DIRECT TESTIMONY OF  
STEVEN M. FETTER  
ON BEHALF OF  
GEORGIA POWER COMPANY  
  
DOCKET NO. 42516

# INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Steven M. Fetter. I am President of Regulation UnFettered. My business address is 1240 West Sims Way, Port Townsend, Washington 98368.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of Georgia Power Company (“Georgia Power” or “the Company”) before the Georgia Public Service Commission (“Commission” or “GPSC”).

Q. By whom are you employed and in what capacity?

A. I am President of Regulation UnFettered, a utility advisory firm I started in April 2002. Prior to that, I was employed by Fitch, Inc. (“Fitch”), a credit rating agency based in New York and London. Prior to that, I served as Chairman of the Michigan Public Service Commission (“Michigan PSC”). I am also an attorney, having graduated from the University of Michigan Law School in 1979.

Q. Please describe your service on the Michigan PSC.

A. I was appointed as a Commissioner to the three-member Michigan PSC in October 1987. In January 1991, I was promoted to Chairman and retained that designation following reappointment in 1993. During my tenure as Chairman, timeliness of commission processes was a major focus and my colleagues and I achieved the goal of eliminating the agency’s case backlog for the first time in 23 years. While on the Michigan PSC, I also served as Chairman of the Board of the National Regulatory Research Institute (“NRRI”), the research arm of the National Association of Regulatory Utility Commissioners (“NARUC”). After leaving regulatory service, I was appointed to the NRRI Board as a public member. I have also served as a lecturer at Michigan State University’s Institute of Public Utilities Annual Regulatory Studies Program (“Camp NARUC”) and at NARUC’s New Commissioner Regulatory Orientation.

Q. Please describe your role as President of Regulation UnFettered.

A. I formed a utility advisory firm to use my financial, regulatory, legislative, and legal expertise to aid the deliberations of regulators, legislative bodies, and the courts, and to assist them in evaluating regulatory issues. My clients have included investor-owned and municipal electric, natural gas and water utilities, state public utility commissions and consumer advocates, non-utility energy suppliers, international financial services and consulting firms, and investors.

Q. What was your role in your employment by Fitch?

A. I was Group Head and Managing Director of the Global Power Group within Fitch. In that role, I served as group manager of the combined 18‑person New York and Chicago utility team. I was originally hired to interpret the impact of regulatory and legislative developments on utility credit ratings, a responsibility I continued to have throughout my tenure at the rating agency. In April 2002, I left Fitch to start Regulation UnFettered.

Q. How long were you employed by Fitch?

A. I was employed by Fitch from October 1993 until April 2002. In addition, Fitch retained me as a consultant for a period of approximately six months shortly after I resigned.

Q. How does your experience relate to your testimony in this proceeding?

A. My experience as Chairman and Commissioner on the Michigan PSC and my subsequent professional experience with financial analysis and ratings of the U.S. electric and natural gas sectors – in jurisdictions involved in restructuring activity as well as those still following a traditional regulated path – have given me solid insight into the importance of a regulator’s role vis-à-vis regulated utilities, both in setting their rates as well as the appropriate terms and conditions for the service they provide. In addition, for almost 20 years I have been a member of the Wall Street Utility Group, an organization comprised of debt and equity analysts assigned to cover and make assessments of companies within the utility sector.

Q. Have you previously given testimony before regulatory and legislative bodies?

A. Since 1990, I have testified before the U.S. Senate, the U.S. House of Representatives, the Federal Energy Regulatory Commission, federal district and bankruptcy courts, and various state and provincial legislative, judicial, and regulatory bodies in more than 100 proceedings or hearings on the subjects of credit risk and cost of capital within the utility sector, electric and natural gas utility restructuring, fuel and other energy cost adjustment mechanisms, regulated utility mergers and acquisitions, construction work in progress and other interim rate recovery structures, utility securitization bonds, and nuclear energy. I have previously testified and been accepted as an expert witness before this Commission on behalf of Georgia Power in Docket Nos. 18300, 27800, 31958, 29849 and 36989. My full educational and professional background is presented in my Appendix -1.

Q. What is the purpose of your direct testimony?

A. Utilizing my past experience as a state utility commission Chairman and head of a major utility credit rating practice, my direct testimony focuses on the importance of credit ratings for regulated utilities and their customers; the importance of constructive utility regulation as an underpinning of strong credit quality; how the Company is currently viewed by the credit rating agencies; and how the financial community currently views the utility regulatory environment within Georgia.

Q. Please summarize the conclusions of your direct testimony.

A. A utility’s credit ratings are central to its ability to raise capital at reasonable cost and on reasonable terms. Regulation is a key qualitative component of a utility’s credit ratings, and Georgia is viewed by the market as among the most credit supportive states, which is a strong positive factor in the credit ratings assigned to the state’s regulated utilities. Dr. James Vander Weide, the Company’s Return on Equity (“ROE”) witness, explains in detail the appropriate ROE level and capital structure for Georgia Power under its current circumstances. Georgia Power currently holds the following credit ratings from the three major rating agencies: Standard & Poor’s (“S&P”), ‘A-’ with a Negative outlook, with both Moody’s and Fitch one notch lower at ‘Baa1’ (with a Stable outlook) and ‘BBB+’ (with a Negative outlook), respectively. These ratings are approximately one notch weaker than they were at the time of Georgia Power’s last *scheduled* rate case in 2016[[1]](#footnote-1), and approximately two notches weaker than they were at the time of Georgia Power’s 2013 rate case. In order for Georgia Power to be able to maintain its current ratings range across all three agencies, I encourage the Commission to set the ROE and capital structure at levels consistent with Dr. Vander Weide’s recommendations. Such a Commission determination would show a continuation of the strong regulatory support that Georgia Power has long experienced, which should avoid further weakening in the Company’s credit profile. On the other hand, a less than constructive decision by the Commission in this case could lead to further negative credit rating actions, potentially moving the Company below the ‘BBB+’ / ‘Baa1’ rating level that I have long testified represents the lowest appropriate credit rating level for a U.S. regulated utility. Such negative ratings actions would increase the Company’s cost of capital during a time of ongoing nuclear construction, along with normal day-to-day capital investment for reliability, ultimately leading to higher rates for customers.

