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

*** * * * ***

| | | |
|---|---|---|
| **IN THE MATTER OF ADVICE NO. 961-** | **)** | |
| **GAS OF PUBLIC SERVICE COMPANY** | **)** | |
| **OF COLORADO TO REVISE ITS** | **)** | |
| **COLORADO PUC NO. 6-GAS TARIFF** | **)** | |
| **TO INCREASE JURISDICTIONAL BASE** | **)** | |
| **RATE REVENUES, IMPLEMENT NEW** | **)** | **PROCEEDING NO. 20AL-_____G** |
| **BASE RATES FOR ALL GAS RATE** | **)** | |
| **SCHEDULES, AND MAKE OTHER** | **)** | |
| **PROPOSED TARIFF CHANGES** | **)** | |
| **EFFECTIVE MARCH 7, 2020** | **)** | |
| | **)** | |

# DIRECT TESTIMONY AND ATTACHMENTS OF SARAH W. SOONG

**ON**

**BEHALF OF**

**PUBLIC SERVICE COMPANY OF COLORADO**

**FEBRUARY 5, 2020**

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

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| **PROPOSED TARIFF CHANGES** | **)** | |
| **EFFECTIVE MARCH 7, 2020** | **)** | |

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## GLOSSARY OF ACRONYMS AND DEFINED TERMS

| Acronym/Defined Term | Meaning |
|---|---|
| 2019 Electric Phase I | Proceeding No. 19AL-0268E |
| AFUDC | Allowance for Funds Used After Construction |
| CCR | Corporate Credit Rating |
| CFO | Cash from Operations |
| Commission | Colorado Public Utilities Commission |
| CWIP | Construction Work in Progress |
| EBITDA | Earnings Before Interest, Taxes, Depreciation and Amortization |
| FFO | Funds from Operations |
| Fitch | Fitch Ratings |
| HTY | Historical Test Year |
| Moody's | Moody's Investors Service |
| Public Service or the Company | Public Service Company of Colorado |
| ROE | Return on Equity |
| S&P | Standard & Poor's |
| Test Year | 9/30/20 Test Year |
| WACC | Weighted Average Cost of Capital |

| **Acronym/Defined Term** | **Meaning** |
|---|---|
| Xcel Energy | Xcel Energy Inc. |
| XES | Xcel Energy Services Inc. |

**OF THE STATE OF COLORADO**

*** * * * ***

| | |
|---|---|
| **IN THE MATTER OF ADVICE NO. 961-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 MARCH 7, 2020** | **PROCEEDING NO. 20AL-_____G** |

**DIRECT TESTIMONY AND ATTACHMENTS OF SARAH W. SOONG**

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

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A. My name is Sarah Soong. 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 and Treasurer. 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 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. A description of my qualifications, duties, and responsibilities is set forth after the conclusion of my testimony in my Statement of Qualifications.

**Q. WHAT RECOMMENDATIONS ARE YOU MAKING IN YOUR DIRECT TESTIMONY?**

A. I recommend that the Colorado Public Utilities Commission ("Commission") approve Public Service's forecasted Weighted Average Cost of Capital ("WACC") for the test year ending September 30, 2020 ("Test Year"), as shown in Table SWS-D-1, below. The requested Return on Equity ("ROE") of 9.95 percent is further supported by Company witnesses Ms. Ann E. Bulkley and Ms. Brooke A. Trammell in their Direct Testimonies.

**Table SWS-D-1: Requested WACC**

| | | As of September 30, 2020[1] | |
|---|---|---|---|
| | **Ratio** | **Rate** | **Wtd Cost** |
| Long-Term Debt | 42.97% | 4.08% | 1.75% |

[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 Test Year ending September 30, 2020.

| | | | |
|---|---|---|---|
| Short-Term Debt | 1.22% | 2.79% | 0.03% |
| Equity | 55.81% | 9.95% | 5.55% |
| **Total Cost** | | | **7.33%** |

The 13-month average capital structure included in the requested WACC is consistent with the capital structure decided upon in the Commission's oral deliberations in the Company's recent 2019 Electric Phase I rate case (Proceeding No. 19AL-0268E) ("2019 Electric Phase I"). In particular, short-term debt is included in the capital structure provided that the Commission ensures adherence to the principle that the inclusion of short-term debt necessitates: 1) including Construction Work in Progress ("CWIP") in rate base, and including an Allowance for Funds Used During Construction ("AFUDC") offset to earnings; and 2) the use of an average capital structure.

The average cost of debt included in the requested WACC appropriately aligns with the composition of the capital structure by using the average costs of long-term and short-term debt as of September 30, 2020.

Most importantly, the Company is requesting a capital structure that allows it to continue to raise capital competitively in order to keep costs low for customers, to support the credit ratings guidance provided by several credit rating agencies, and to help maintain the Company's financial integrity.

