ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

SANDRA W. CALLAHAN

Q. Please state your name, business address and position with Tampa Electric Company.

A. My name is Sandra W. Callahan. My business address is 702 North Franklin Street, Tampa, Florida, 33602. I am the Vice President-Treasurer for TECO Energy, Tampa Electric Company's parent, and Treasurer for Tampa Electric Company ("Tampa Electric" or "company").

Q. Please provide a brief outline of your educational background and business experience.

A. I graduated from the University of Baltimore with a degree in finance. I am also a Certified Public Accountant. My responsibilities at TECO Energy include corporate finance activities, financial communications, investor relations, and the management and administration of corporate funds and funded benefit assets. Previously I was the director of internal audit and in that capacity was responsible for the audit function for TECO Energy and all subsidiaries. Before joining TECO Energy, I was an audit manager with the Tampa office of Coopers & Lybrand.

Q. What is the purpose of your direct testimony?

A. The purpose of my testimony is to explain why Tampa Electric's equity ratio was appropriate in 1997 and 1998. I will show that the company's capital structure policy has been reasonable during the period contemplated in Order No. PSC-96-0670-EI dated May 26, 1996 and Order No. PSC-96-1300-EI dated October 24, 1996 ("Stipulations").

Q. Please provide the background relating to Tampa Electric's equity ratio during the Stipulation period.

A. Tampa Electric entered into two separate agreements with the Office of Public Counsel ("OPC") and the Florida Industrial Power Users Group ("FIPUG") that addressed earnings and rates from 1995 through 1999. These agreements specifically addressed many subjects that would affect earnings during the Stipulation period. The equity ratio level, however, was not specifically considered.

In 1997, the Florida Public Service Commission ("Commission") examined the retail earnings of Tampa Electric for 1995, the first year of the deferred revenue period. As a part of this earnings review, the Commission addressed the appropriate equity ratio in the capital structure for calculating the amount of revenues to defer in 1995. The Commission decided that Tampa Electric's actual equity ratio of 58.7 percent was appropriate for 1995, determining that there was no showing that the company's actual level of equity in 1995 was unreasonable.

In 1998, the Commission addressed the retail earnings of Tampa Electric for 1996 and again debated the equity ratio to use for determining the amount of revenues to defer. Rather than using the company's actual 59.5 percent equity ratio, the Commission's decision was to maintain Tampa Electric's equity ratio in 1996 at 58.7 percent for calculating the amount of earnings to defer. The Commission stated that it could find no reason to change the equity ratio from the 1995 level.

In 1999, the Commission addressed the retail earnings of Tampa Electric for 1997 and 1998. The Commission Staff recommended that the company's equity ratio be capped at the same 58.7 percent approved for 1995 and 1996, rather than use the actual equity ratios of 59.6 percent for 1997 and 60.9 percent for 1998. Tampa Electric disagreed that the equity ratio should remain constant for this extended period given the need to offset increased business risks brought about by changes within the industry and FloridA. The Commission, however, made a decision to keep the equity ratio at 58.7 percent for these two years, stating that they were attempting to balance the equity ratio within the overall Stipulation that was presented to them and come to a fair result both for Tampa Electric's stockholders and customers.

FIPUG subsequently protested the 1997 and 1998 orders that were issued as proposed agency actions, on various issues including whether the Commission's decision on Tampa Electric's equity ratio was appropriate.

Q. Please explain why Tampa Electric's actual equity ratio was appropriate in 1997 and 1998.

A. Tampa Electric has a long record of being financially strong, and the financial integrity of Florida's utilities is something the Commission has supported over time. The capital structure that Tampa Electric maintained in 1997 and 1998 was very consistent with its long-standing policy of having a strong equity ratio. Our industry went through some significant changes in the 1990's, and our response to the changing business risk was to very gradually strengthen the balance sheet, just as most other utilities within the electric industry did. In fact, from 1994 through 1998 Tampa Electric's equity ratio increased less than many other utilities.

Q. What changes in the electric utility industry increased risks for utility investors and prompted the utilities to strengthen capital structures?

A. The most significant impact on investor market returns has been the advent of restructuring and deregulation around the nation. These events have impacted the perceived business risk of all utilities, even where restructuring has not actually occurred, because the events introduced uncertainty. The uncertainty causes investors to be less confident about the safety of their long-term investment and the stability of the associated income stream. Investors typically will require either a higher return to compensate for the additional risk in their investment or a stronger balance sheet to offset the declining security.

Q. Were there activities in 1997 and 1998 within Florida that affected the business risk of the utilities?

A. Yes. There have been instances in which large industrial customers within a primary utility company's service territory have attempted to negotiate with other parties for energy supply alternatives. The potential loss of large blocks of generation load directly impacts revenues for the utility, and leads to stranded investment concerns. These implications impact the earnings variability, and therefore the business risk of a company.

Other important activities during the period involved merchant plants and reserve margins. The merchant plant activity in 1997 and 1998 was perceived by investors as an additional risk to an investment in a Florida utility due to the uncertain future of the Florida market. The reserve margins of the Florida utilities also were being reexamined in this period and the solution was uncertain. The potential need for additional capital spending to meet new reserve margin criteria along with continuing high load growth was an important and likely cash constraint being considered by investors as well as the bond rating agencies.