# CREDIT RATINGS AND THEIR IMPORTANCE TO REGULATED UTILITIES

Q. What is a credit rating and why is it important?

A**.** A credit rating reflects an independent judgment of the general creditworthiness of an obligor or of a specific debt instrument. While credit ratings are important to both debt and equity investors for a variety of reasons, their most important purpose is to communicate to investors the financial strength of a company or the underlying credit quality of a particular debt security issued by that company.

Credit rating determinations are made by credit rating agencies through a committee process involving individuals with knowledge of a company, its industry, and its regulatory environment. Corporate rating designations of Standard and Poor’s (“S&P”) and Fitch have ‘AAA’, ‘AA’, ‘A’ and ‘BBB’ category ratings within the investment-grade ratings sphere, with ‘BBB-’ as the lowest investment-grade rating and ‘BB+’ as the highest non-investment-grade rating. Comparable rating designations of Moody’s Investors Service (“Moody’s”) at the investment-grade dividing line are ‘Baa3’ and ‘Ba1’, respectively. In addition, the agencies seek to make their rating judgments even more precise by dividing each of the rating categories into three levels (“+”, “neutral”, and “-” at S&P and Fitch, and 1, 2 & 3 at Moody’s). The following chart illustrates the comparability of ratings between the three agencies.

CHART 1

Ratings Categories – Comparability Between Agencies

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Investment Grade | | |  | Below Investment Grade | | |
| S&P and Fitch |  | Moody's |  | S&P and Fitch |  | Moody's |
| AAA |  | Aaa |  | BB+ |  | Ba1 |
| AA+ |  | Aa1 |  | BB |  | Ba2 |
| AA |  | Aa2 |  | BB- |  | Ba3 |
| AA- |  | Aa3 |  | B+ |  | B1 |
| A+ |  | A1 |  | B |  | B2 |
| A |  | A2 |  | B- |  | B3 |
| A- ([[2]](#footnote-2)) |  | A3 |  | CCC |  | Caa |
| BBB+ ([[3]](#footnote-3)) |  | Baa1 ([[4]](#footnote-4)) |  | CC |  | Ca |
| BBB |  | Baa2 |  | C |  | C |
| BBB- |  | Baa3 |  | D |  | [C] |

Corporate credit rating analysis considers both qualitative and quantitative factors to assess the financial and business risks of fixed-income debt issuers. A credit rating is an indication of an issuer’s ability to service its debt, both principal and interest, on a timely basis. At times, a credit rating also incorporates some consideration of ultimate recovery of investment in case of default or insolvency. Ratings can also be used by contractual counterparties to gauge both the short-term and longer-term financial health and viability of a company, including decisions related to required collateral levels, with higher-rated entities facing lower requirements.

Q. How would you describe Georgia Power’s credit ratings status?

A. Georgia Power’s corporate issuer credit ratings span between the lowest level of the ‘A’ category, and the highest level of the ‘BBB’ / ‘Baa’ category.[[5]](#footnote-5) I have long testified that a regulated utility should aim to hold ratings no lower than ‘BBB+’, with a longer-term goal of moving into (or maintaining in) the ‘A’ category. Accordingly, Georgia Power now rests at the lower end of my recommended scale, which increases the importance of this rate proceeding.

Q. Why are credit ratings important for regulated utilities and their customers?

A. A utility’s credit ratings have a significant impact on its ability to raise capital on a timely basis and upon reasonable terms. As economist Charles F. Phillips states in his treatise on utility regulation:

Bond ratings are important for at least four reasons: (1) they are used by investors in determining the quality of debt investment; (2) they are used in determining the breadth of the market, since some large institutional investors are prohibited from investing in the lower grades; (3) they determine, in part, the cost of new debt, since both the interest charges on new debt and the degree of difficulty in marketing new issues tend to rise as the rating decreases; and (4) they have an indirect bearing on the status of a utility’s stock and on its acceptance in the market.[[6]](#footnote-6)

Thus, a utility with strong credit ratings is not only able to access the capital markets on a timely basis at reasonable rates, but is also able to share the benefit from those attractive interest rate levels with customers since cost of capital gets factored into utility rates. Conversely, but of equal importance, the lower a utility’s credit rating, the more the utility must pay to raise funds from debt and equity investors to carry out its capital-intensive operations, and those higher capital costs get factored into the rates that consumers are required to pay. Maintaining Georgia Power’s credit profile is especially important in view of its significant nuclear construction activities, along with capital investment related to its ongoing duty to serve its customers in a safe and reliable manner. Significantly, a regulated utility is required to raise funding even if the markets are in turmoil and costs are escalating wildly. Strong credit ratings limit the negative effects of having to finance at times of great volatility within the capital markets.