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

A. I discuss a number of topics related to the Company's cost of capital in my testimony. In particular, I:

1. Discuss financial integrity, its importance to Public Service and its stakeholders, and the need for Public Service to demonstrate stable overall financial health in order to access the market in varied conditions and raise debt capital for utility expenditures at low 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 as of the Test Year ending September 30, 2020; and
5. Present and support the recommended 7.33 percent WACC for the Gas Department as of the Test Year ending September 30, 2020.

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

A. Yes, I am sponsoring the following attachments:

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

- Attachment SWS-2, which is a Moody's publication entitled *Rating Methodology Regulated Electric and Gas Utilities*;

- Attachment SWS-3, which is an S&P publication entitled *Key Credit Factors for the Regulated Utilities Industry*;

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

- Attachment SWS-5, which presents Public Service's recommended capital structure and cost of capital at September 30, 2020, and the resulting WACC; and

- Attachment SWS-6, which is a Moody's Credit Opinion entitled *Public Service Company of Colorado: Update to Credit Analysis*.

## 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 testimony, I will:

- Describe the importance of this case in supporting Public Service's future financial integrity;
- Explain how capital investors evaluate the financial integrity of utilities like Public Service and Public Service's current financial integrity when viewed through that analysis, which includes Public Service's key financial metrics; and
- Identify both how Public Service is working to maintain its financial integrity and how its financial integrity could be maintained and strengthened through a supportive regulatory decision in this case.

### 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 to support operations and infrastructure investment over the course of an economic cycle. The ability to attract capital at a reasonable cost in all market conditions is integral to a utility's ability to meet its obligation to provide safe and reliable utility service to customers.

**Q. WHY DOES MAINTAINING FINANCIAL INTEGRITY BENEFIT PUBLIC SERVICE'S GAS CUSTOMERS?**

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

It is important to note, however, 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. Stronger financial integrity has the opposite effect, which in turn, benefits customers.

## B. FACTORS IMPACTING 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 a utility's financial integrity. To maintain a strong financial profile, 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 RATING AGENCY PERCEPTIONS AND INFLUENCE INVESTOR DECISIONS?**

A. Credit rating agencies determine credit ratings, which investors may rely on for investment decisions. The rating agencies have emphasized that balanced, constructive outcomes in utility rate proceedings are indicative of a supportive stable regulatory environment and underpin a utility's financial integrity.[2] This 2020 Gas rate case presents an opportunity to achieve a constructive outcome with respect to the Company's allowed equity ratio, similar to the equity ratio that was achieved in the Company's 2019 Electric Phase I.

**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. These credit ratings are determined by independent firms that have no financial stake in the outcome of its analysis. The independent nature of credit ratings can make them a valuable resource for utility regulators to help navigate through the many

[2] These concepts are discussed in Attachments SWS-2 at 3-15 and SWS-3 at 6-7.

decisions they must make in the course of balancing the various stakeholder interests that come before them.

**Q. PLEASE EXPLAIN THE ROLE OF A CREDIT RATING AGENCY IN MORE DETAIL.**

A. A credit rating agency provides an assessment of the creditworthiness of a company (one component of financial integrity) or an assessment of a financial instrument to facilitate access to fixed income capital markets at the most efficient cost. 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 major rating agencies appear in Attachment SWS-1.

**Q. WHO USES CREDIT RATINGS?**

A. Investors use them 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 across time.

Investors generally fall into two basic categories with distinct risk characteristics: fixed income investors (i.e., 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 debts are paid. Fixed income investors use ratings as one consideration when

deciding whether and at what cost to lend capital to a utility or other company competing for their investment. Both fixed income and equity investors use the credit analyses performed by rating agencies to help them understand the overall risk of an issuer.

**Q. HOW IS A CREDIT RATING ESTABLISHED?**

A. The analysis centers on two main areas of analysis: qualitative analysis 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.[3]

[3] Attachments SWS-2 at 3; Attachment SWS-3 at 6.

**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.[4] 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 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.[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 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

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

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

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 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."[6] 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."[7] The same document contains an extensive discussion regarding the importance of the regulatory environment in which the utility operates.

**Q. HOW CAN THE COMMISSION SUPPORT FAVORABLE CREDIT RATING**

[6] Attachment SWS-3 at 6.
[7] Attachment SWS-3 at 6.

**AGENCY AND INVESTOR VIEWS OF THE COMPANY'S REGULATORY RISK?**

A. As noted earlier, the rating agencies have emphasized that balanced, constructive outcomes in utility rate proceedings are indicative of a supportive regulatory environment and underpin a utility's financial integrity. Such regulatory outcomes convey to the rating agencies the positive relationships between companies and commissions, which in turn may lower the perceived risk for external investors.

