARE CONSTRUCTIVE OUTCOMES IN THIS RATE CASE RELATED TO ROE, EQUITY RATIO/CAPITAL STRUCTURE, AND TIMELINESS OF COST RECOVERY IMPORTANT TO PUBLIC SERVICE?

A. I will address each component in turn:

- First, the authorized ROE and equity ratio affect Public Service's earnings and directly affect its ability to fund capital investment with internally generated cash flow. In addition to credit ratings, investors also assess the capital structure and ROE when making judgments about the credit quality of a regulatory jurisdiction. As such, the ROE/equity ratio combination is a powerful and effective communication tool to underscore the interest of regulators in attracting capital to provide safe, reliable, and environmentally-sound gas service in this State.

- Second, the capital structure and authorized costs directly affect all of Public Service's key credit metrics, because either total debt or interest expense is a component of each of the primary credit metrics that rating agencies analyze. The credit rating agencies also evaluate the relative amounts of debt and equity in the Company's capital structure to determine whether the Company is appropriately capitalized given its business risk profile, and to determine whether the Company has the ability to issue additional debt to fund its utility capital expenditures. The credit rating agencies are very interested in Public Service's liquidity to meet its short-term capital needs should conditions of financial stress arise, and they consider the debt portfolio maturity schedule and other future obligations as part of this assessment.

- Third, debt and equity investors expect Public Service to be able to recover its costs in a timely manner and to have a reasonable opportunity to earn its authorized ROE. Investors and rating agencies track the decisions of regulatory agencies relating to capital structure, cost of debt, ROE, overall cost recovery and forward-looking cost recovery mechanisms, and they categorize the state regulatory environments in their assessment of the relative risks of different utility investment opportunities.

- Finally, as previously noted, for regulated utilities, investors tend to prefer stable, predictable, regulatory environments (so long as they are constructive) because this simplifies pricing risk and enables investors to generate predictable returns. If investor perceive more risk or uncertainty, they will demand a high return. Therefore, a consistent and constructive regulatory environment. This benefits customers because it keeps costs down long-term.

Q. WHAT IS PUBLIC SERVICE'S PROPOSED EQUITY RATIO IN THIS PROCEEDING?

A. Public Service supports a capital structure composed of 55.66 percent equity, 43.13 percent long-term debt, and 1.21 percent short-term debt, to reflect its anticipated capital structure based on a 13-month average for the CTY ending December 31, 2022. The inclusion of short-term debt in the capital structure, as mentioned earlier in my Direct Testimony, requires construction work in progress ("CWIP") in rate base with an allowance for funds used during construction ("AFUDC") offset to earnings.

Q. HOW IS THE 13-MONTH AVERAGE CALCULATED?

A. The 13-month average uses balances taken at the month-end of 13 consecutive months in order to capture 12 full months of financial data. For HTY 2021, the capital structure is based on 13 months of actual data ending on June 30, 2021 used to calculate the 13-month average. For the CTY 2022, thirteen months of forecasted balances were used to calculate the 13-month average.[18]

[18] Forecasted month-end balances were used to calculate the 13-month average for the CTY ending December 31, 2022 and included month-end balances from December 2021 to December 2022.

Q. WHAT WAS THE ACTUAL CAPITAL STRUCTURE OF PUBLIC SERVICE AS OF JUNE 30, 2021?

A. The actual capital structure of Public Service as of June 30, 2021 is shown below and is included in the Company's 2021 informational HTY supplied by Company witness Mr. Freitas in Direct Testimony.

TABLE PAJ-D-3: Capital Structure and WACC as of June 30, 2021

	As of June 30, 2021		
	Ratio	**Rate**	**Wtd Cost**
Long-Term Debt	43.84%	3.84%	1.68%
Short-Term Debt	0.52%	1.66%	0.01%
Equity	55.64%	10.75%	5.98%
		Total Cost	**7.67%**

Q. ARE THERE ANY DIFFERENCES IN THE METHODOLOGIES USED TO CALCULATE THE CAPITAL STRUCTURE, INCLUDING COST OF LONG- AND SHORT-TERM DEBT, FOR THE INFORMATIONAL HTY AS COMPARED TO THE CTY ENDING DECEMBER 31, 2022?