Q. What qualitative factors are used by the rating agencies to establish utility credit ratings?

A. The most important qualitative factors are regulation, management and business strategy, and access to energy, gas and fuel supply with recovery of associated costs.

Q. What are the key quantitative measures?

A. The major rating agencies use several financial measures within their utility financial analysis. S&P has been the most transparent of the rating agencies and currently highlights the following two core financial ratios as its key indicators: Funds from Operations to Debt (FFO / Debt), which focuses on cash flow; and Debt to Earnings Before Interest, Taxes, Depreciation and Amortization (Debt / EBITDA), which provides a comparative profitability measure.[[7]](#footnote-7) A focus on these two ratios is consistent with S&P’s long-held belief that “Cash flow analysis is the single most critical aspect of all credit rating decisions,”[[8]](#footnote-8) an opinion shared by both Moody’s and Fitch. I note that all three agencies often adjust these key ratios to reflect imputed debt and interest-like fixed charges related to operating leases and certain other off‑balance sheet obligations.

Q. Why is regulation a key qualitative component of the utility credit rating process?

A. Regulation is a key factor in assessing the financial strength of a utility because a state public utility commission determines revenue levels (recoverable expenses including depreciation and operations and maintenance, fuel cost recovery, and return on investment) and the terms and conditions of service that affect a utility’s cost of service. As Moody’s has long noted, “A utility’s ability to recover its costs and earn an adequate return are among the most important analytical considerations when assessing utility credit quality and assigning credit ratings.”[[9]](#footnote-9) More recently, Moody’s reiterated those points, emphasizing that:

The ability to recover prudently incurred costs on a timely basis and to attract debt and equity capital are crucial credit considerations. The inability to recover costs, for instance if fuel or purchased power costs ballooned during a rate freeze period, has been one of the greatest drivers of financial stress in this sector, as well as the cause of some utility defaults.[[10]](#footnote-10)

Thus, clearly the quality and direction of regulation play a key role in shaping investors’ expectations of how these factors may change in the future. With the era of restructuring now into its third decade, regulation has had to evolve as the nature of a utility’s responsibilities in providing energy services to customers has undergone dramatic change. In some states, industry restructuring was the result of plans formulated by the state legislature. In other states, the regulators, rather than the legislators, have determined the nature and pace of restructuring, or whether it would occur at all.

The regulatory environment affects utility investors’ decisions because, before they are willing to put forward substantial sums of money, they must assess the degree to which regulators understand and accommodate the economic requirements and the financial and operational risks of a rapidly changing industry. Utility investors understand and accept the role of extensive regulation, but they seek decision-making from the regulatory process that is fair, with a significant degree of predictability.

For these reasons, rating agencies look for the consistent application of sound economic and regulatory principles by utility regulators. If a regulatory body were to encourage a utility to make investments based upon an expectation of the opportunity to earn a reasonable return, and then did not apply regulatory principles in a manner consistent with those expectations, investor interest in providing funds to the utility would decline, debt ratings would likely suffer, and the utility’s cost of capital would increase, to the detriment of ratepayers.

Q. WHAT DOES “constructive utility regulation” entail?

A.With a background as both a state utility regulator and an advisor to regulated utilities and consumer advocates, I view “constructive utility regulation” as that which aligns the seemingly competitive interests of utility investors with utility customers in a manner that is consistent and steady over time in such a way that all parties have reasonable expectations about the future of regulatory policy. Importantly, it supports a utility’s ability to provide safe, clean and reliable electricity to its customers with high levels of customer service at reasonable rates. Constructive regulation is efficient and predictable with a long-term focus on stable rates, while also recognizing the need for timely recovery of costs and the value to customers of a financially-strong utility with ready access to the capital markets at attractive rates, even when the financial markets are under stress. It recognizes that utility investors react negatively to sudden changes in regulatory policy and that such uncertainty ultimately has an adverse effect on customers. In sum, longstanding constructive regulatory policy should provide a utility with the confidence to make capital intensive investments and incur O&M expenses for the benefit of its customers, with the reasonable expectation that those costs would be recovered in a timely manner consistent with that stable and consistent regulatory policy.

Q. Have the ratings agencies discussed the importance of “constructive regulation” in their assessment of utility credit profiles?

A. Yes, as I saw firsthand when Fitch recruited me to provide regulatory analysis after I had decided to move on from the Michigan PSC. Moody’s has highlighted the critical role that regulators play in its 2017 rating methodology for regulated utilities:

An over-arching consideration for regulated utilities is the regulatory environment in which they operate. While regulation is also a key consideration for networks, a utility’s regulatory environment is in comparison often more dynamic and more subject to political intervention. The direct relationship that a regulated utility has with the retail customer … can lead to a more politically charged rate-setting environment. …Our views of regulatory environments evolve over time in accordance with our observations of regulatory, political, and judicial events that affect issuers in the sector.[[11]](#footnote-11)

And S&P has long held the same view:

Regulatory advantage is the most heavily weighted factor in [S&P’s] analysis of a regulated utility's business risk profile. …An established, dependable approach to regulating utilities is a hallmark of a credit-supportive jurisdiction. …Major or frequent changes to the regulatory model invariably raise risk due to the possibility of future changes. Steady application of transparent, comprehensible policies and practices lowers risk. …We adjust the assessment downward if the development of the framework was contentious due to policy disputes or legal actions, indicating that the political consensus regarding utility regulation is fragile. … [A] regulatory approach that allows utilities the opportunity to consistently earn a reasonable return as a positive credit factor in our regulatory assessments. …We measure the timeliness of rate decisions, the obsolescence of the costs on which the rates are based, the timing of interim rates, and other practices (such as allowing rates to automatically change in a future period based on inflation) that affect a utility's ability to earn its authorized return. …Practices such as legislative or regulatory recognition of the need for preapproval of [large capital projects], periodic reviews that substantively involve the regulator in the progress of the project, and rolling prudence determinations during construction can reduce the general level of risk…[W]e consider financial stability to be of substantial importance [with cash taking] precedence in credit analysis. …We assess a jurisdiction most strongly if all large expense items are recoverable through an automatic tariff clause that is based on projected costs, adjusts frequently, and has no record of any significant disallowances. … [A] primary factor … is the political independence of regulators.[[12]](#footnote-12)

# FINANCIAL COMMUNITY PERCEPTIONS OF THE GPSC

Q. How is the commission viewed by the financial community?

A. Very positively. Probably the most objective and respected commentator on regulatory policy and activities from a financial community perspective is Regulatory Research Associates (“RRA”). RRA currently rates the Georgia regulatory environment (which goes beyond the Commission to also include legislative and executive branch policies) as Above Average 2, a step up from the ranking at the time of the Company’s last *scheduled* rate case in 2016, and among the top six of the 53 regulatory jurisdictions upon which RRA currently opines. Such status is a strong positive factor within the context of credit rating analysis.

Q. Does Moody’s share the positive assessment about Georgia regulation?

A. Yes. Citing the Commission’s “strong regulatory support” for continuation of construction of the Vogtle new nuclear project and a settlement agreement that increased the Company’s equity ratio to mitigate the negative cash flow effects from the recent U.S. tax legislation, Moody’s stated that Georgia’s “overall regulatory environment remains credit supportive.” Specifically, Moody’s bases its ‘Baa1” rating and Stable outlook on its view that:

the Vogtle cost increases and schedule delays announced thus far are manageable …; that strong regulatory and political support for the project will continue and the utility will recover all prudently incurred Vogtle related costs on a timely basis; that the overall regulatory framework in Georgia will remain credit supportive; and that financial metrics will remain at levels that support the rating …

At the same time, Moody’s warned that:

A downgrade of Georgia Power could occur if there are additional delays or cost increases at the Vogtle project; if material project costs are deemed imprudent or recovery is denied, delayed, or otherwise restricted by the GPSC; if there is a decrease in the level of regulatory, political, public, or partner support for the project; if construction on the project is stopped or slows considerably; or if financial metrics are expected to decline for an extended period …[[13]](#footnote-13)

Q. how does S&P view the georgia regulatory environment?

A. Also positive, but with similar concerns about future Plant Vogtle nuclear construction cost recovery. In its October 12, 2018 report on Georgia Power, S&P stated that it expects the Commission’s “broad-based political and regulatory support for the nuclear construction project to continue,” and that the Company “has effectively managed regulatory risk.” That all said, notwithstanding that S&P maintains the only ‘A’ category rating on Georgia Power, its Negative outlook:

reflects the company’s construction and project execution risks mainly stemming from the company’s cost estimate assumptions, potential change to the project’s scope, missed productivity targets, and the potential inability to attract skilled workers, all of which could result in material cost overruns. In addition, longer-term regulatory risks are likely to persist at least until the Vogtle units 3 and 4 nuclear power plants are completed on schedule and placed into base rates.[[14]](#footnote-14)

Q. what is Fitch’s assessment of the georgia regulatory environment?

A. Fitch similarly views the Commission’s continuing support for the Vogtle units “as constructive and aligned with the conditions” in the Company’s going-forward plan. Not surprisingly, its Negative outlook tracks the concerns of the other two agencies, stating that negative rating action could occur should there be:

Material cost and/or schedule escalation for Vogtle units and any adjustments to the overall project costs not deemed recoverable by the [Commission] and/or absorbed by Georgia Power; Faltering regulatory support in Georgia [for Vogtle] and unfavorable outcome in [this rate case]; [or] Cancellation of the Vogtle project …[[15]](#footnote-15)

Clearly, Georgia Power’s future financial health, already significantly supported by the Commission, will turn on whether the Company can effectively manage future activities related to the completion of Vogtle Units 3 and 4, coupled with sustained regulatory support as the Company proceeds toward that goal.

Q. In addition to the Commission’s key support for Vogtle construction, you refer to its activities related to the federal tax reform legislation as a positive factor. Would you explain your view?

A. Yes. Generally speaking, while the “Tax Cuts and Jobs Act of 2017” (“TCJA”) holds out the promise of lower utility rates for customers, the manner in which those benefits are provided will have an effect on both the financial strength of a regulated utility as well as the size of those reductions once all relevant issues have been factored into the equation. Specifically, two policy provisions in the TCJA will have a significant impact on cash flow for most regulated utilities: the cessation of bonus depreciation, and the lowering of tax rates that might require the near term refunding to customers of currently deferred tax liabilities. With cash flow in most cases being the most important financial factor in the assigning of utility credit ratings, implementation of the tax law has placed newfound financial pressures on regulated utilities across the U.S.

