PUBLIC DISCLOSURE

BEFORE THE
GEORGIA PUBLIC SERVICE COMMISSION

APPLICATION FOR CERTIFICATION OF	:	
UNITS 3 AND 4 AT PLANT VOGTLE AND	:	DOCKET NO. 27800
UPDATED INTEGRATED RESOURCE PLAN	:	

DIRECT TESTIMONY

AND EXHIBITS

OF

RICHARD A. BAUDINO

ON BEHALF OF

GEORGIA PUBLIC SERVICE COMMISSION
PUBLIC INTEREST ADVOCACY STAFF

J. KENNEDY AND ASSOCIATES, INC.

DECEMBER 2008

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DIRECT TESTIMONY OF RICHARD A. BAUDINO

Q. Please state your name and business address.

A. My name is Richard A. Baudino. My business address is J. Kennedy and Associates, Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

Q. What is your occupation and by whom are you employed?

A. I am a consultant to Kennedy and Associates.

Q. Please describe your education and professional experience.

A. I received my Master of Arts degree with a major in Economics and a minor in Statistics from New Mexico State University in 1982. I also received my Bachelor of Arts Degree with majors in Economics and English from New Mexico State in 1979.

I began my professional career with the New Mexico Public Service Commission Staff in October 1982 and was employed there as a Utility Economist. During my employment with the Staff, my responsibilities included the analysis of a broad range of issues in the ratemaking field. Areas in which I testified included cost of service, rate of return, rate design, revenue requirements, analysis of sale/leasebacks of generating plants, utility finance issues, and generating plant phase-ins.

In October 1989, I joined the utility consulting firm of Kennedy and Associates as a Senior Consultant where my duties and responsibilities covered substantially the same areas as those during my tenure with the New Mexico Public Service Commission Staff. I became Manager in July 1992 and was named Director of Consulting in January 1995. Currently, I am a consultant with Kennedy and Associates.

Exhibit ____(RAB-1) summarizes my expert testimony experience.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Public Interest Advocacy Staff ("Staff") of the Georgia Public Service Commission ("GPSC" or "Commission").

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to respond to the Direct Testimony of Georgia Power Company ("GPC" or "Company") witness Steven M. Fetter and to provide recommendations to the Commission with respect to GPC's proposal to include costs of Vogtle Units 3 and 4 construction work in progress ("CWIP") in rate base rather than capitalize the financing costs during construction as allowance for funds used during construction ("AFUDC"). My testimony will focus on the Company's financial projections during the construction phase and what those projections suggest with respect to GPC's future bond and credit ratings. In forming my recommendations, I also reviewed the panel testimony and exhibits of Company witnesses Ann Daiss and Robert Morris.

Q. Please summarize your conclusions for the Commission.

A. My conclusions are as follows:

1. The financial forecast submitted by GPC does not require the Commission to authorize the inclusion of Vogtle Units 3 and 4 CWIP in rate base at this time.

2. The traditional AFUDC approach for Vogtle Units 3 and 4 still results in sufficient financial metrics for the Company to maintain an investment grade bond rating throughout the entire construction period, according to GPC's financial forecast.

3. The Commission can reconsider including some amount of Vogtle Units 3 and 4 CWIP in rate base at a later date if the Company can demonstrate a financial need.

4. The traditional AFUDC approach for Vogtle Units 3 and 4 during construction results in a fair balance of ratepayer and shareholder interests.

Q. Please briefly summarize the Direct Testimony of Mr. Fetter.

A. Mr. Fetter began his testimony with a general discussion of credit ratings and the process used by the major bond rating agencies (Fitch, Moody's, and Standard and Poor's) to determine corporate credit and bond ratings. Mr. Fetter summarized both the qualitative and quantitative measures used by these agencies in the rating process. In particular, Mr. Fetter presented the Standard and Poor's ("S&P") methodology on page 14 of his Direct Testimony.

Mr. Fetter testified that the S&P methodology was helpful in understanding the factors used in the credit rating process.