In addition, companies like Tampa Electric that depend on coal-fired generation faced additional uncertainty and risk in 1997 and 1998 due to environmental issues. The uncertainty during these two years has come to fruition as additional environmental rules and requirements have been implemented that place significant additional requirements on Tampa Electric's coal plants.

Q. Are there benefits to customers from maintaining financial strength?

A. Yes. Financial strength allows the company to access capital markets under any conditions at the most attractive rates available. Tampa Electric's credit quality has allowed it to issue debt at the lowest credit spreads in the industry. It also allows the company to carry higher levels of variable rate debt, the lowest cost form of borrowing.

It has also enabled the company to utilize some innovative financing structures, such as the advance refunding of high-coupon tax-exempt debt issues, that have reduced borrowing costs.

Most significantly, financial strength is very important for raising the capital required to serve the needs of our customers. Tampa Electric serves a high growth area where load growth and reliability needs result in a continuing need for capital.

Q. Has Tampa Electric's equity ratio increased significantly from the time the parties entered into the Stipulations?

A. No. Tampa Electric's equity ratio did not increase significantly in 1997 and 1998 compared to the actual equity ratios at the time the Stipulations were signed and approved by the Commission.

On March 25, 1996, Tampa Electric, OPC and FIPUG filed a joint motion for approval for a Stipulation for the period from 1996 through 1998. The most currently available surveillance report at the time the Commission approved this Stipulation was the February 1996 report, which included a 58.7 percent equity ratio.

On September 25, 1996, Tampa Electric, OPC and FIPUG filed another Stipulation with the Commission for approval of the Polk Power Station and an extension of the deferred revenue plan to 1999. The most currently available surveillance report at that time and when the Commission approved this second agreement was the July 1996 report which included a 59.0 percent equity ratio.

Prior to these two Stipulations, the Commission issued Order No. PSC-95-0580-FOF-EI as a proposed agency action on May 10, 1995. This order established a new return on equity for Tampa Electric and deferred 1995 revenues for future determination. The March 1995 surveillance report was filed with the Commission on May 12 with a 59.3 percent equity ratio.

Q. What bearing do these actual equity ratios have on FIPUG's protest?

A. FIPUG had access to all of these surveillance reports at these points in time and gave no indication that the prospective equity ratio would need to remain flat or be reduced.

Q. What is the company's position on the Commission's equity ratio decisions?

A. While the Commission did not find Tampa Electric's decision-making for its capital structure in 1996 through

1998 to be unreasonable, the Commission applied the actual 1995 equity ratio of 58.7 percent in each subsequent year for calculating retail earnings for 1996 through 1998. As a result, the company earned a debt return on capital actually invested as equity, and has recorded significant below-the-line charges to shareholders to reflect this difference.

It has been Tampa Electric's position that the company should be able to make capital structure decisions within a reasonable framework to appropriately respond to market conditions, and the company has done so in a prudent manner. It has been difficult, therefore, to accept the Commission's decision. However, in the spirit of compromise and in order to make progress in resolving issues related to the Stipulation agreements, Tampa Electric will accept the 58.7 percent equity ratio for purposes of determining deferred revenues for 1997 and 1998.

Q. Is it reasonable to lower Tampa Electric's equity ratio in 1997 or 1998 from the current Commission decision as suggested by FIPUG?

A. No. The company has maintained a prudent and reasonable capital structure policy both before and during the Stipulation period.

It is unreasonable for FIPUG to suggest that the Stipulations allow a reduction in the equity ratio below where it was at the time the agreements were reached and approved by the Commission. Such a provision in the Stipulations would have been a significant concession on Tampa Electric's part during the negotiations and would have caused changes in other important aspects of the Stipulations such as the guaranteed refunds and the sharing arrangements. To impose an equity ratio now that is even lower than the actual levels at the time the Stipulations were approved could never have been anticipated by the company and is not within the reasonable boundaries of the Stipulations.

Q. Are there other reasons why FIPUG's protest is unreasonable?

A. Yes. In 1994, the year before the Stipulation period began, Tampa Electric's 13-month average equity ratio was 59.0 percent. This further supports that equity ratios below 58.7 percent should not be considered.

Q. Please summarize your testimony.

A. Tampa Electric's capital structure in 1997 and 1998 was reasonable for calculating the amount of deferred revenues to be refunded to customers. Tampa Electric's capital structure policy has been consistent for a long period of time and remained reasonable and prudent in 1997 and 1998.

Changes and activities in the industry and within Florida have affected the business risk of all utilities and should be taken into consideration. Tampa Electric has attempted to respond to these changes in order to maintain the financial strength needed to make operating decisions that benefit the company's customers.

Tampa Electric also believes its equity ratio was appropriate in 1997 and 1998 given the capital structure that was being sustained at the time it entered into the Stipulations and the 59 percent equity ratio maintained in 1994.

The company, however, will accept the Commission's equity ratio decisions for 1997 and 1998, but strongly disagrees with any consideration of an equity ratio below this level. A lower equity ratio would not have been acceptable to the company while negotiating the Stipulation agreements without necessary changes in other provisions of the Stipulations related to the guaranteed refunds and the sharing arrangements.

Q. Does this conclude your testimony?

A. Yes, it does.