

DOCKET NO. _____

APPLICATION OF SOUTHWESTERN § PUBLIC UTILITY COMMISSION
PUBLIC SERVICE COMPANY FOR §
AUTHORITY TO CHANGE RATES § OF TEXAS

DIRECT TESTIMONY
of
TODD A. SHIPMAN, CFA

on behalf of

SOUTHWESTERN PUBLIC SERVICE COMPANY

(Filename: ShipmanRRDirect.doc)

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GLOSSARY OF ACRONYMS AND DEFINED TERMS

<u>Acronym/Defined Term</u>	<u>Meaning</u>
CFO	Cash Flow from Operations
Commission	Public Utility Commission of Texas
ROE	Return on Common Equity
S&P	S&P Global Ratings
SPS or Company	Southwestern Public Service Company, a New Mexico corporation
Xcel Energy	Xcel Energy Inc.

LIST OF ATTACHMENTS

<u>Attachment</u>	<u>Description</u>
TAS-RR-1	Resume of Todd A. Shipman <i>(Non-native format)</i>
TAS-RR-2	Utility Credit Consultancy LLC Filings for Todd A. Shipman <i>(Non-native format)</i>
TAS-RR-3	Moody's and S&P Ratings Scales <i>(Non-native format)</i>

**DIRECT TESTIMONY
OF
TODD A. SHIPMAN**

1 **I. WITNESS IDENTIFICATION AND QUALIFICATIONS**

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

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

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

6 A. I am testifying on behalf of Southwestern Public Service Company, a New Mexico
7 corporation (“SPS” or “Company”). SPS is a wholly-owned electric utility
8 subsidiary of Xcel Energy Inc. (“Xcel Energy”).

9 **Q. What is your education and business experience?**

10 A. I graduated from Texas Christian University with a Bachelor of Business
11 Administration (B.B.A.) degree with a major in economics and from Texas Tech
12 University School of Law with a Juris Doctor (J.D.) degree. I was awarded the
13 Chartered Financial Analyst (C.F.A.) designation in 1989. I have over 35 years of
14 experience in the financial and utility industries. I began in the financial industry as
15 an analyst with a research firm that specialized in analyzing and reporting the
16 investment implications of the actions and behavior of utility regulators.
17 Subscribers to the research included investment bankers and analysts at major Wall
18 Street firms, large institutional investors such as insurance companies and mutual
19 funds, utilities, and regulators. I then joined an independent power producer. My
20 primary responsibility was in regulatory affairs, where I coordinated its
21 participation in state regulatory proceedings.

1 I spent the last 21 years of that stage of my career at S&P Global Ratings
2 (“S&P”), a major ratings agency that has been in business over 150 years and issues
3 more than one million ratings on over \$46 trillion of debt across all global capital
4 markets. I performed credit surveillance of utilities, pipelines, midstream energy,
5 and diversified energy companies. In the final ten years at S&P, I was the Sector
6 Specialist on the North American utilities team. In that role, I was the lead analyst
7 on the team, charged with ensuring ratings quality, assisting in the training and
8 development of new analysts, and creating the criteria used to establish ratings on
9 utilities. I also led outreach efforts to investors and the regulatory community and
10 performed a lead analytical role in the development and application of global
11 ratings criteria for hybrid capital securities such as preferred stock.

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

18 **Q. Have you previously sponsored testimony before regulatory authorities?**

19 A. Yes. I filed rebuttal testimony on behalf of SPS in Texas in Docket No. 49831. In
20 addition to filing testimony before the Public Utility Commission of Texas
21 (“Commission”), I have submitted testimony to the Federal Energy Regulatory
22 Commission, the Hawaii Public Utilities Commission, the Wisconsin Public
23 Service Commission, the California Public Utilities Commission, the New York

1 Public Service Commission, the Virginia State Corporation Commission, the
2 Mississippi Public Service Commission, the New Mexico Public Regulation
3 Commission, and the Arizona Corporation Commission. A list of the proceedings
4 and filings is provided as Attachment TAS-RR-2.

1 ample funds needed to operate and invest in a business, is improved with a rating
2 because it offers investors high-quality information from a third party regarding the
3 risk of investing in or doing business with the issuer. The agencies publish analyses
4 of the issuers and issuances to explain the ratings to the capital markets. Ratings
5 are expressed in a series of letters, numbers, and/or symbols to summarize the
6 relative creditworthiness of the entity or issue. The ratings scales of the two major
7 rating agencies appear in Attachment TAS-RR-3.