Next, Mr. Fetter analyzed GPC's credit ratings and the Company's forecast of key credit ratios found in Exhibit ___(APD RBM-1). This Exhibit compared forecasted credit ratios under two scenarios: (1) 100% of Vogtle CWIP in rate base during construction and (2) no Vogtle CWIP in rate base during construction. Mr. Fetter concluded that Scenario (2) would likely result in a downgrade of GPC's bond rating. He also suggested that Scenario (1) would likely support the Company's current A bond rating. Specifically, Mr. Fetter stated that he believed "the absence of cash recovery of financing costs of CWIP during the extended Plant Vogtle construction cycle could stress the Company's cash flow and create the potential for a downgrade." Fetter Direct at 5.

Q. What are the key financial ratios that Mr. Fetter evaluated in his Direct Testimony?

A. Mr. Fetter evaluated the forecasted levels of three key financial ratios used by Standard and Poor's in developing and assigning bond ratings. These ratios are as follows:

- Funds from Operations ("FFO") Interest Coverage
- Funds from Operations / Total Debt
- Total Debt / Total Capital

Beginning on page 12 of his Direct Testimony, Mr. Fetter explained how these key ratios are used by S&P in developing a "Business Risk Profile" and "Financial Risk Profile". The Financial Risk Profile is assessed based on the three key ratios cited above. The Business Risk Profile encompasses S&P's qualitative assessment of factors such as the quality of regulation, the markets in which the company operates, operations, competitiveness, and management. Business Risk Profiles are characterized by S&P as Excellent, Strong, Satisfactory, Weak, or Vulnerable. Financial Risk Profiles are characterized as Minimal, Modest, Intermediate, Aggressive, or Highly Leveraged.

Q. What are Georgia Power Company's current credit ratings and Business and Financial Risk Profiles?

A. Georgia Power's current credit ratings are "A" from S&P and Fitch and "A2" from Moody's. The Company's Business Risk Profile is Excellent and its Financial Risk Profile is Intermediate. Taken together, these credit ratings and profiles show that Georgia Power is a financially strong company with a stable credit rating outlook.

Q. Based on your review of GPC's testimony, should the Commission approve the Company's request to include 100% of Vogtle CWIP in rate base during the construction period?

A. No. I recommend that the Commission deny Georgia Power's request to include Vogtle CWIP in rate base at this time.

Q. Please summarize the key financial ratios from GPC's financial forecast.

A. Table 1 below contains updated financial ratios that were provided by Georgia Power in response to STF-K&A-4-12a. These ratios were revised based on the results of a revised financial model analysis provided to the Staff by the Company. I included the S&P ratios for the Intermediate Financial Risk Profile included in Table 2 of Mr. Fetter' testimony since this reflects GPC's current Financial Risk Profile.

TABLE 1

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Q. Are there significant differences between the Company's updated results and the ratios relied upon by Mr. Fetter in his testimony?

A. Yes. The most important difference is that the Total Debt/Total Capital ratios are all greater than 50% under both the CWIP and AFUDC scenarios. This ratio now falls outside of the upper bound for an A rated company with an Intermediate Financial Risk Profile. Funds From Operations/Interest still falls within the A range under both scenarios. Funds From Operation/Total Debt is below 25% for all years under the AFUDC scenario and for the years 2010 - 2015 for the CWIP scenario.

Exhibit ___(RAB-2) contains a comparison of the key ratios from the Company's original filing and from the update provided in response to Staff's discovery requests. To briefly summarize the differences, FFO/Interest ratios improve under both revised scenarios while FFO/Debt is slightly lower in most years. Total Debt/Total Capital increases substantially under both revised scenarios.

Q. Did the Company provide revisions to the ratio projections for Moody's ratios also?

A. Yes. Georgia Power provided new projections for the expected ratios for Moody's. I have included revised graphs produced by Georgia Power that show both S&P and Moody's key financial ratios and the expected bond ratings associated with each ratio in Exhibit ___(RAB-3). Pages 1 through 3 show the S&P bond ratings associated with the three key financial ratios I included in Table 1. Pages 4 through 6 show the Moody's financial ratios and the associated bond ratings.