**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 is the effect of tax reform on utilities, which has 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.[8] 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. Items that the rating agencies regard

[8] For Moody's, the measurement is called "CFO pre-Working Capital-to-Debt." S&P has a similar measure, called "funds-from-operations" or FFO, which they also compare to the overall debt burden.

as debt-like include lease liabilities, long-term power purchase obligations, pension obligations, and asset-retirement obligations.

Credit metrics are calculated for both historical periods and future forecasts. Credit metrics are often used to calculate two different types of ratios: leverage and coverage ratios. Leverage ratios attempt to assess the relative burden of debt and other fixed-income obligations as compared to the financial responsibility borne by shareholders. Coverage ratios are more focused on the near-term cash flow of the company and gauge how much cash flow is available to service debt obligations. Credit agencies use both ratios to assess the probability of financial distress.

**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 funds from operations or cash from operations to total debt ("FFO/Total Debt" or "CFO/Debt"); (ii) the ratio of funds from operations or cash from operations 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 on-balance sheet obligations such as finance and operating leases, as well as off-balance sheet obligations. Off-balance sheet obligations are payment obligations (such as long-term purchase power obligations, pension obligations, and asset retirement obligations) that do not appear on the balance sheet as debt, but rating agencies may treat them as debt because the utility has little or no discretion whether to pay for these obligations.[9]

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

A. 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 pressure on cash flow metrics, credit ratings, and cost of capital to the utility and its customers.

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

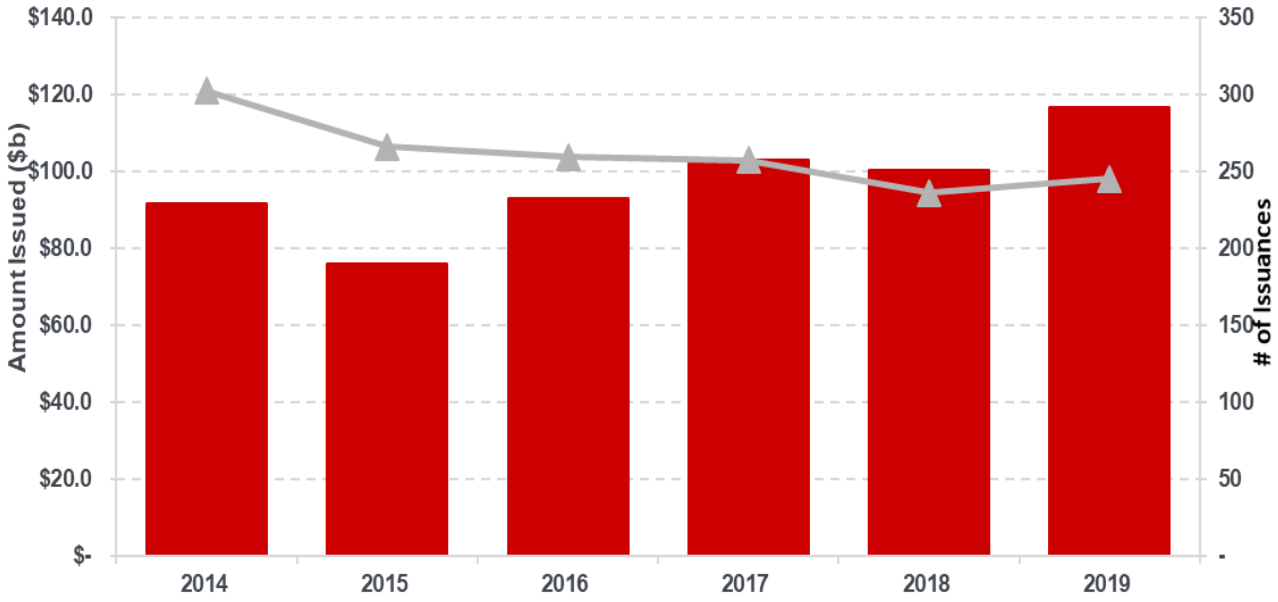
**Q. HOW DOES REGULATORY LAG IMPACT A REGULATED UTILITY'S CREDIT METRICS?**

A. 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 adversely impacted. 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. CAN YOU PROVIDE ADDITIONAL INFORMATION REGARDING THE ROLE A UTILITY'S CREDIT RATINGS PLAY IN ITS ABILITY TO ACCESS CAPITAL ON REASONABLE TERMS?**

A. Yes. Credit ratings also help debt investors differentiate between utilities – all of whom are competing (with companies within and outside the utility sector) for the same investment dollars. During the period 2014-2019, debt investors have provided approximately $581 billion of capital investment to the U.S. utility sector. Capital provided from these investors allows utilities to fund a portion of their capital investment programs. In order to attract capital in this competitive environment, protecting Public Service's credit rating is critical. See Chart SWS-D-1, below.