8 Ratings in the BBB/Baa category and above are considered “investment-
9 grade” by market participants. Ratings below BBB-/Baa3 are known as
10 “speculative-grade,” or colloquially “junk,” securities. Because some investors are
11 precluded from holding speculative-grade issues, the difference between
12 investment-grade and speculative-grade ratings is significant and recognized as
13 such by rating agencies and market participants.

14 **Q. Are credit ratings a useful and accurate measure of a company’s risk profile**
15 **and financial strength?**

16 A. Yes. The default experience of issuers validates the usefulness of credit ratings as
17 a measure of risk. According to Moody’s, in the 1994-2020 time period, the five-
18 year average, volume-weighted corporate bond default rate increased from one
19 rating category to the next lower one in the ratings scale, from a low of 0.4% for
20 the Aaa category to 39.3% for the combined “Caa-C” categories.² Thus, experience
21 shows that lower ratings do in fact correspond to higher default risk and poorer
22 financial health.

² See Exhibit 54 in Moody’s Investor Service, *Annual Default Study*, January 28, 2021.

1 **Q. Who uses credit ratings?**

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

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

14 A. Ratings are established by a committee that specializes in the industry or industries
15 of the rated entity, not by individual analysts. Ratings conform to common
16 standards of credit risk across all issuers, industries, and markets by employing
17 consistently applied ratings criteria. The basic analysis is two-fold. The
18 quantitative side of the analysis examines financial ratios and other metrics to
19 analyze the financial risk of a particular issuer. The qualitative side is the
20 assessment of business risk, which is built up from the broad macro risks at the
21 country and industry level. The issuer's more specific risk within its business and
22 economic environment is then determined. For a utility, the major business risks
23 are regulatory risk, operating risk, and cash-flow diversity. The first, regulatory

1 risk, is an overwhelmingly major factor in the analysis. Because utilities are tightly
2 regulated on financial matters that limit how much financial metrics can vary over
3 time, it is often the qualitative analysis that drives ratings outcomes.

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

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

18 Credit metrics, which are calculated for both historical periods and future
19 forecasts, fall into two basic types: leverage and coverage ratios. Since ratings are
20 forward-looking, the forecast is given more weight than the historical period in the

³ For Moody's it's 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.

1 analysis. Leverage metrics attempt to assess the relative burden of debt and other
2 fixed-income obligations compared to the financial responsibility being carried by
3 shareholders. Coverage metrics are something of the opposite, gauging the
4 question of how cash flow compares to the need to service the fixed-income
5 obligations in the near term.

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

8 A. Evaluating business risk for utilities is predominantly a matter of regulatory risk.
9 Even for areas that do not explicitly touch on regulatory behavior, business risk
10 determinations almost invariably circle back to the central question of utility
11 regulation: cost recovery, including the ability to recover the cost of capital through
12 a reasonable authorized return on equity. The nature and pace of the process of
13 recognizing an incurred cost as recoverable through rates is the paramount
14 business-risk factor for a utility credit analyst. The other elements of regulatory
15 risk, such as the political influences on regulation, are analyzed to discern the risk
16 surrounding the ultimate factor of covering all costs sufficiently to earn a
17 reasonable return on investment.

18 **Q. How is regulatory risk analyzed?**

19 A. For Moody's regulatory risk constitutes over 80% of business risk, and for S&P it
20 is 60%.⁴ Both focus on the basic regulatory framework, including (1) the legal
21 foundation for utility regulation, (2) the ratemaking policies and procedures that

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

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

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

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

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

17 A. No. Rating agencies also look holistically at the consistency and transparency
18 displayed within a regulatory jurisdiction.⁵ Consistency refers to the predictability
19 of regulatory behavior in that precedents are respected and any changes in major
20 decisions are measured, deliberate, and gradual. Transparency is a related concept
21 and refers to regulation that is open and balanced in a manner that allows utilities

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

1 to make long-term decisions with confidence that the expected regulatory treatment
2 will be followed. Rating agencies rate many types and tenors of fixed income
3 securities, but they regard debtholders who extend credit over long periods as their
4 primary audience and strive to rate long-term debt as accurately as possible over
5 the longest timeframe as possible. Utilities ultimately fund capital expenditures
6 with long-dated maturities to match the long-lived assets they are supporting, and
7 utility investors' value ratings that are forward-looking and stable. Regulatory
8 frameworks and practices that allow rating agencies to confidently project future
9 cash flows and debt leverage will naturally be accorded a better business risk
10 profile. This predictability offers creditors the ability to accurately assess risk over
11 most of the debt's term and improves the ability of the company to manage its
12 business activities and capital program for the long-term benefit of ratepayers.