With Georgia Power facing stress on its credit ratings due to the decrease in operating cash flows, the Commission stepped in to increase the Company’s equity layer to 55%, which helps to limit negative effects flowing from the changed operational and financial circumstances. The Company is requesting an increase in its current 55% equity layer to 56%, along with ROE to be set at 10.9%, slightly below Georgia Power’s current authorized level of 10.95%. In addition, as noted in the testimony of Company witnesses David Poroch and Sarah Adams, Georgia Power has proposed an amortization schedule of regulatory assets that will lend further support for the Company’s cash flow and its overall financial profile. During this “post-tax reform” transitional phase, I view these recommendations – if adopted – as appropriately responding to financial community concerns in a way that will allow investors to maintain confidence in both the Company’s and the Commission’s actions. Importantly, I believe such actions should stabilize the Company’s credit ratings no lower than the minimum “BBB+” level I recommend.

Q. does support for continuation of THE Vogtle UNITS 3 and 4 construction exist outside the borders of Georgia?

A. Yes. The Massachusetts Institute of Technology (“MIT”) completed a two-year study in 2018 that concluded that reducing carbon emissions while meeting electricity demand will require a mix of generation assets, including renewable energies along with an important contribution from nuclear.[[16]](#footnote-16) In a follow-up Letter to the Editor of The Augusta Chronicle, MIT Professors Jacopo Buongiorno and John Parsons stated that, in order to meet the aims of the study:

the U.S. should preserve its current fleet of nuclear power plants and invest in new nuclear technologies, such as the AP1000 reactors under construction at the Vogtle site in Georgia. The technology to be demonstrated at Vogtle is sound and advanced because it inaugurates a new generation of more robust nuclear reactors that ultimately should be simpler and cheaper to operate.

Significantly, the MIT faculty members came to that conclusion with full awareness that “the project has been plagued with delays and cost overruns.”[[17]](#footnote-17)

Further, S&P, in a November 6, 2018 report entitled “Can Nuclear Regain Momentum in the U.S. Without Jeopardizing Credit Quality for Regulated Utilities?,” sums up the policy issues in play in this case:

For U.S regulated electric utilities, maintaining credit quality may ultimately depend on several key factors, including financial flexibility, project execution, and strong regulatory support. With the abandonment of the V.C. Summer nuclear power project, the focus now shifts to Vogtle Units 3 and 4, expected to come on-line in November 2021, and 2022, respectively. Successful execution on these units may start to diminish the memory of the myriad of challenges faced by recent plant developers.

In addition, the U.S. Department of Energy has continued its support for new nuclear in the form of an additional $3.7 billion in loan guarantees for Vogtle owners, bringing the total amount of loan guarantees up to $12 billion. In announcing this support, Energy Secretary Rick Perry stated, “The Vogtle project is critically important to supporting the Administration’s direction to revitalize and expand the U.S. nuclear industry. A strong nuclear industry supports a reliable and resilient grid, and strengthens our energy and national security.”[[18]](#footnote-18)

Q. Turning back to the Company’s credit profile, can you discuss how S&P reset its Corporate Methodology in 2013, through which it frames qualitative and quantitative factors into a matrix to assist analysts and investors?

A. Yes. As can be seen in the rating agency statements above, both business risks and financial risks are factored together into determination of an entity’s credit profile, which then is publicly disseminated in the form of a credit rating. I have described how regulation plays a key role in how S&P and the other rating agencies assess a utility’s qualitative factors. Building upon two indicative ratios (FFO / Debt and Debt / EBITDA), S&P then utilizes a matrix to illustrate the interplay between quantitative and qualitative factors. S&P arrives at a “Business Risk Profile” designation that it considers in concert with its “Financial Risk Profile.” Financial Risk is assessed based upon indicative ratios for the two core credit measures noted above, among other financial metrics. The weaker the Business Risk Profile designation, the stronger the financial ratios must be in order to support a particular rating level.[[19]](#footnote-19)

Q. What does S&P’s Business Risk Profile designation reflect?

A. The Business Risk Profile designation reflects S&P’s assessment of qualitative factors such as country risk, industry risk, competitive position, and profitability / peer group comparisons. In the past, S&P explained that assessment of regulation, markets, operations, competitiveness, and management enters into the determination of a Business Risk Profile designation.[[20]](#footnote-20)Under the S&P Methodology, Business Risk Profiles are ranked as ‘Excellent’, ‘Strong’, ‘Satisfactory’, ‘Fair’, ‘Weak’, or ‘Vulnerable’. Similarly, S&P has described the Financial Risk Profile designation as capturing risks related to accounting, financial governance and policies / risk tolerance, cash flow adequacy, capital structure / asset protection, and liquidity / short-term factors. Financial Risk Profiles are designated as ‘Minimal’, ‘Modest’, ‘Intermediate’, ‘Significant’, ‘Aggressive’, or ‘Highly Leveraged’, words that, in my opinion, are used more for ranking than they are accurate descriptions of the strategies adopted by regulated utilities or the actions taken by their regulators.