**Chart SWS-D-1: 2014-2019 Debt Amount Issued to the U.S. Utility Sector**




Source: Bloomberg

**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 Standard and Poor's ("S&P") and Fitch Ratings ("Fitch") through the use of pluses or minuses to show a company's relative standing within the categories.[10] The highest investment-grade rating is AAA; the lowest investment-grade rating is BBB-. Debt rated BB+ or below is

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

considered speculative grade. Attachment SWS-1 contains a description of the ratings used by the agencies.

## C. PUBLIC SERVICE'S FINANCIAL INTEGRITY AND CREDIT RATINGS

**Q. WHAT TOPICS DO YOU DISCUSS IN THIS SECTION OF YOUR TESTIMONY?**

A. I describe rating agency assessments of Public Service's financial integrity, including as specified through its credit ratings, and explain how they have changed over time. I also describe Public Service's individual business and financial risks, including regulatory risk.

**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 SWS-D-2 below.

**Table SWS-D-2: Public Service's Current Corporate Credit Ratings**

| | S&P | Moody's | Moody's S&P Equivalent* | Fitch |
|---|---|---|---|---|
| Corporate Rating | A- | A3 | A- | A- |
| Senior Secured | A | A1 | A+ | A+ |

| | | | | |
|---|---|---|---|---|
| Commercial Paper | A-2 | P-2 | A-2 | F-2 |

*S&P equivalent rating of Moody's rating

**Q. HAS THE COMPANY ALWAYS HAD THE CONSISTENTLY STRONG CREDIT RATING IT HAS TODAY?**

A. No. In 2006, Public Service had an unsecured credit rating of BBB- by S&P, which is one notch above speculative or "junk bond" status, in large part because of its low authorized equity ratio and extensive off-balance sheet obligations such as purchased power agreements.

It took a number of 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 as a whole 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 (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.

The path to a higher equity ratio (which supports increased cash flows that tend to result in higher credit ratings for Public Service) has not been without setbacks. The Commission's decisions in Proceeding No. 17AL-0363G to authorize a capital structure composed of 54.6 percent equity and 45.4 percent long-term debt resulted in an authorized capital structure that was significantly lower than the actual equity ratio of 56.06 percent at the end of the 2016 Historical Test Year ("HTY") in that case.[11]

However, most recently, in its oral decision in Public Service's 2019 electric rate **case** (Proceeding No. 19AL-0268E), the Commission adopted a 13-month average capital structure including short-term debt as of August 31, 2019, which included an equity ratio of 55.61 percent.[12] That equity ratio, similar to the ratio being requested in this proceeding, puts the Company within S&P and Moody's credit metric guidelines but leaves little room for downward pressure, as I discuss later in my Direct Testimony.

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

A. The Company's improved financial strength has resulted in a lower overall cost of

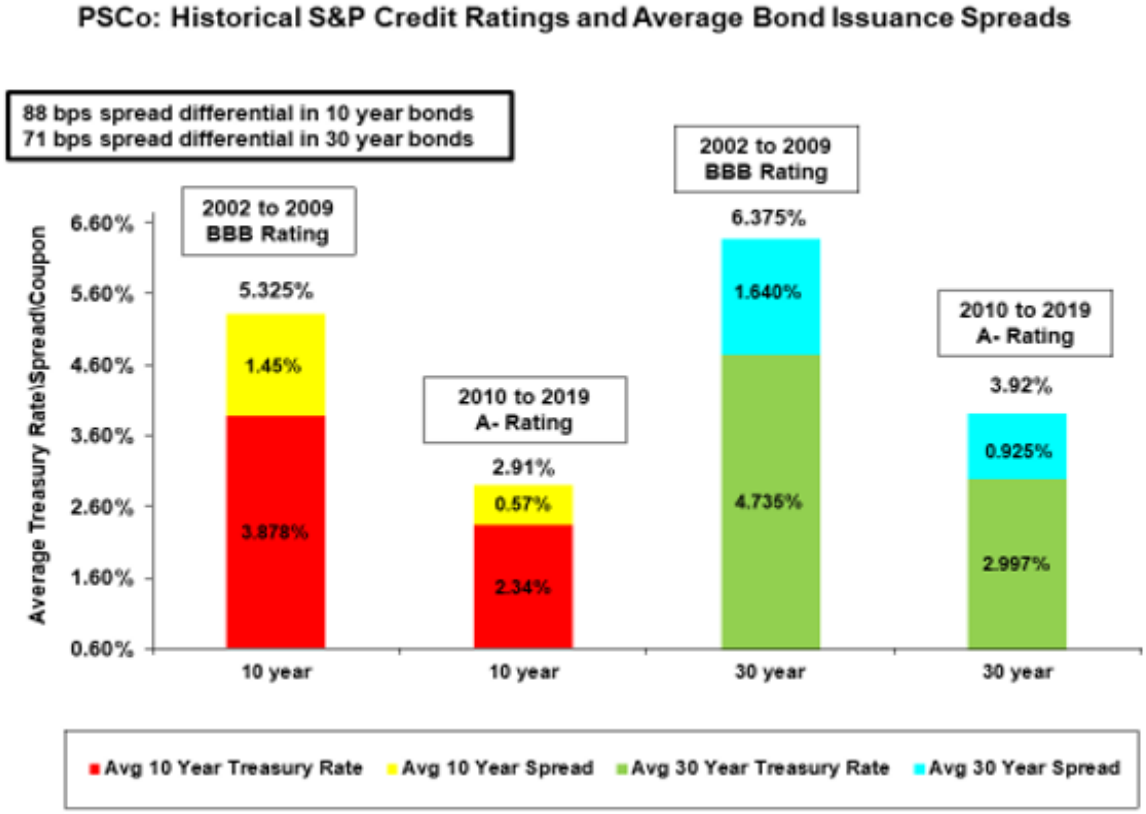
[11] Decision Nos. C18-0736-I (mailed date Aug. 29, 2018), C18-1158 (mailed date Dec. 21, 2018), and C19-0232 (mailed date Mar. 19, 2019). Public Service has requested review of these decisions in the Denver County District Court.