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

14 A. The most straightforward effect is on a utility's cost of capital. Fixed-income
15 investors and other creditors consult ratings to assist them in determining the
16 "price" they will charge the utility for the use of their money. The total price is the
17 combination of the interest rate of the instrument and its initial value in relation to
18 the stated amount on the instrument. There is an inverse relationship between the
19 cost of debt and ratings: the higher the rating, the lower the cost. Equity investors
20 also use credit ratings as a risk guide to help them decide the terms under which
21 they will offer their capital to a utility. The more risk they detect, the greater return
22 they will require as compensation for bearing that risk. The effect is not as direct or

1 precisely quantifiable as it is with fixed-income instruments, but in my experience
2 equity investors often take notice of and react to credit ratings.

3 **Q. How does regulation influence credit ratings?**

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

14 **Q. Why are the authorized ROE and capital structure strong influences on a
15 utility’s credit rating?**

16 A. The authorized ROE and capital structure are important for two reasons. From the
17 standpoint of credit metrics, these two elements of the revenue requirement
18 calculation have a clear impact. More supportive determinations on these inputs
19 give a utility a better opportunity to earn its actual cost of capital and provide more
20 operating cash flow. Secondly, investors and rating agencies view them as
21 indicators of a regulator’s attitude toward the utility’s providers of capital.

22 From the financial markets’ perspective, the authorized ROE is the most
23 prominent feature of a rate case decision after the amount of the rate increase or

1 decrease. The authorized ROE reveals the regard that the regulator has toward the
2 investors that are furnishing the capital needed to maintain safe and reliable utility
3 service and achieve other public policy goals. An in-depth analysis of all aspects
4 of the rate decision is required to fully understand the ratings implications of the
5 outcome and assess the utility’s ability to earn its return in the wake of the order,
6 but the authorized return is widely used by investors to make preliminary judgments
7 about the relative supportiveness of a regulatory jurisdiction. As such, it is an
8 important signaling device to the investment community and can affect the cost of
9 capital, both equity and debt, and therefore customer utility rates over the long term.

10 For fixed-income investors, the equity component in the approved capital
11 structure takes on added importance, as the utility will be constrained in managing
12 its balance sheet by the regulatory capital structure. The utility has no incentive to
13 inject more equity capital to support credit quality and improve ratings than the
14 amount the regulator deems sufficient for ratemaking purposes. The ROE/equity
15 ratio combination is an effective communication tool to underscore a regulator’s
16 interest in attracting capital to facilitate safe and reliable utility service in its state.

17 **Q. Is the authorized ROE the only important measure of profitability that the**
18 **rating agencies use to assess regulatory risk?**

19 A. No. In fact, ratings agencies care as much about a utility’s ability to actually *earn*
20 the authorized return as they do about the authorized ROE. One of the most
21 prominent factors in the Moody’s methodology as it pertains to regulatory risk is
22 called “Ability to Recover Costs and Earn Returns.”⁶ While Moody’s addresses

⁶ Moody’s, *Rating Methodology*, p. 12.

1 the sufficiency of returns elsewhere and acknowledges that it is interrelated with
2 the ability to earn returns, they are mostly focused on “the ability of a utility to
3 recover its costs and earn a return over a period of time, including during differing
4 market and economic conditions.”⁷ S&P has also highlighted this principle:

5 “We review authorized returns and capital structures in our
6 analysis, but we focus mainly on actual earned returns.
7 Examples abound of utilities with healthy authorized returns
8 that have no meaningful expectation of earning those returns
9 due to, for example, rate case lag (i.e., the relationship
10 between approved rates and the age of the costs used to set
11 those rates) or expense disallowances.”⁸

12 The rating agencies emphasize the difference between authorized and earned
13 returns because both must be analyzed to accurately assess regulatory risk. An
14 authorized ROE that corresponds with the utility’s actual cost of common equity
15 capital is just the first step. Actually earning that return on a consistent basis is the
16 real test of a regulatory environment. That is why rating agencies devote so much
17 effort to understanding regulatory regimes and ratemaking procedures to determine
18 how they alleviate or impede a utility’s ability to manage risk.

⁷ Ibid.

⁸ S&P, *Assessing U.S. Investor-Owned Utility Regulatory Environments*, May 18, 2015, pp. 3-4.