Pages 4 and 5 of Exhibit ___(RAB-3) show that under both the AFUDC and CWIP scenarios, the Company's ratios stay in the A rating category. Page 6, which shows the forecasted FFO/Debt, indicates that for all years except one, the AFUDC scenario stays within the A rating category.

Q. Please summarize your observations regarding the results of the Company's revised financial forecast.

A. Under both the CWIP and AFUDC scenarios, two of the three key ratios relied upon by Mr. Fetter in his testimony fall outside the S&P ranges for an A rated company with an Intermediate Financial Risk Profile during the Vogtle construction period. However, the Moody's ratios stay within the A rating range for the AFUDC scenario, with the one exception I noted earlier.

Q. Does the Company's revised financial forecast summarized in your Table 1 require that the Commission authorize Vogtle CWIP in rate base at this time?

A. No, it does not. First, the recent revisions to GPC's financial forecast indicate that there is little difference between the CWIP and AFUDC scenarios with respect to the S&P ratios. In fact, both scenarios show that two out of the three key financial ratios relied upon by Mr. Mr. Fetter are outside the range for an A rated company with an Intermediate Financial Risk Profile. Thus, it could be argued either scenario would likely have the same impact on the

Company's bond ratings according to the Company's forecast.

Second, the Company's revised forecast indicates that the AFUDC scenario is consistent with an A bond rating from Moody's throughout the Vogtle construction period. If this is correct, then there is no need for CWIP in rate base at this time.

Third, it is important to note that the Company's financial projections are based on a number of assumptions that may or may not hold once the construction of Vogtle begins. For example, if GPC's debt ratio would be the factor that would cause a bond rating downgrade, then the Company would likely alter its financing plans to avoid the downgrade. This could be accomplished by additional equity infusions from Southern Company. In any event, the Company's financing plans have not been finalized, according to GPC's response to STF-K&A-4-4. In that response, the Company stated:

> "The Company has not finalized its financing plan for funding the Company's financing requirements during the construction of Vogtle 3 and 4. It has merely made assumptions, given current market conditions, about how it might choose to meet it financing requirements in the future."

I have included the Company's response in Exhibit ___(RAB-4).

The forecasted results under the AFUDC only option suggest that Georgia Power will still be able to obtain investment grade financing throughout the Vogtle construction period And the Company will have opportunities during the construction period through fuel cases and base rate cases to address the need for additional revenues and/or CWIP in rate base to prevent a downgrade. In my opinion, it is important that the Commission consider that GPC's bond rating will likely stay in the investment grade range throughout the construction of Vogtle Units 3 and 4.

Q. Did Georgia Power show what its historical key financial ratios were using the S&P methodology?

A. Yes. Table 2 below summarizes the S&P key financial ratios for 2006 and 2007 from the Company's revised financial forecast.

TABLE 2

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Table 2 shows that both FFO/Debt and Total Debt/ Total Capital are not consistent with an A rating and an Intermediate Financial Risk Profile. However, these are the ratings that Georgia Power currently has. Thus, the results from the Company's financial model are not necessarily indicative of what the rating agencies may or may not do with regard to the Company's bond rating.

Q. Why is an investment grade bond rating important?

A. An investment grade bond rating is important because this rating indicates that a bond issuer has sufficient financial strength to meet its financial obligations. Investment grade ratings are BBB/Baa or higher. Bonds that receive these ratting are considered suitable investments for banks, trusts, and fiduciaries. Investment grade bonds are also have the lowest cost in terms of interest rates.

Below investment grade bonds are speculative in nature and highly risky. The cost of these types of bonds is substantially higher than investment grade securities.

Q. Does Georgia Power's financial forecast indicate that the Company could suffer a downgrade into a less than investment grade rating?

A. No. Nothing in the Company's financial forecast indicates that Georgia Power's financial ratios would come anywhere near a below investment grade bond rating during the Vogtle construction period.