[12] The Commission's written decision has not yet been issued in that proceeding as of the finalization of this testimony.

debt, which is directly passed on to customers. Public Service improved from its unsecured rating from S&P of BBB- in 2006 to BBB in 2007, and to BBB+ in 2008. From 2002 through 2008, Public Service issued eight bond offerings in which the average 10- and 30-year bond coupons were 5.325 percent and 6.375 percent, respectively. Between 2010 and 2019, Public Service had an A- unsecured rating and issued fourteen bonds with average coupon rates of approximately 2.90 percent for a 10-year bond and approximately 3.90 percent for a 30-year bond. Although market conditions have changed over this period with declining U.S. Treasury yields, the differentials in Public Service's average credit spreads were approximately 88 basis points on the 10-year bonds and 71 basis points on the 30-year bonds. Chart SWS-D-2 illustrates this below. The average 30-year coupon rate declined from 6.38 percent in 2009 to 3.92 percent[13] in 2019, reflecting not only a change in market conditions but also the improvement in Public Service's financial health and credit rating.

[13] The 3.92 percent average coupon rate is based on the average of all coupon rates for bonds issued during the period 2010-2019. This is not reflective of additional bond issuance expenses as noted in the actual requested cost of debt.

**Chart SWS-D-2: Public Service's Historical S&P Unsecured Credit Ratings and Average Bond Issuance Spreads**




Favorable pricing continues, as demonstrated in August 2019, when Public Service issued $550 million of 30-year "green" bonds with a coupon of 3.20 percent.[14] As of September 30, 2020, the (13-month average) embedded cost of long-term debt is projected at 4.08 percent. In other words, the costs of capital to the Company and its customers were substantially reduced over time as its credit rating improved.

Finally, as a result of Public Service's financial strength, the Company has been able to make needed investments in its utility infrastructure. Over the last

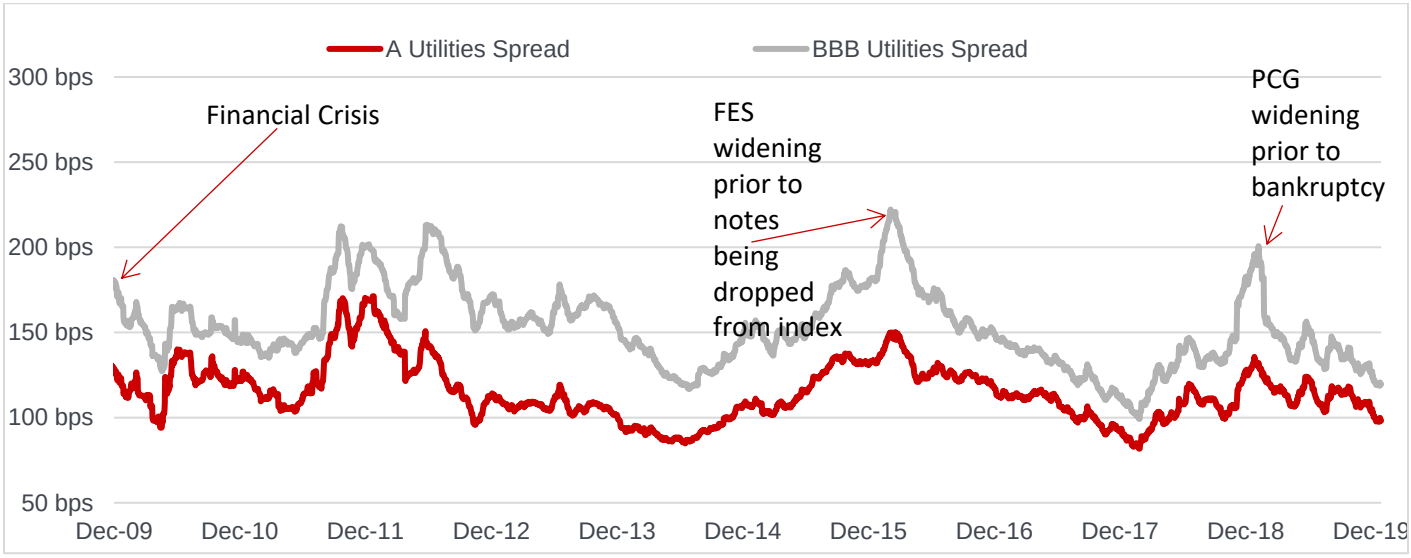
[14] A "green" bond is a bond specifically earmarked to be used for climate and environmental projects.