Georgia Power has been assigned an S&P Business Risk Profile of ‘Excellent’, and a Financial Risk Profile of ‘Significant’.[[21]](#footnote-21) As shown in S&P’s Table 1 printed below, the Company’s risk profiles equate to its current “A-” corporate rating, an assessment that remains within the “A” category, but resides at that category’s lowest notch, along with a Negative outlook.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Table 1  Business and Financial Risk Profile Matrix | | | | | | |
| Business Risk Profile | Financial Risk Profile | | | | | |
|  | Minimal | Modest | Intermediate | Significant | Aggressive | Highly Leveraged |
| Excellent | AAA/AA+ | AA | A+/A | A- | BBB | BBB-/BB+ |
| Strong | AA/AA- | A+/A | A-/BBB+ | BBB | BB+ | BB |
| Satisfactory | A/A- | BBB+ | BBB/BBB- | BBB-/BB+ | BB | B+ |
| Fair | BBB/BBB- | BBB- | BB+ | BB | BB- | B |
| Weak | BB+ | BB+ | BB | BB- | B+ | B/B- |
| Vulnerable | BB- | BB- | BB-/B+ | B+ | B | B- |

Accordingly, I encourage the Commission to continue its supportive regulatory policies and procedures to solidify the Company’s current credit ratings – with the potential that the ratings from Moody’s and Fitch will be able to strengthen over time. Alternatively, a downgrade of S&P’s ‘A-’ rating to ‘BBB+’, joining the other two agencies, would be financially injurious to both customers and investors, especially amidst the Company’s effort to regain momentum with regard to bringing the Vogtle project to completion.

**Q.** **RETURNING TO THE RISK MATRIX, WHY DO YOU FIND S&P’S METHODOLOGY MEANINGFUL?**

A. S&P’s methodology helps facilitate a general understanding of how a credit rating agency carries out the process of formulating a credit rating and the factors that go into such a determination.[[22]](#footnote-22)

Q. Can you discuss how S&P’s methodology can provide guidance to the Commission in this case?

A. Yes, I can. With my background as former head of the Fitch utility ratings practice, I certainly appreciate that the credit rating process goes beyond the mere matching up of ratios with rating ranges. However, the S&P Financial Risk Indicative Ratios (Table 2 below) combined with the business and financial risk profiles (in Table 1 above) are very helpful with regard to indicating rating trends. By combining both quantitative factors (in the form of financial ratios) with qualitative assessments (in the form of a business risk profile ranking), S&P is able to provide useful tools to assess potential credit rating outcomes for individual utility companies.

|  |  |  |  |
| --- | --- | --- | --- |
| Table 2  Cash Flow/Leverage Analysis Ratios – Medial Volatility  (Financial Risk Profile Core Ratios) | | | |
|  | FFO/Debt (%) | Debt/EBITDA (x) |  |
| Minimal | 50+ | less than 1.75 |  |
| Modest | 35-50 | 1.75-2.5 |  |
| Intermediate | 23-35 | 2.5-3.5 |  |
| Significant | 13-23 | 3.5-4.5 |  |
| Aggressive | 9-13 | 4.5-5.5 |  |
| Highly Leveraged | less than 9 | greater than 5.5 |  |

Q. How do you view Georgia Power within the context of the S&P matrix?

A. S&P expects Georgia Power’s FFO/Debt measure to average approximately 15% through 2019, with gradual improvement beginning in 2020. Thus, the Company’s financial profile would be consistent with its “Significant” Financial Risk Profile designation, and when combined with its “Excellent” Business Risk Profile designation, would point to continuation of the Company’s “A-” rating from S&P.[[23]](#footnote-23) Accordingly, I would expect that a constructive decision in this proceeding that shows sustained regulatory support for the Company’s construction of Vogtle Units 3 and 4 to completion, along with the Company’s ongoing capital investment needs, should allow the Company to maintain its current S&P rating of ‘A-’.

# CONCLUSION

Q. Do you have concluding thoughts?

A. Yes. During my participation in regulatory proceedings in Georgia over the past fifteen years, I have seen firsthand this Commission wrestle with difficult issues affecting customers and investors in a constructive manner. Such balanced decision-making has allowed this body to create a regulatory climate in which investors desire to fund utilities in their efforts to provide reliable service at reasonable rates. As I have testified to before this Commission in the past, I believe that utilities and their regulators should strive to attain corporate / issuer credit ratings no lower than ‘BBB+’ / ‘Baa1’, with a longer-range strategy to achieve ratings within the “A” category. A utility that holds “A” category rating status should possess sufficient financial strength to access the capital markets, even under the most stressful of conditions. And this Commission has been supportive of that position. Accordingly, my recommendation in this testimony is that the Company should seek to achieve excellent operational performance going forward, and the Commission should sustain the ongoing constructive regulatory environment, which together should maintain Georgia Power’s current credit ratings through the nuclear construction cycle, with the potential for near-term removal of the Negative outlooks on the S&P and Fitch ratings.

Q. Does this conclude your testimony?

A. Yes, it does.

STEVEN M. FETTER

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Education University of Michigan Law School, J.D. 1979

Bar Memberships: U.S. Supreme Court, New York, Michigan

University of Michigan, A.B. Media (Communications) 1974

April 2002 – Present

President - Regulation UnFettered- Port Townsend, Washington

Founder of advisory firm providing regulatory, legislative, financial, legal and strategic planning advisory services for the energy, water and telecommunications sectors, including public utility commissions and consumer advocates; federal and state testimony; credit rating advisory services; negotiation, arbitration and mediation services; skills training in ethics, negotiation, and management efficiency.

Service on Boards of Directors of: Central Hudson (Fortis Inc. subsidiary) (Chairman, Governance and Human Resources Committee); and Previously CH Energy Group (Lead Independent Director; Chairman, Audit Committee, Compensation Committee, and Governance and Nominating Committee); National Regulatory Research Institute (Chairman); Keystone Energy Board; and Regulatory Information Technology Consortium; Member, Wall Street Utility Group; Participant, Keystone Center Dialogues on RTOs and on Financial Trading and Energy Markets.

