BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF	)	
OKLAHOMA GAS AND ELECTRIC COMPANY	)	
FOR AN ORDER OF THE COMMISSION	)	
AUTHORIZING APPLICANT TO MODIFY ITS	)	CASE NO. PUD2023-000087
RATES, CHARGES, AND TARIFFS FOR RETAIL	)	
ELECTRIC SERVICE IN OKLAHOMA	)	

Direct Testimony

of

Charles B. Walworth

on behalf of

Oklahoma Gas and Electric Company

December 29, 2023

Q. **Please state your name, position, by whom you are employed and business address.**

A. My name is Charles B. Walworth. I am employed by OGE Energy Corp. ("OGE") and serve as Treasurer of OGE and its subsidiary, Oklahoma Gas and Electric Company ("OG&E" or "Company"). My business address is 321 North Harvey, Oklahoma City, Oklahoma 73102.

Q. **Briefly summarize your education and professional qualifications.**

A. I have Bachelor of Business Administration and Bachelor of Science degrees from the University of Oklahoma and a Master of Business Administration degree with a concentration in Finance from the University of Notre Dame. I am also a Certified Public Accountant in the State of Oklahoma. I joined OGE in January 1999 as an intern at the Enogex subsidiary and became an analyst in June of 1999. Following a brief absence to pursue a graduate degree, I joined the OGE Corporate Finance and Treasury group in 2005, where I held the positions of analyst, manager, Assistant Treasurer and now Treasurer. In my current role, I have management responsibility for Corporate Finance and Treasury Operations. These groups handle cash management, short and long-term financings, financial forecasting, corporate banking relationships, and rating agency relationships. During my career at OGE I have assisted in the raising of at least $6 billion of Senior Notes and multiple revolving credit facilities. I have been personally accountable for managing the last $4.7 billion of Senior Notes issued.

Q. **Have you previously filed testimony before the Oklahoma Corporation Commission ("Commission")?**

A. Yes. I testified before the Commission in Cause Nos. PUD 201600330, PUD 201600511, PUD 201800067 and PUD 202100072.

Q. **What is the purpose of your testimony in this proceeding?**

A. The purpose of my testimony is to support the Company's capital structure for ratemaking purposes and an appropriate overall fair rate of return. The capital structure that I recommend is based on the actual weighted average components of capital as of September 30, 2023. In recommending a fair overall rate of return, I consider OG&E's cost of long-term debt and the fair return on equity recommended by OG&E's witness Ann Bulkley in her direct testimony in this case.

Q. **What is the relationship between allowed rate of return and cost of capital in the context of utility ratemaking?**

A. Under a traditional regulatory model, regulatory commissions usually authorize a total rate of return on rate base equal to the utility's total cost of capital. A commission does not want to authorize a return that is too low or too high. If the authorized rate of return is less than the utility's overall cost of capital, the financial health of the utility could degrade, making it both more difficult and more expensive for the utility to raise necessary capital. An inability to raise sufficient capital could impair the quality of service and more expensive capital would result in increased rates. Thus, customers are best served when the Commission-authorized rate of return is set equal to the utility's overall weighted average cost of capital.

Q. **Can you please explain what the term "capital structure" means?**

A. Capital structure refers to the mix of debt and equity capital that a utility uses to finance its assets. Because this capital is used to fund long term investments, utility capital structures tend to include long-term securities, generally a combination of common equity and long-term debt.

Q. **What is the weighted average cost of capital?**

A. Weighted average cost of capital is the sum of the debt and equity costs within a utility's capital structure, weighted by the relative contribution of each capital component to the entity's total capitalization. Table 1 shows OG&E's capital structure as of the end of the test year:

Table 1: OG&E's Test Year End Capital Structure

A	B	C	D	E
Capital Source	Capital Amount	% of Total Capital Amount	Cost of Capital Component	Weighted Cost (= C x D)
Total Long-Term Debt	$4,280,368,355	46.50%	4.85%	2.25%
Common Equity	$4,925,141,905	53.50%	10.50%	5.62%
Total Capital	**$9,205,510,260**	**100%**		**7.87%**

Q. **What is the primary standard for determining a fair rate of return?**

A. According to the *Bluefield* and *Hope* U.S. Supreme Court decisions, as described in more detail by witness Bulkley, a utility's rates must be set at a level that allows the utility to generate revenues sufficient to: (i) maintain the financial integrity of its existing invested capital; (ii) maintain its creditworthiness; and (iii) attract sufficient capital on competitive terms to continue to provide a source of funds for continued investment and enable the company to meet the needs of its customers.[1] As described below, a commission-authorized ROE that is consistent with other businesses having similar or comparable risks and signals to the investment community that OG&E will have the opportunity to provide its investors a fair, timely and predictable return on investments is important to continue to attract willing investors.