five years (2015 – 2019), the Company has invested approximately $6.9 billion in electric, gas, and steam utility infrastructure. Those investments have continued to build the operational strength and reliability of the Company's systems, all investments to better serve our customers.

**Q. DO CREDIT SPREADS DIFFER BASED ON CREDIT RATINGS?**

A. Yes. Chart SWS-D-3 shows that the credit spreads of BBB rated utility companies are historically wider than those of A rated utility companies, especially in times of market volatility. This chart demonstrates that although in current market conditions the credit spread between A and BBB ratings is approximately 30 basis points, in periods of market volatility, such as June 2009, the credit spread increased dramatically, at an average spread of 100 basis points. Therefore, focusing on the total coupon rate Public Service has received in recent times ignores the impact of the credit rating on the credit spread component of bond pricing.

**Chart SWS-D-3: A vs. BBB Rated Utility Spreads**



Source: Bloomberg

**Q. WHAT OTHER BENEFITS DO CUSTOMERS RECEIVE FROM A STRONG CREDIT RATING?**

A. A strong credit rating benefits 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 the operations of Public Service 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 need to borrow directly from its $700 million credit facility and pay up to 131 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 $1.3 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 in multiple respects.

[15] Public Service 30-day Commercial Paper rate at January 9, 2020 vs. One-Month London Inter-Bank Offered Rate ("LIBOR")as of January 9, 2020, plus credit facility drawn spread.

## D. 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 factor in 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, 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 regulatory environments (so long as they are constructive) because this simplifies pricing risk and enables investors to generate predictable returns. 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 55.81 percent equity, 42.97 percent long-term debt, and 1.22 percent short-term debt, to reflect its anticipated capital structure based on a 13-month average for the Test Year ending September 30, 2020. The inclusion of short-term debt in the capital structure, as mentioned earlier in my Direct Testimony, requires CWIP in rate base with an 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 the Test Year, three months of actual balances were available and ten months of forecasted balances were used to calculate the 13-month average.[16]

**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. Table SWS-D-3 identifies the Moody's credit metrics guidelines for Public Service to maintain its current credit ratings, and how the Company's proposed 55.81 percent regulated equity ratio (in combination with a 9.95 percent ROE) will continue to support the current A3 rating.

Financial metrics account for 40 percent of Moody's methodology grid, with the CFO pre-WC/Debt ratio being the most important financial measure. In a 55.81 percent regulated equity ratio analysis (in combination with a 9.95 percent Gas ROE), the Company's CFO pre-WC/Debt metric for all years is

[16] Actual month-end balances were available as of September 2019, October 2019, and November 2019. Forecasts were available for month-end balances as of December 2019 through September 2020.

forecasted to be just above 20 percent, which is the downgrade threshold for the current A3 rating. This analysis is set forth in Table SWS-D-3:

**Table SWS-D-3: Moody's Debt Metrics at 55.81% Regulated Gas Equity Ratio**

| Guidelines for Baa2 Corp. Rating | Moody's Guidelines | Moody's 2017 | Actual 2018 | Forecast 2019 | Forecast 2020 | Forecast 2021 |
|---|---|---|---|---|---|---|
| **CFO pre-WC /Debt*** | **no less than 20%** | 22.7% | 18.5% | ***20.7%*** | ***20.5%*** | ***21.0%*** |
| **CFO pre-WC/Interest**** | **no less than 3x – 4.5x** | 6.6x | 5.7x | ***5.7x*** | ***5.9x*** | ***6.0x*** |
| **CFO-Div/Debt***** | **no less than 9 – 17%** | 15.9% | 11.9% | ***14.0%*** | ***13.5%*** | ***13.8%*** |

* Cash from Operations before Working Capital-to-Debt. Public Service threshold for downgrade is 20 percent per Moody's report.
** Cash from Operations before working capital plus interest/interest.
*** Cash from Operations before working capital-Dividends/Debt.