1 **IV. SPS'S CREDIT RATINGS**

2 **Q. What are the Company's credit ratings?**

3 A. Because Moody's and S&P produce the most commonly relied on credit ratings, I
4 will focus on their ratings for SPS. I address the basic long-term and short-term
5 credit ratings, the *issuer* ratings, because these measure the risk of default and
6 preserve comparability without introducing ancillary matters that affect individual
7 issue ratings such as recovery and seniority. Default risk is the fundamental risk of
8 an entity. Recovery and seniority affect the degree of an investor's losses only if
9 default occurs and thus are not relevant for this discussion.

10 Moody's carries an issuer rating of 'Baa2' for SPS.⁹ S&P's issuer rating
11 for the Company is 'A-', two notches higher than the Moody's rating due to support
12 from parent company Xcel Energy.¹⁰ S&P also publishes a stand-alone credit
13 profile (SACP) of 'bbb+' that is comparable to the Moody's approach to rating an
14 issuer with less emphasis on the influence of the parent.¹¹ In my experience,
15 investors look to both types of evaluations when making investment decisions but
16 tend to place more value on the stand-alone credit quality of the entity to whom
17 they are considering lending money. The short-term ratings are 'A-2'/'P-2.'

18 **Q. How would you generally describe Moody's and S&P views regarding SPS's**

⁹ This was recently reviewed and affirmed. Moody's, *Announcement of Periodic Review: Moody's announces completion of a periodic review of ratings of Xcel Energy Inc.*, October 16, 2020.

¹⁰ S&P, *Southwestern Public Service Co.*, Oct. 19, 2020.

¹¹ The SACP is an intermediate determination in S&P's ratings methodology that signifies what an issuer's rating would be absent extraordinary parental support. S&P, *General Criteria: Stand-Alone Credit Profiles: One Component of a Rating*, September 25, 2020.

1 **credit profile?**

2 A. The specifics of how the SPS-specific credit assessment is determined suggest that
3 the agencies view the Company’s risk profile as slightly below (i.e. riskier than)
4 the average U.S. utility. For S&P, the business risk profile and financial risk profile
5 combination places SPS roughly in the middle or even a little above the U.S. utility
6 average.¹² The scoring that brings the assessment down is a peer analysis that S&P
7 performs to fine-tune the analysis.¹³ Moody’s analysis is similar, where most of its
8 scoring falls along the A/Baa divide with a final step akin to a peer analysis that
9 brings the rating down even further than the S&P evaluation.¹⁴

10 **Q. Should the Commission be satisfied with those ratings?**

11 A. No. I believe the ratings are below the optimal level for SPS, ratepayers, and other
12 stakeholders.

¹² S&P, *Southwestern Public Service Co.*, Oct. 19, 2020, p. 6.

¹³ *Id.* at 10.

¹⁴ Moody’s, *Credit Opinion, Southwestern Public Service Company, Update to credit analysis*, Dec. 31, 2020, Exhibit 8 on page 8.

1 **V. OPTIMIZING THE SPS RATING**

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

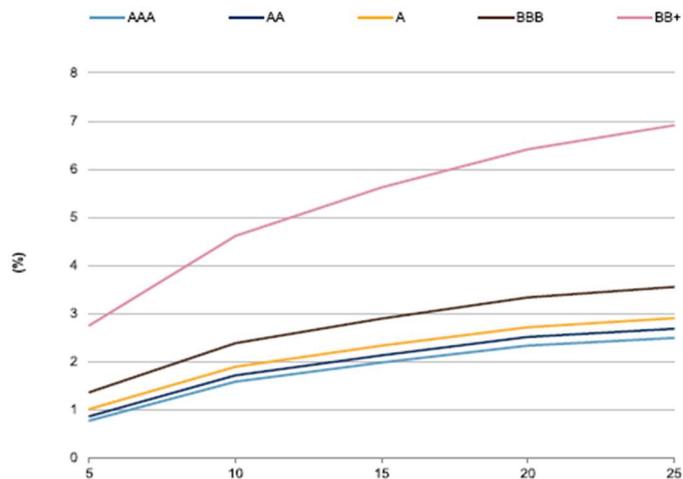
3 A. The Public Utility Commission of Texas should set a goal of a single-A issuer credit
4 rating for SPS to guide future decisions that could affect credit quality. Achieving
5 that goal and maintaining that rating would result a lower cost of capital over time
6 for customers and assure the Company ample access to capital in all economic and
7 credit-market conditions.