Q. **Mr. Fetter expressed concern over the "current roiled credit markets, where questions are already being raised as to whether any utility is safe from troubled financial institutions having to pull back from the short-term financing they have traditionally provided." Fetter Direct at 19 - 20. Please respond to this concern.**

A. It is true for the last two to three months world credit markets have gone through a serious upheaval. However, it should be noted that the United States government and governments around the world have moved to stabilize these markets and provide liquidity. Some examples of these actions in the U.S. include:

- The Emergency Economic Stabilization Act of 2008, which authorized the U.S. Treasury to spend up to $700 billion to purchase distressed assets from banks and to make capital injections into banks.

- Significant increase in loans by the Federal Reserve through is Term Auction Facility, which is designed to make loans to depository institutions (such as banks) available at its discount window.

- Creation by the Federal Reserve of the Term Asset-Backed Securities Loan Facility ("TALF"), which is designed to assist the credit needs of households and small businesses by supporting the issuance of asset-backed securities.

- Interest rate reductions by the Federal Reserve. The Fed's Discount Rate currently stands at 0.50%.

Q. Please describe GPC's planned use of loans from the Department of Energy ("DOE") to finance the construction of Vogtle Units 3 and 4.

A. According to work papers submitted by the Company in response to STF-HPSC-3-6, [redacted]

Q. What is the DOE loan program?

A. The DOE loan program was created by the Energy Policy Act of 2005. Among other things, its intent is to support financing and development of new energy projects such as new nuclear by guaranteeing 80% of the eligible costs of these projects. A recent article by Fitch provides a detailed explanation of how this program works, considerations for regulated utilities, and Fitch's views on the implications of this program for credit ratings.[1] This Fitch report states if a company receives such loan guarantees from the DOE, the loans will have "the same rating as US government obligations ('AAA') …"[2]

Q. Would the use of the DOE loan program alleviate much of the concern regarding GPC's ability to finance the Vogtle Units 3 and 4 in today's financial markets?

A. Yes. Funds obtained by Georgia Power through the DOE loan program would be a secure, low-risk, and low cost form of financing for the Company and its ratepayers. The AAA rating on this DOE guaranteed debt would likely mitigate concerns with respect to a potential downgrade for GPC and for increasing the cost of debt from such a downgrade.

Q. If the Commission rejects the CWIP in rate base option in this certification proceeding, would the Commission retain the ability to allow CWIP in rate base at a later date if Georgia Power could justify inclusion on the basis of financial need?

A. Yes. As I stated earlier, currently there is no need for the Commission to approve the inclusion of Vogtle CWIP in rate base. However, the Company will retain the ability to

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1 *Fitch's Perspective on the U.S. Department of Energy's Loan Guarantee Program - Update,* FitchRatings, October 29, 2008.

2 *Ibid,* page 7.

request inclusion of Vogtle CWIP in rate base at a later date based on financial need. For example, if the Company is assigned a negative credit outlook with a strong possibility of a rating downgrade, GPC could file an application seeking to include Vogtle CWIP in rate base. However, the Company would be required to show without CWIP in rate base a rating downgrade would occur. In such a request, the Company should be required to include the additional expected cost associated with such a rating downgrade. This would enable the Commission to render an informed decision that would serve the interests of both ratepayers and the Company's investors.

Q. Does the rejection of the Company's request to include Vogtle CWIP in rate base serve the interests of ratepayers and shareholders?

A. Yes. It is inconclusive as to whether the traditional AFUDC approach will have a detrimental effect on the Company's current bond ratings, based on the Company projected cost for the project and its projected financial statements and metrics. Exhibit ___(RAB-3) shows that the Company's projections for Moody's key ratios are consistent with an A bond rating. The S&P projections indicate that a rating downgrade may occur under either the CWIP or AFUDC scenario. The traditional AFUDC approach also would protect current ratepayers from having to shoulder the costs of a nuclear plant that has not yet been placed into service. And the Company could return to the Commission in the future to request CWIP in rate base if it can present evidence that a rating downgrade would occur without it. In my opinion, this is a fair and balanced resolution to the treatment of the construction costs of Vogtle Units 3 and 4 in this proceeding.

Q. Does this conclude your Direct Testimony?

A. Yes.