**Q. WHAT ARE THE COMPANY'S PROJECTED METRICS UNDER THE S&P METHODOLOGY?**

A. Table SWS-D-4 identifies the S&P credit metric guidelines for Public Service to maintain its current credit rating, and how the Company's proposed 55.81 percent Gas regulated equity ratio (in combination with a 9.95 percent proposed Gas ROE) will continue to support the current A- rating:

**Table SWS-D-4: S&P Metrics at 55.81% Regulated Gas Equity Ratio**

| A Corp. Rating Medial Volatility | S&P Guidelines | Actual 2017 | Actual 2018 | Forecast 2019 | Forecast 2020 | Forecast 2021 |
|---|---|---|---|---|---|---|
| **FFO/Debt *** | **no less than 15-20** | 22.3% | 17.8% | ***20.2%*** | ***20.3%*** | ***20.8%*** |
| **Debt/EBITDA**** | **no more than 3.5-4.5** | 3.8x | 4.3x | ***4.1X*** | ***4.1X*** | ***3.9X*** |

* Funds from Operations/Total Debt including adjustments.

** Debt including adjustments/Earnings before interest taxes depreciation and amortization.

As illustrated in the above Table, the Company's proposed regulated equity ratio puts the credit metrics within the range of S&P's guidelines for an A- rated company.

**Q. DOES PUBLIC SERVICE ONLY NEED A RATING FROM S&P?**

A. No. It is essential that Public Service obtaina rating from at least two of the three major rating agencies (S&P, Moody's, and Fitch) in order to issue debt in the capital markets. To obtain optimal pricing, Public Service requires credit ratings from both Moody's and S&P, who are the most widely-accepted agencies for bond investors.

**Q. DOES APPROVAL OF A 55.81 PERCENT GAS EQUITY RATIO POSITION PUBLIC SERVICE FAVORABLY WITHIN MOODY'S GUIDELINES FOR AN A RATED UTILITY?**

A. No. At the Company's requested 55.81 percent Gas equity ratio, the resulting credit metrics place Public Service at the very bottom of Moody's allowable CFO pre-WC/Debt metric range for an A3 public utility. In order to maintain a strong

credit rating at the A level, it is not advisable for Public Service to position itself as a borderline credit, or a credit just above the threshold for the next lower credit rating. However, this is likely to be Public Service's credit metric position with Moody's even if the Commission accepts the Company's recommended WACC in this proceeding.

**Q. IN LIGHT OF THESE METRICS, WILL APPROVAL OF THE COMPANY'S REQUESTED 55.81 EQUITY RATIO ELIMINATE DOWNWARD PRESSURE ON THE COMPANY'S FINANCIAL INTEGRITY?**

A. No. Even at the Company's requested 55.81 percent Gas equity ratio, the downward pressure on Public Service's CFO to debt credit metrics will continue. This is because an equity ratio of 55.81 percent results in metrics at the very bottom of the Moody's allowable CFO pre-WC/Debt metric range for an A3 public utility.

It is also important to note that the metrics shown above are based on the assumption of the requested 9.95 percent Gas ROE in this case, which, as I mentioned earlier, is supported by Company witnesses Ms. Bulkley and Ms. Trammell in their Direct Testimonies. An ROE result below the Company's request in this case would further reduce cash flow for all of Public Service, which will put more pressure on the metric and increase the risk of not meeting the credit metric threshold. Metrics at the lower end of the range of the credit metric threshold could increase credit rating agency perception of risk because

this may indicate a reduction in Public Service's ability to respond to unexpected business or economic events.

**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 exceeded 88 basis points for 10-year bonds and exceeded 71 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.[17]

[17] 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 seeks to do so at reasonable levels and 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 4.08 percent embedded cost of long-term debt, which is the Company's 13-month average forecasted cost of long-term debt as of September 30, 2020. The detailed calculation is shown in page 2 of Attachment SWS-5. 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 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 2.79 percent embedded cost of short-term debt, which is the Company's 13-month average

forecasted cost of short-term debt as of September 30, 2020. The cost of short-term debt is based on the 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.

**Q. WHY IS THE COMPANY PROPOSING TO INCLUDE SHORT-TERM DEBT IN THE COMPANY'S CAPITAL STRUCTURE?**

A. The rationale for including short-term debt is that the Company is using short-term debt to fund CWIP. Public Service is therefore proposing to include short-term debt in the Company's capital structure, provided that the Commission allows the Company to adhere to the principle that the inclusion of short-term debt necessitates the inclusion of CWIP in rate base, as well as an AFUDC offset to earnings.