Q. **Why is it important that the Commission use OG&E's actual capital structure when setting rates in this case?**

A. Using the actual capital structure of the Company allows OG&E to maintain strong cash flow and ensure the financial health necessary to attract investment to finance utility operations and provide reliable service to its customers at a reasonable cost. Strong cash flow and overall financial health are critical as it allows the Company to offer an attractive and competitive, risk-adjusted return to equity investors and to maintain strong credit

[1] *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) and *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944).

metrics and investment grade credit ratings, which in turn reduces future costs. Those strong metrics and ratings, as discussed further below, lead to continued access to debt capital at a reasonable cost and under reasonable terms and conditions. This is important because if debt costs increase, these increased costs result in higher rates for customers.

Q. **What is the capital structure that you are recommending in this case?**

A. I recommend that the Commission use OG&E's actual test year ending capital structure of 53.5% equity and 46.5% debt as shown in Table 1 above.

OG&E'S CAPITAL STRUCTURE IS REASONABLE

Q. **What factors should be considered when determining the reasonableness of a utility's capital structure?**

A. One should determine whether the capital structure is consistent with the financial strength necessary for the utility to access the capital markets under reasonable terms and whether the cost of capital resulting from such a structure is reasonable. While debt, relative to equity, is generally a less expensive form of capital due in part to the tax deductibility of interest expense, too much debt can increase a utility's probability of default and the related costs of financial distress. Beyond a certain point, dependence on debt as a source of capital increases the risk associated with a utility's cash flow, which correspondingly increases a utility's overall cost of capital.

Q. **Does OG&E's actual test year capital structure support a financially healthy utility?**

A. Yes. OG&E maintains the balance of debt and equity in its capital structure to minimize its overall cost of capital and to maintain financial health. Maintaining financial health includes supporting strong credit metrics and securing investment grade credit ratings that will allow the Company to attract new capital at a reasonable cost and on reasonable terms to support affordability for customers as we compete nationally for capital. Strong credit metrics also will ensure that OG&E has access to the capital markets under varying and difficult economic conditions. As noted, a greater proportion of debt in a capital structure increases the risk for the Company because a larger portion of the cash flows would be required to service the increased level of debt. This increased risk could result in higher interest rates on future debt, as well as a greater cost of equity because of the increased risk to equity holders as the residual claimants on the utility's cash flows, and therefore a corresponding increase in the costs of capital. At the same time, increased debt and the service obligations that go along with that debt result in less cash flow available to equity holders, thus making our stock less attractive.

Q. **Why is it necessary and important for OG&E to attract new capital?**

A. As a public utility, OG&E is required to continuously provide safe and reliable service to its customers, who continually tell OG&E that reliability is the most important priority for OG&E electric service. Given the intensive capital investment needed on an ongoing basis, including the generating capacity needs established in our most recent IRP, to maintain and update OG&E's power delivery and generation infrastructure for the benefit of customers, it is critical that OG&E be able to access new capital on a timely basis, at a reasonable cost, and under reasonable terms and conditions. Setting a capital structure for ratemaking purposes that differs from the actual capital structure of the operating company (*i.e.*, a "hypothetical" capital structure) signals to investors that not all their contributed capital dollars will receive a return at the required cost of debt or equity, making it more difficult to attract future capital.

Q. **Why is it necessary that OG&E be able to access the capital markets during all economic conditions?**

A. Just as OG&E must continue to serve customers in all weather conditions, it also must continue to serve customers in all economic conditions as well. During recessions, volatile economic conditions or in an inflationary environment, OG&E must still access low-cost capital to continue to fund its operations. A capital structure must be strong enough to allow OG&E to fund its operations in inflationary and volatile economic conditions so that safe and reliable service to its customers is not harmed.