October 1993 – April 2002

Group Head and Managing Director; Senior Director -- Global Power Group, Fitch IBCA Duff & Phelps -- New York / Chicago

Manager of 18-employee ($15 million revenue) group responsible for credit research and rating of fixed income securities of U.S. and foreign electric and natural gas companies and project finance; Member, Fitch Utility Securitization Team.

Led an effort to restructure the global power group that in three years’ time resulted in 75% new personnel and over 100% increase in revenues, transforming a group operating at a substantial deficit into a team-oriented profit center through a combination of revenue growth and expense reduction.

Achieved national recognition as a speaker and commentator evaluating the effects of regulatory developments on the financial condition of the utility sector and individual companies; Cited by Institutional Investor (9/97) as one of top utility analysts at rating agencies; Frequently quoted in national newspapers and trade publications including The New York Times, The Wall Street Journal, International Herald Tribune, Los Angeles Times, Atlanta Journal-Constitution, Forbes and Energy Daily; Featured speaker at conferences sponsored by Edison Electric Institute, Nuclear Energy Institute, American Gas Assn., Natural Gas Supply Assn., National Assn. of Regulatory Utility Commissioners (NARUC), Canadian Electricity Assn.; Frequent invitations to testify before U.S. Senate (on C-Span) and House of Representatives, and state legislatures and utility commissions.

Participant, Keystone Center Dialogue on Regional Transmission Organizations; Member, International Advisory Council, Eisenhower Fellowships; Author, "A Rating Agency's Perspective on Regulatory Reform," book chapter published by Public Utilities Reports, Summer 1995; Advisory Committee, Public Utilities Fortnightly.

March 1994 – April 2002

Consultant -- NYNEX -- New York, Ameritech -- Chicago, Weatherwise USA -- Pittsburgh

Provided testimony before the Federal Communications Commission and state public utility commissions; Formulated and taught specialized ethics and negotiation skills training program for employees in positions of a sensitive nature due to responsibilities involving interface with government officials, marketing, sales or purchasing; Developed amendments to NYNEX Code of Business Conduct.

October 1987 - October 1993

Chairman; Commissioner -- Michigan Public Service Commission -- Lansing

Administrator of $15-million agency responsible for regulating Michigan’s public utilities, telecommunications services, and intrastate trucking, and establishing an effective state energy policy; Appointed by Democratic Governor James Blanchard; Promoted to Chairman by Republican Governor John Engler (1991) and reappointed (1993).

Initiated case-handling guideline that eliminated agency backlog for first time in 23 years while reorganizing to downsize agency from 240 employees to 205 and eliminate top tier of management; MPSC received national recognition for fashioning incentive plans in all regulated industries based on performance, service quality, and infrastructure improvement.

Closely involved in formulation and passage of regulatory reform law (Michigan Telecommunications Act of 1991) that has served as a model for other states; rejuvenated dormant twelve-year effort and successfully lobbied the Michigan Legislature to exempt the Commission from the Open Meetings Act, a controversial step that shifted power from the career staff to the three commissioners.

Elected Chairman of the Board of the National Regulatory Research Institute (at Ohio State University); Adjunct Professor of Legislation, American University’s Washington College of Law and Thomas M. Cooley Law School; Member of NARUC Executive, Gas, and International Relations Committees, Steering Committee of U.S. Environmental Protection Agency/State of Michigan Relative Risk Analysis Project, and Federal Energy Regulatory Commission Task Force on Natural Gas Deliverability; Eisenhower Exchange Fellow to Japan and NARUC Fellow to the Kennedy School of Government; Ethics Lecturer for NARUC.

August 1985 - October 1987

Acting Associate Deputy Under Secretary of Labor; Executive Assistant to the Deputy Under Secretary -- U.S. Department of Labor -- Washington DC

Member of three-person management team directing the activities of 60-employee agency responsible for promoting use of labor-management cooperation programs. Supervised a legal team in a study of the effects of U.S. labor laws on labor-management cooperation that has received national recognition and been frequently cited in law reviews (U.S. Labor Law and the Future of Labor-Management Cooperation, w/S. Schlossberg, 1986).

January 1983 - August 1985

Senate Majority General Counsel; Chief Republican Counsel -- Michigan Senate -- Lansing

Legal Advisor to the Majority Republican Caucus and Secretary of the Senate; Created and directed 7-employee Office of Majority General Counsel; Counsel, Senate Rules and Ethics Committees; Appointed to the Michigan Criminal Justice Commission, Ann Arbor Human Rights Commission and Washtenaw County Consumer Mediation Committee.

March 1982 - January 1983

Assistant Legal Counsel -- Michigan Governor William Milliken -- Lansing

Legal and Labor Advisor (member of collective bargaining team); Director, Extradition and Clemency; Appointed to Michigan Supreme Court Sentencing Guidelines Committee, Prison Overcrowding Project, Coordination of Law Enforcement Services Task Force.