A. No. As noted earlier in my testimony, 13-month averages were used to calculate the capital structure, as well as the cost of long- and short-term debt, for both the CTY and HTY periods. The only difference, which does not represent a departure in terms of methodology, is that the capital structure for the informational HTY is based on actuals. The CTY for the period ending December 31, 2022 is based on thirteen months of forecasted data, as noted above.

Q. HAVE YOU ASSESSED HOW THIS PROPOSED EQUITY RATIO FITS WITH THE FINANCIAL METRICS PUBLIC SERVICE MUST MAINTAIN IN ORDER TO MAINTAIN ITS CURRENT CREDIT RATINGS?

A. Yes. The Company's proposed 55.66 percent regulated equity ratio (in combination with the proposed 10.25 percent ROE for the CTY will continue to support the current A3 rating from Moody's and A- ratings from S&P and Fitch.

Q. WHY IS IT IMPORTANT FOR PUBLIC SERVICE TO MAINTAIN ITS A- CORPORATE RATING?

A. Earlier in my Direct Testimony I demonstrated that when Public Service issued bonds as a corporation with an unsecured BBB credit rating versus issuing bonds with an unsecured A rating, the pricing differential was 77 basis points for 10-year bonds and 68 basis points when issuing 30-year bonds. This is a real cost that affects what rates customers pay. To further support this position, Dr. Roger Morin, a noted expert on regulatory finance, analyzes the optimal capital structure for utilities in his book *New Regulatory Finance.* Based on that analysis, Dr. Morin concludes that an A rated utility is in the best interest of the customers and utilities:

> The message from the model is clear: over the long run, a strong A bond rating will minimize the pre-tax cost of capital to ratepayers. Long term achievement of at least an A rating is in the electric utility company's and ratepayers' best interests.
>
> The model results show that on an incremental cost basis, a strong A bond rating generally results in the lowest pre-tax cost of capital for electric utilities, especially under adverse economic

conditions, which are far more relevant to the question of capital structure.[19]

[19] Roger A. Morin, *New Regulatory Finance* 515 (2006).

III. COST OF LONG- AND SHORT-TERM DEBT

Q. HOW DOES THE COST OF DEBT FACTOR INTO THE COMPANY'S OVERALL RECOMMENDED COST OF CAPITAL?

A. As described above, the Company must utilize debt to fund investments on behalf of customers and seek to do so at reasonable costs of debt. In this section of my Direct Testimony, I identify the reasonable costs of debt the Company anticipates for the Test Year.

Q. WHAT EMBEDDED COST OF LONG-TERM DEBT IS PUBLIC SERVICE ASKING THE COMMISSION TO APPROVE?

A. The Company is recommending the Commission approve a 3.73 percent embedded cost of long-term debt, which is the Company's 13-month average forecasted cost of long-term debt as of December 31, 2022. The detailed calculation is shown on Attachment PAJ-6. The cost of long-term debt is based on a yield-to-maturity calculation where the debt expenses include interest as well as fees associated with issuing the bond, such as costs for legal, underwriting, and rating agency fees (these fees are unavoidable for public debt issuances). These annualized costs are divided by the 13-month average principal amount of the bonds to derive an overall cost of long-term debt for Public Service.

Q. WHAT EMBEDDED COST OF SHORT-TERM DEBT IS PUBLIC SERVICE ASKING THE COMMISSION TO APPROVE?

A. The Company is recommending the Commission approve a 0.79 percent

embedded cost of short-term debt, which is the Company's 13-month average forecasted cost of short-term debt as of December 31, 2022. The cost of short-term debt is based on forecasted short-term debt interest rates as well as actual short-term debt costs, including interest on commercial paper as well as fees associated with maintaining the Company's credit facility. These annualized costs are divided by the 13-month average amount of the short-term debt outstanding to derive an overall cost of short-term debt for Public Service.