Q. **Could OG&E just wait for more favorable market conditions to access the capital markets?**

A. No. Unlike many unregulated companies, OG&E has an obligation to serve our customers and provide them with reliable electric service to live their lives and run their businesses. The Company cannot slow or stop the production and sales of electricity because financial market conditions have deteriorated. Through the worst recessions or the highest inflationary periods, OG&E must still be able to access capital to build and maintain a reliable electric power system.

Q. **Could you give some examples of when OG&E has not had the luxury of waiting out the market?**

A. Yes. Going back to the "Great Recession" of 2008-2009, OG&E was in the process of purchasing the Redbud Generating Facility to serve customer load. OG&E had to access the capital markets to issue bonds to help finance the acquisition.

Q. **Are the bond markets always available to meet the needs of the Company?**

A. No. It takes time to put together a bond transaction. Considerable documentation work, due diligence, and blackout dates (generally after the end of a quarter, but before the Company reports its financial data), means that the Company needs to prepare for at least several months before the public capital markets can be accessed.

Q. **Have you had a time when a significant and very immediate source of capital was required?**

A. Yes. Winter Storm Uri was such a time. Due to the astronomically high price of natural gas during that period, the Company would have been unable to pay its natural gas suppliers the next month and required emergency financing to be put in place.

Q. **Can you please describe this emergency financing?**

A. The Company was able to secure short-term bank loans at reasonable rates to serve as a bridge before the more extensive work of issuing bonds could be done.

Q. **How did this benefit customers?**

A. During Winter Storm Uri, several gas suppliers made inquiries about the Company's ability to pay for gas. If the company had not been able to access this financing, it could have limited the number of suppliers willing to sell gas to OG&E, potentially increasing the price to customers or resulting in suppliers being unwilling to supply the Company with the natural gas needed to run its generating units and therefore putting electric service at risk for customers.

Q. **How did OG&E's capital structure benefit customers in this case over the long-term?**

A. While S&P and Moody's changed OG&E's outlook from stable to negative as a result of Winter Storm Uri, neither downgraded the credit ratings. The combination of a strong capital structure and line-of-sight to a regulatory mechanism to recover the costs avoided a downgrade.