October 1979 - March 1982

Appellate Litigation Attorney -- National Labor Relations Board -- Washington DC

Other Significant Speeches and Publications

Filing for Bankruptcy Isn’t the Right Solution for Puerto Rico (Forbes Online, November 2015)

The “A” Rating (Edison Electric Institute Perspectives, May/June 2009)

Perspective: Don’t Fence Me Out (Public Utilities Fortnightly, October 2004)

Climate Change and the Electric Power Sector: What Role for the Global Financial Community (during Fourth Session of UN Framework Convention on Climate Change Conference of Parties, Buenos Aires, Argentina, November 3, 1998)(unpublished)

Regulation UnFettered: The Fray By the Bay, Revisited (National Regulatory Research Institute Quarterly Bulletin, December 1997)

The Feds Can Lead…By Getting Out of the Way (Public Utilities Fortnightly, June 1, 1996)

Ethical Considerations Within Utility Regulation, w/M. Cummins (National Regulatory Research Institute Quarterly Bulletin, December 1993)

Legal Challenges to Employee Participation Programs (American Bar Association, Atlanta, Georgia, August 1991) (unpublished)

Proprietary Information, Confidentiality, and Regulation's Continuing Information Needs: A State Commissioner's Perspective (Washington Legal Foundation, July 1990)

1. Georgia Power never filed for a rate case in 2016, based upon a provision of the settlement agreement related to the Southern Company/AGL merger. [↑](#footnote-ref-1)
2. Georgia Power corporate credit rating from S&P with a Negative outlook. [↑](#footnote-ref-2)
3. Georgia Power corporate credit rating from Fitch with a Negative outlook. [↑](#footnote-ref-3)
4. Georgia Power corporate credit rating from Moody’s with a Stable outlook. [↑](#footnote-ref-4)
5. Corporate or issuer utility credit ratings reflect the intrinsic financial strength of the utility being rated, with no backing from or recourse against specific utility assets.  At times, regulated utilities issue secured debt, representing utility borrowings that are backed by collateral, usually in the form of utility real property.  In almost all instances, secured credit ratings are higher than corporate/issuer credit ratings because, in the case of a utility defaulting on its bond payment obligations, secured debtholders have recovery priority on the defined collateral as compared to the claims of unsecured debtholders. [↑](#footnote-ref-5)
6. Phillips, Charles F., Jr., The Regulation of Public Utilities, Arlington, Virginia: Public Utilities Reports, Inc., 1993, at p. 250 (emphasis supplied). *See also* Public Utilities Reports Guide: “Finance,” Public Utilities Reports, Inc., 2004 at pp. 6-7 (“Generally, the higher the rating of the bond, the better the access to capital markets and the lower the interest to be paid.”). [↑](#footnote-ref-6)
7. S&P Research: “Corporate Methodology,” November 19, 2013 (republished on April 1, 2019 with revisions and nonmaterial changes unrelated to references to that report in this testimony). [↑](#footnote-ref-7)
8. S&P Research: “A Closer Look at Ratings Methodology,” November 13, 2006. [↑](#footnote-ref-8)
9. Moody’s Research: “Cost Recovery Provisions Key to Investor Owned Utility Ratings and Credit Quality: Evaluating a Utility’s Ability to Recover Costs and Earn Returns,” June 18, 2010. [↑](#footnote-ref-9)
10. Moody’s Research: “Rating Methodology: Regulated Electric and Gas Utilities,” June 23, 2017. [↑](#footnote-ref-10)
11. Moody’s Research: “Rating Methodology: Regulated Electric and Gas Utilities,” June 23, 2017. [↑](#footnote-ref-11)
12. S&P Research: “Assessing U.S. Investor-Owned Utility Regulatory Environments,” January 7, 2014. [↑](#footnote-ref-12)
13. Moody’s Research: “Georgia Power Company,” October 1, 2018. [↑](#footnote-ref-13)
14. S&P Research: “Georgia Power Co.,” October 12, 2018. [↑](#footnote-ref-14)
15. Fitch Research: “Fitch Downgrades Georgia Power’s IDR’; Places on Negative Watch,” August 9, 2018. [↑](#footnote-ref-15)
16. “The Future of Nuclear Energy in a Carbon-Constrained World, an interdisciplinary MIT study,” 2018. [↑](#footnote-ref-16)
17. “Letter: The Importance of Vogtle to the U.S. Electricity Sector,” The August Chronicle, October 1, 2018. [↑](#footnote-ref-17)
18. “Secretary Perry Announces Financial Close on Additional Loan Guarantees During Trip to Vogtle Advanced Nuclear Energy Project,” U.S. Department of Energy Press Release, March 22, 2019. [↑](#footnote-ref-18)
19. S&P Research: “Corporate Methodology,” November 19, 2013 (republished on April 1, 2019 with revisions and nonmaterial changes unrelated to references to that report included in this testimony). [↑](#footnote-ref-19)
20. S&P Research: “U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix,” November 30, 2007. [↑](#footnote-ref-20)
21. S&P Research: “Georgia Power Co.,” October 12, 2018. [↑](#footnote-ref-21)
22. *See*, for example, S&P Research: “Corporate Methodology,” November 19, 2013 (republished with nonmaterial changes December 7, 2018), as well as prior, now superseded reports for context: S&P Research: “U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix,” November 30, 2007, and S&P Research: “Methodology: Business Risk / Financial Risk Matrix Expanded,” September 18, 2012. [↑](#footnote-ref-22)
23. S&P Research: “Georgia Power Co.,” October 12, 2018. In its October 1, 2018 report on Georgia Power, Moody’s noted that the recent supportive decisions from the GPSC “should allow Georgia Power to maintain a [cash flow to debt ratio] in the 19-20% range going forward and support its credit quality” at the ‘Baa1’ level. [↑](#footnote-ref-23)