**REBUTTAL TESTIMONY OF**

**STEVEN M. FETTER**

**ON BEHALF OF**

**GEORGIA POWER COMPANY**

**DOCKET NO. 42516**

1. **INTRODUCTION**

**Q. Please state your name, position, and business address.**

A. My name is Steven M. Fetter. My business address is 1240 West Sims Way, Port Townsend, Washington 98104.

**Q. Did you file direct testimony in this case?**

A. Yes.

**II. PURPOSE OF REBUTTAL TESTIMONY**

**Q. What is the purpose of your rebuttal testimony?**

A. The purpose of my rebuttal testimony is to respond to the following points testified to by Michael P. Gorman in his direct testimony on behalf of the Georgia Public Service Commission Public Interest Advocacy Staff:

* Mr. Gorman is wrong when he states: “[T]he effects of the TCJA are now fully reflected in observable market data including bond ratings and stock prices.” (at 6);
* He is wrong when he states: “…Steven Fetter acknowledged the increase in common equity used to support stronger credit metrics largely due to reductions in impact due to the TCJA. Beyond this statement, however, Mr. Fetter provided no support that an increase in the common equity ratio is necessary to support GPC’s bond rating…” (at 23);
* He is wrong when he states: “I disagree with Mr. Fetter’s assertion that GPC will achieve these objectives only if the Commission adopts the Company’s proposed ratemaking capital structure with a 56% common equity ratio and adopts GPC witness Vander Weide’s recommended return on equity of 10.9%. Importantly, Mr. Fetter provided no substance supporting or any evidence that credit rating and financial integrity objectives can only be achieved if the Company’s return on equity and capital structure positions are adopted.” (at 27);
* He is wrong when he states: “However, contrary to Mr. Fetter, I also place high importance on meeting these financial integrity objectives at the lowest possible cost to customers.” (at 27);
* He is wrong when he states: “The Company’s leverage obligations increase significantly starting in 2018 associated with coal ash remediation ARO obligations and other factors. However, because GPC is expected to begin to recover those costs at the conclusion of this proceeding, I adjusted GPC’s estimated off-balance sheet ARO debt to accommodate the regulatory plan that imposes significant cost on customers to allow the Company to start recovering these obligations. With a regulatory plan that permits high likelihood of full cost recovery of these ARO costs, it is reasonable to expect that the credit rating agencies will reduce the off-balance sheet debt obligations with these ARO obligations to reflect an incurrence of revenue to offset the actual costs incurred. As shown on page 6 of Exhibit\_\_\_(MPG-20), these factors were used to develop a total debt obligation of GPC to use for credit metric purposes.” (at 61)

I also respond to Maureen L. Reno where in her direct testimony on behalf of the US Department of Defense and All Other Federal Executive Agencies she states: “[T]o the extent that there is increased risk from the TCJA, these risks impact all utility companies not just Georgia Power. Therefore, there is no increased risk for the Company relative to the proxy group, and any adjustment to the estimated ROE is not necessary.” (at 42).

**III. DISCUSSION**

**Q. What is your overall conclusion in this rebuttal testimony?**

A. The Commission should maintain GPC’s equity level and authorized return on equity no lower than current levels: 55% and 10.95%, respectively in order to maintain the Company’s financial integrity. This is especially true in light of current financial and market conditions including the effects of the recent tax reform. The ultimate request by the Company of a 56% equity ratio and a 10.9% return on equity will provide a small increment of additional support for GPC’s current credit ratings. The most important quantitative factor affecting the Company’s financial integrity is maintaining an FFO to Debt of 20% or greater. Mr. Gorman’s recommended 9.2% ROE and 51% equity layer[[1]](#footnote-1) would result in a significant movement away from and well below that metric, as shown in the Company witnesses Poroch and Adams rebuttal testimony. This Commission was wise to understand the importance of that metric and the stress the most recent tax reform put on the Company’s credit metrics when it adjusted Georgia Power’s current equity level of 55%. Any change such as those recommended by Mr. Gorman and Ms. Reno, if adopted by this Commission, would move away from the Commission’s long record of constructive regulation characterized by consistency and gradualism in balancing the interests of customers and investors and would be very detrimental to the Company’s financial integrity and credit ratings.