IV. CONCLUSION

Q. IN LIGHT OF THESE ANALYSES, WHAT IS PUBLIC SERVICE'S PROPOSED CAPITAL STRUCTURE AND OVERALL COST OF CAPITAL?

A. To maintain the Company's financial integrity and remain within credit rating agency guidelines for an A3/A- rated Company, Public Service proposes its 13-month average capital structure and costs of debt for the CTY ending December 31, 2022, as shown in Table PAJ-D-4 below. The Gas ROE is set at 10.25 percent, as supported by Ms. Bulkley in her Direct Testimony.

TABLE PAJ-D-4: Public Service's Proposed WACC

		December 31, 2022	
	Ratio	**Rate**	**Wtd Cost**
Long-Term Debt	43.13%	3.73%	1.61%
Short-Term Debt	1.21%	0.79%	0.01%
Equity	55.66%	10.25%	5.71%
		Total Cost	**7.33%**

Detailed supporting schedules for the calculation of long-term and short-term debt are included in Attachment PAJ-6.

Q. WHY DOES PUBLIC SERVICE SUPPORT A CAPITAL STRUCTURE COMPOSED OF 55.66 PERCENT EQUITY, 43.13 PERCENT LONG-TERM DEBT, AND 1.21 PERCENT SHORT-TERM DEBT?

A. As discussed throughout this Direct Testimony, Public Service proposes this capital structure because it:

- Reflects the Company's 13-month average forecasted regulated equity ratio as of December 31, 2022;[20]

- Supports Public Service's financial integrity, which will allow continued long-term debt financing at reasonable rates and ultimately lower the cost of service to its customers through lower interest expense;

- If approved, would signal continued regulatory environment stability and a balanced outcome; and

- Is consistent with rating agency expectations of a credit-supportive environment and sufficient capital to maintain the utility's capital structure.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

[20] Attachment PAJ-6 at 1.

Statement of Qualifications

Paul A. Johnson

I received my Bachelor of Science in Business from Winona State University and my MBA from the University of St. Thomas. I am a CFA charter holder and passed the CPA and CMA exams.

I currently serve as the Vice President of Investor Relations and Treasurer and have held this position since July 2021. Prior to this role, I served in the following roles during my tenure at Xcel Energy: Vice President, Investor Relations (2013-2021);Vice President, Investor Relations and Business Development (2012-2013); Vice President, Investor Relations and Financial Management (2011-2012); Managing Director of Investor Relations and Assistant Treasurer (2008-2011); Managing Director of Investor Relations (2007-2008); Director of Investor Relations (2001-2006); Director of External Reporting (1998-2001); Controller and Assistant Treasurer for Energy Masters (1995-1998); and Administrator in Internal Reporting (1992-1995).

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * * *

IN THE MATTER OF ADVICE NO. 993-GAS OF PUBLIC SERVICE COMPANY OF COLORADO TO REVISE ITS COLORADO PUC NO. 6-GAS TARIFF TO INCREASE JURISDICTIONAL BASE RATE REVENUES, IMPLEMENT NEW BASE RATES FOR ALL GAS RATE SCHEDULES, AND MAKE OTHER PROPOSED TARIFF CHANGES EFFECTIVE FEBRUARY 24, 2022	)	**PROCEEDING NO. 22AL-_____G**

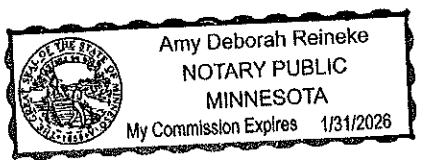
AFFIDAVIT OF PAUL A. JOHNSON
ON BEHALF OF
PUBLIC SERVICE COMPANY OF COLORADO

I, Paul A. Johnson, being duly sworn, state that the Direct Testimony and attachments were prepared by me or under my supervision, control, and direction; that the Direct Testimony and attachments are true and correct to the best of my information, knowledge and belief; and that I would give the same testimony orally and would present the same attachments if asked under oath.

Dated at Minneapolis, Minnesota, this 17 day of January, 2022.

Paul A. Johnson
Vice President, Treasurer and Investor Relations

Subscribed and sworn to before me this 17 day of January, 2022.



Amy Deborah Reineke
Notary Public

My Commission expires 1/31/2026