The inclusion of short-term debt in the capital structure also helps maintain consistency between Public Service's largest departments, Gas and Electric. The Company maintains one capital structure across its entities and this will align the Gas and Electric Departments. Finally, the Commission approved including short-term debt in the Company's capital structure for the Electric Department in the recent 2019 Electric Phase I, and circumstances have not changed materially. Including short-term debt in the capital structure in this case in the

manner proposed by the Company is consistent with maintaining a single capital structure.

## IV. OVERALL RECOMMENDATION AND CONCLUSION

**Q. IN LIGHT OF THESE ANALYSES, WHAT ARE 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 Test Year ending September 30, 2020, as shown in Table SWS-D-5 below. The Gas ROE is set at 9.95 percent, as supported by Ms. Bulkley and Ms. Trammell in their Direct Testimonies.

**Table SWS-D-5**

| | | **September 30, 2020** | |
|---|---|---|---|
| | **Ratio** | **Rate** | **Wtd Cost** |
| Long-Term Debt | 42.97% | 4.08% | 1.75% |
| Short-Term Debt | 1.22% | 2.79% | 0.03% |
| Equity | 55.81% | 9.95% | 5.55% |
| **Total Cost** | | | **7.33%** |

Detailed supporting schedules for the calculation of long-term and short-term debt are included in Attachment SWS-5.

**Q. WHY DOES PUBLIC SERVICE SUPPORT A CAPITAL STRUCTURE**

**COMPOSED OF 55.81 PERCENT EQUITY, 42.97 PERCENT LONG-TERM DEBT, AND 1.22 PERCENT SHORT-TERM DEBT?**

A. Public Service proposes this capital structure because it:

- Reflects the Company's 13-month average forecasted regulated equity ratio as of September 30, 2020, and is consistent with the recent Public Service 2019 Electric Phase I outcome for the equity ratio that has been considered credit positive by credit rating agencies;[18]

- Supports Public Service's financial integrity, which will allow continued long-term debt financing at reasonable rates;

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

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

**Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

A. Yes, it does.

[18] Attachment SWS-6 at 1.

**Statement of Qualifications**

**Sarah W. Soong**

I received my Bachelor of Arts degree in Government in 1992 from the College of William and Mary, my Master of Arts degree in Western European and French Studies in 1997 from Lauder Institute at the University of Pennsylvania, and my Master of Business Administration degree in Finance in 1997 from The Wharton School at the University of Pennsylvania.

My current position with Xcel Energy is Vice President and Treasurer. I have been employed by Xcel Energy Inc. since August 2018. 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 policy.

I worked for ONCOR Electric Delivery Company, LLC in Dallas, Texas, from 2017 through 2018 as the Vice President and Treasurer. I also worked for Hunt Consolidated Inc. in Dallas, Texas, from 2005 through 2017. I started as the Manager of Corporate Finance from 2005 through 2010, followed by the Director of Project Finance from 2010 through 2012, and finally as the Vice President of Project Finance from 2012 through 2017.

From 2004 through 2005, I worked for The Neiman Marcus Group Inc. in Dallas, Texas, as the Manager of Corporate Finance. I worked for Exodus Energy, LLC., in

Houston, Texas, in 2003 as the Director and for Enron Corporation in Houston, Texas, from 1997 through 2002 as the Manager of Global Finance and Treasury.

I worked for ABN Amro Bank, Netherlands, Czech Republic from 1993 through 1995 as the Relationships Manager, Global Clients. I worked for N.M. Rothschild and ČESKOSLOVENSKÁ OBCHODNÍ BANKA (ČSOB), Prague, Czech Republic, during 1993 as the Financial Advisor and Consultant to N.M. Rothschild on behalf of ČSOB.

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

* * * *

| | | |
|---|---|---|
| **IN THE MATTER OF ADVICE NO. 961-GAS OF** | ) | |
| **PUBLIC SERVICE COMPANY OF COLORADO TO** | ) | |
| **REVISE ITS COLORADO PUC NO. 6-GAS TARIFF** | ) | |
| **TO INCREASE JURISDICTIONAL BASE RATE** | ) | **PROCEEDING NO. 20AL-_____G** |
| **REVENUES, IMPLEMENT NEW BASE RATES** | ) | |
| **FOR ALL GAS RATE SCHEDULES, AND MAKE** | ) | |
| **OTHER PROPOSED TARIFF CHANGES** | ) | |
| **EFFECTIVE MARCH 7, 2020.** | ) | |

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**AFFIDAVIT OF SARAH W. SOONG**
**ON BEHALF OF**
**PUBLIC SERVICE COMPANY OF COLORADO**

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I, Sarah W. Soong, 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 Denver, Colorado, this 29 day of January, 2020.

Sarah W. Soong
Vice President and Treasurer

Subscribed and sworn to before me this 29 day of January, 2020.

JODY FOSTER
NOTARY PUBLIC - MINNESOTA
My Commission Expires
January 31, 2024

Notary Public

My Commission expires 1-31-24