**Q. How would you expect the rating agencies to react if the**

**Commission were to adopt Mr. Gorman’s recommendations?**

A. As the rating agencies have made clear, the Commission’s response to Georgia Power’s reduced cash flow following the recent tax reform was supportive and led to no negative rating actions being taken against Georgia Power. In contrast, Moody’s did change 25 regulated utility outlooks in a negative direction shortly after enactment of tax reform legislation.[[2]](#footnote-2) Mr. Gorman acknowledged that he did not do any analysis of how his recommendations might be considered by Moody’s (Tr. 1596).

While credit rating agencies certainly give great weight to the FFO to Debt metric, which Mr. Gorman and Ms. Reno would place in peril, Mr. Gorman has also ignored the qualitative side of the bond rating process in his financial recommendations. Based on my leadership role at a major rating agency, I know that the qualitative assessment is given virtually equal weight as the quantitative factors that are discussed in the Poroch and Adams rebuttal testimony. As I discussed in my direct testimony, regulation is the most important qualitative factor. Mr. Gorman’s proposed significant downward movement in GPC’s financial measures not only severely undercalculates the quantitative metrics, he ignores the qualitative impacts. If adopted by this Commission, Mr. Gorman’s recommendations would be a clear break with the Commission’s past constructive decision-making. The likely result would be negative actions by the rating agencies as they recognize the less supportive financial measures along with concerns about a potentially declining regulatory climate.

**Q. Do you agree with Mr. Gorman when he says Georgia Power can be returned to its earlier 51% equity level with a much lower authorized return on equity of 9.2% because the effects of tax reform “are now fully reflected in observable market data including bond ratings and stock prices?”**

A. No. First of all, this entirely misses the mark and sets up a red herring. Whether or not the effects of tax reform “are now fully reflected in observable market data including bond ratings and stock prices,”the effects of the tax reform act are reflected in the FFO to Debt metrics. So, whether Mr. Gorman argues that those effects are observable or not, he cannot change the financial metrics used by the markets to assess risk and credit quality. Ms. Reno implicitly acknowledges that fact in her opinion that tax reform has resulted in increased risk for all utility companies, including Georgia Power. While she used that fact as a comparison point between proxy utilities and authorized ROEs, her observation is just as true when placed in the context of credit metrics. With the Company facing that increased risk, it follows that if this Commission were to back away from its post-tax reform support, it would increase the potential for a negative rating agency action for Georgia Power, whether it be an outlook change or a downgrade. Indeed, even in the absence of either of those rating actions, the Company’s credit profile would still be materially weaker.

It is clear that this Commission’s timely response to tax reform – movement from a 51% to a 55% equity level -- has had an ameliorative effect on the Company’s credit ratings. Any movement away from that constructive regulatory support would have the reverse effect. It is important to note, however, that even with that positive change from a 51% to a 55% equity level, coupled with GPC’s then authorized ROE of 10.95%, it still has only resulted in maintenance of the Company’s ratings within my minimum range of BBB+ to A-, and even then with continuing Negative outlooks. Contrary to Mr. Gorman’s belief, Moody’s continues to be clear that tax reform’s impact on cash flow across the utility industry will continue on into the future (see Exhibit 1 below).[[3]](#footnote-3) Avoiding downgrades will always benefit customers who are best-served by maintaining the Company’s financial integrity and access to capital markets. For this reason, the Commission should maintain the Company’s equity layer and ROE level no lower than current levels, although I do recognize the tradeoff provided by the small increase in the equity level to offset a slight reduction in the ROE level as recommended by Dr. VanderWeide. This would continue to allow the Company to maintain both its qualitative factors and quantitative metrics with the rating agencies that assess the Company’s credit profile.



**Q. Mr. Gorman states that you provide “no substance supporting or any evidence that credit rating and financial integrity objectives can only be achieved if the Company’s return on equity and capital structure positions are adopted.” Please comment on his views.**

A. Mr. Gorman is wrong. As discussed in the Poroch and Adams rebuttal testimony, the correct calculation of FFO to Debt shows that his recommendations would be well below the metrics used by the credit rating agencies to maintain the Company’s current credit ratings. The Company’s proposal maintains, but just barely, the bottom end of those metrics. Those are facts upon which the Company and I rely. But I also rely upon my years of experience in a leadership role at a major rating agency. I know that a reduction in equity levels and ROE as proposed by Mr. Gorman would have a deleterious effect on the reputation of this Commission and its reputation for constructive regulation and gradual changes between rate cases.