8 **Q. Why do you think a single-A issuer credit rating will produce a lower cost of**
9 **capital?**

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

14 **Chart 1¹⁵**

U.S. Corporate Bond Yields By Maturity



Data as of Jan. 27, 2021. Source: S&P Global Ratings Research.
Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

¹⁵ S&P, *Credit Trends: U.S. Corporate Bond Yields as of January 27, 2021*, Jan. 28, 2021.

1 **Q. What is the other major benefit to a single-A rating?**

2 A. Getting into the ‘A’ category is not sufficient to obtain the full ratepayer benefit of
3 better credit quality. Upgrading to an ‘A’ issuer credit rating, in the middle of the
4 category, would raise SPS’s short-term ratings.¹⁶ Short-term ratings are tied to
5 long-term ratings. In normal markets, that provides adequate access to
6 cost-effective, short-term debt in the commercial paper market. ‘A-1’/‘P-1’ short-
7 term ratings ensure better access to capital during stressful market conditions, such
8 as those that prevailed during the 2008 financial crisis. Prudent risk management
9 anticipates all contingencies, including infrequent but keenly disruptive markets
10 that impede access to short-term capital for working capital needs and capital
11 expenditures. Increasingly globalized capital and commodity markets have
12 experienced many episodes of varying intensity in the past few decades. In living
13 memory capital markets have been subject to such disparate and globally dispersed
14 incidents as the 1998 Asian Tiger phenomenon, the 2009 Euro crisis, the 2008 U.S.
15 financial system, and the 2020 COVID-19 pandemic near-collapse that saw
16 widespread bank failures, severe equity market volatility, and constrained capital
17 access for all but the strongest corporations. ‘A-1’/‘P-1’ short-term ratings would
18 allow SPS to maintain greater access to short-term capital to withstand those kinds
19 of events.

¹⁶ S&P, *General Criteria: Methodology For Linking Long-Term And Short-Term Ratings*, Aug. 7, 2020. Moody’s, *Cross-Sector Rating Methodology: Short-Term Ratings*, May 10, 2019.

1 **Q. What is the path to an ‘A’ S&P rating for SPS?**

2 A. Both financial and business risks should be considered in order to address the peer
3 modifier that depresses the SPS rating below the optimal level. On the financial
4 side, higher authorized ROEs and a strong capital structure will help improve credit
5 metrics.¹⁷ Business risk is a matter of regulatory risk. Progress on both sides of
6 the credit equation will continue the process of moving the peer analysis toward a
7 positive ratings influence.

8 **Q. What is the path to an ‘A’ Moody’s rating for SPS?**

9 A. Moody’s assigns lower scores to SPS in important areas such as “Consistency and
10 Predictability of Regulation” and “Sufficiency of Rates and Returns.”¹⁸ Stronger
11 financial performance from higher ROEs and a strong capital structure, combined
12 with consistent improvement in regulatory risk, would raise these relatively low
13 scores. A positive trend on returns, both in terms of authorizing a competitive
14 return on equity that can be consistently achieved, would help persuade Moody’s
15 to consider raising the scores over time to produce an indicated rating in the ‘A’
16 category and assign a rating that corresponds to the indicated outcome. Although
17 adopting the requested return and capital structure in this case would be a positive
18 first step, that would not likely result in an immediate ratings upgrade.¹⁹

¹⁷ Authorizing the requested ROE and capital structure in this proceeding will support the current credit profile. Direct Testimony Patricia A. Martin at 25.

¹⁸ Moody’s, *Credit Opinion, Southwestern Public Service Company, Update to credit analysis*, Dec. 31, 2020, Exhibit 8 on page 9.

¹⁹ *See id.* at 2.

1 **Q. You identify credit metric improvement as a key to the rating goal. What**
2 **other factors may be impediments to improving credit metrics?**

3 A. In addition to better returns and a strong capital structure, it is important to
4 understand that off-balance-sheet adjustments that rating agencies make to SPS's
5 reported financial results have a significant impact. For instance, the three primary
6 S&P adjustments – for lease obligations, purchased power debt equivalency, and
7 asset retirement obligations – add a third more adjusted debt to the Company's
8 actual debt balances.²⁰ Regulators should keep that in mind when gauging the level
9 of financial support needed to achieve better ratings.