As I have explained above, following enactment of tax reform legislation in December 2017, GPC’s ratings were under threat, including S&P and Fitch ratings holding Negative outlooks.[[4]](#footnote-4) The Commission responded in a timely and favorable manner to secure the Company’s then current ratings, as acknowledged by the three rating agencies. As I have already noted, Moody’s has indicated that the effects from tax reform will undoubtedly continue into the period going forward from the decision in this proceeding. Those are the substantive facts supporting my opinion. For these reasons, I continue to recommend that the Commission not ignore the qualitative and quantitative factors that allow the Company to maintain its sound financial condition by maintaining a stable “cash flow” sufficient to protect its current credit ratings.

**Q. Do you agree when Mr. Gorman claims that you do not “place high importance on meeting these financial integrity objectives at the lowest possible cost to customers?”**

A. Mr. Gorman is wrong in that assertion. In fact, it appears that Mr. Gorman placed such a high importance on the lowest cost to customers that he failed to correctly consider at all the impact on the Company’s financial integrity and the long-term negative effect of his recommendations on customers. I believe that neither customers nor investors would benefit if Georgia Power’s credit ratings were to be downgraded or the Company’s financial integrity was impaired. I believe I may be the only (or at least one of very few) utility consultants who have also been retained by consumer advocates and utility commissions for sound objective advice. As a former state Commissioner, I always speak from a balanced position. Far from not caring about customer interests, I would not take the position I advocate here if I did not believe that it was good public policy, and represented the balance all commissioners strive to achieve in carrying out their duties.

The Company has shown that its filing achieved only the bottom end of the 20% FFO to Debt metric and clearly established that it was cognizant of seeking the lowest cost to customers while maintaining financial integrity. Two of Georgia Power’s issuer ratings currently hold Negative outlooks. I do not see how Georgia Power’s financial parameters could be lowered in the manner described by Mr. Gorman (indeed, even in the lesser fashion as proposed by Ms. Reno) without the likelihood that a downgrade would follow upon the Commission’s decision. As Mr. Gorman has acknowledged, if he is wrong, all stakeholders bear that risk. (Tr. at 1596.)

**Q. Are you aware of S&P actually reducing an entity’s total debt amount for the off-balance sheet debt obligations related to ARO obligations in calculating an entity’s credit metrics as suggested by Mr. Gorman?**

A. No. I have not seen any of the agencies announce such a policy.

**Q. Based on this, is it appropriate for this Commission to assume that credit rating agencies will reduce the Company’s off-balance sheet debt obligations related to their ARO obligations as Mr. Gorman recommends??**

A. No it is not. No guidance has been provided by the rating agencies to this effect. In my opinion this is far too important a decision to be based on the condition that it “is reasonable to expect” the rating agencies will modify their policies. Thus, Mr. Gorman’s described “off balance sheet” adjustment when calculating GPC’s FFO to total debt ratio to reduce GPC’s total debt amount for its ARO obligation is inappropriate and results in artificially overstating the Company’s projected FFO to total debt ratio.

**IV. CONCLUSION**

**Q. Do you have concluding thoughts?**

A. Yes, for the reasons stated above, my recommendation remains the same as in my direct testimony: the Commission should maintain its reputation and constructive regulation which has provided the Company a framework in which to attract capital and to achieve excellent operational performance. This will help maintain Georgia Power’s current credit ratings and financial strength and be in the best interests of customers.

**Q. Does that conclude your rebuttal testimony?**

A. Yes.

1. While Ms. Reno’s ROE recommendation at 9.1% is slightly below that of Mr. Gorman, her acceptance of GPC’s current equity level of 56% dampers the negative effects compared to Mr. Gorman’s recommendation, though not entirely avoiding them. [↑](#footnote-ref-1)
2. Moody’s Research: “Moody’s Changes Outlooks on 25 US Regulated Utilities Primarily Impacted By Tax Reform,” January 19, 2018. [↑](#footnote-ref-2)
3. *See* Moody’s Research: “2019 Outlook Shifts to Negative Due to Weaker Cash Flows, Continued High Leverage,” June 18, 2018. [↑](#footnote-ref-3)
4. In its Global Ratings Definitions, S&P defines “outlooks” as assessing “the potential direction of a long-term credit rating over the intermediate term (typically six months to two years).” [↑](#footnote-ref-4)