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

12 A. I cannot stress enough the crucial role that *consistency* in a regulator's decision-
13 making plays in the exercise. Actively changing a rating agency's fundamental
14 attitude toward a jurisdiction will rely more on confidence that trends that reduce
15 regulatory risk will be durable. Another way of putting it, which appears in the S&P
16 criteria on rating utilities, is predictability.²¹ Consistency and predictability form
17 the core of the first of S&P's four "pillars" of a utility regulatory framework. Given
18 that a rating is at its heart a forward-looking measure of risk, offering the
19 consistency and predictability that contain risk is essential.

20 **Q. Does this conclude your direct testimony?**

21 A. Yes.

²⁰ Direct Testimony of Patricia A. Martin at 26.

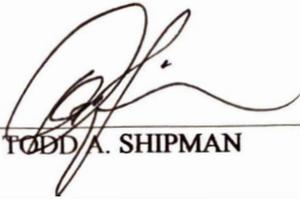
²¹ S&P, *Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry*, Dec. 4, 2019, paragraph 24.

AFFIDAVIT

STATE OF MASSACHUSETTS)
)
COUNTY OF BARNSTABLE)

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

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



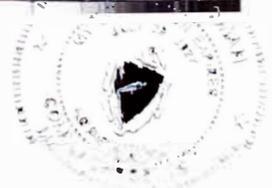
TODD A. SHIPMAN

SUBSCRIBED AND SWORN TO before me this 1st day of February, 2021
TODD A. SHIPMAN



Notary Public of the State of Massachusetts

My Commission Expires: July 29, 2027



TODD A. SHIPMAN, CFA

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Experience

Utility Credit Consultancy LLC **Orleans, MA**
Principal May 2018 - Present

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

Boston University **Boston, MA**
Lecturer January 2017 – June 2020

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

S&P Global Ratings **New York, NY and Boston, MA**
Senior Director April 2014 - May 2018
Director April 2000 - April 2014
Associate Director March 1997 - April 2000

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

Electric Utility Research Inc (defunct), San Francisco, CA
Senior Vice President May 1996 - March 1997

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

Sithe Energies Inc. **New York, NY**
Manager, Regulatory Affairs November 1993 - May 1996

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

Regulatory Research Associates **Jersey City, NJ**
Vice President October 1993 - November 1993
Senior Analyst August 1989 - October 1993
Analyst August 1985 - August 1989

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

Education

J.D., Texas Tech University School of Law, Lubbock, TX May 1984

B.B.A., Texas Christian University, Fort Worth, TX May 1981

Professional Affiliations & Other Activities

Executive Advisor, Concentric Energy Advisors, Marlborough MA

Chartered Financial Analyst

Wall Street Utility Group

Fixed Income Analysts Society Inc

Society of Utility and Regulatory Financial Analysts

Other Activities

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



FILINGS

Unless otherwise noted, the proceeding was a rate case.

Company: Hawaiian Electric Companies

State: Hawaii

Docket/Proceeding: # 2018-0088, *Instituting a Proceeding to Investigate Performance-Based Regulation*

Date: October 25, 2018

Submittal: Regulatory Assessment Brief (Appendix: Effect of Major Regulatory Reform on Credit Quality)

Company: Wisconsin Electric Power Co. / Wisconsin Gas LLC

State: Wisconsin

Docket/Proceeding: #05-UR-109

Date: March 28, 2019 / September 17, 2019

Submittal: Direct and Rebuttal Testimony

Company: Wisconsin Public Service Corp.

State: Wisconsin

Docket/Proceeding: #6690-UR-126

Date: March 28, 2019

Submittal: Direct Testimony

 Utility
 Credit
 Consultancy LLC

FILINGS

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

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

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

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

 Utility
 Credit
 Consultancy LLC

FILINGS

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

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

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

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

 Utility
 Credit
 Consultancy LLC

FILINGS

Company: Hawaiian Electric Companies

State: Hawaii

Docket/Proceeding: # 2018-0088, *Instituting a Proceeding to Investigate Performance-Based Regulation*

Date: June 18, 2020

Submittal: Phase 2 Statement of Position (Exhibit C2: Financial Integrity and Credit Ratings)

Company: Arizona Public Service Co.

State: Arizona

Docket/Proceeding: #E-01345A-19-0236

Date: November 6, 2020

Submittal: Rebuttal Testimony

Company: Southwestern Public Service Co.

State: New Mexico

Docket/Proceeding: #20-00238-UT

Date: December 18, 2020

Submittal: Direct Testimony

EXHIBIT TAS-R-3

RATINGS SCALES

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

Note: The line demarcates the investment-grade/speculative-grade divide