Q. **Has OG&E maintained a capital structure similar to its test year capital structure for many years?**

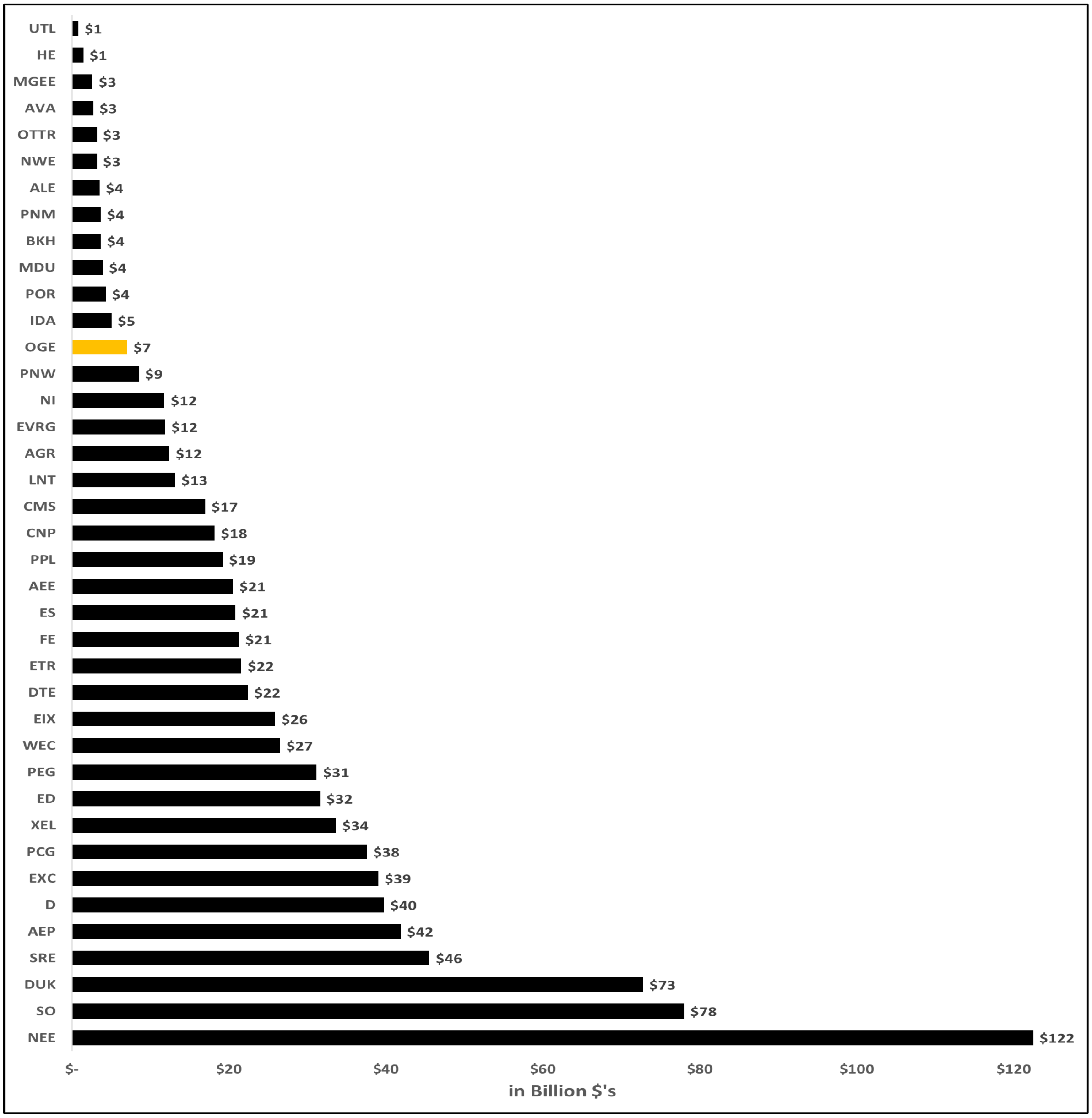
A. Yes. OG&E attempts to maintain a consistent capital structure over time, and rating agencies value that consistency when considering a company's financial profile. OG&E's actual capital structure has remained consistent over time and has remained consistent for purposes of ratemaking for the past 15 years.

Q. **Is it even more important for OG&E, as small utility, to be able to compete for capital?**

A. Yes. Due to industry consolidation, OG&E's parent company is now one of the smaller electric utilities. This is illustrated in the chart below which shows the equity market capitalization of the EEI utilities. Further, as industry consolidation has occurred, many utility holding companies now cover multiple jurisdictions across the U.S., whereas OG&E

is headquartered in Oklahoma City and predominantly operates in the state of Oklahoma.

Figure 1: EEI Equity Market Capitalization Comparison



Q. **Why is OG&E's market capitalization and single operating company status relevant?**

A. Investors of larger, multi-jurisdiction utilities enjoy a diversified portfolio of geographies, economic conditions, and regulatory environments. This prevents a single adverse event from significantly impacting the company. Adverse market, operational or other noncontrollable events and regulatory decisions can have a larger impact on a single operating company like OG&E with limited diversification since there is little or no levels of consolidated financials through which to "filter" these adverse impacts.

Q. **How does a balanced capital structure such as OG&E's capital structure help ensure access to capital?**

A. Capital structure is one metric that credit rating agencies look at when evaluating a utility's creditworthiness and assigning a credit rating. A healthy capital structure is one that results in a reasonable balance between the overall cost of capital and the expected cost of financial distress. OG&E's actual capital structure is designed specifically to achieve a balance between too much leverage (and the financial risk associated with too much debt) and a creditworthiness profile that ensures overall financial health. The appropriately balanced capital structure also influences credit metrics on which credit ratings are based. Credit ratings are used by investors to evaluate the creditworthiness of a debt issuer and to make investment decisions.

Q. **What is a credit rating?**

A. A credit rating is an evaluation by a credit rating agency of a company's ability to meet its debt obligations in a timely manner. It reflects the opinion of the rating agency of the overall creditworthiness of the company based on the company's relevant business and financial risks. A credit rating can be specific to a particular security or to a particular securities issuer.

Q. **Why do credit ratings matter?**

A. Credit ratings have a significant effect on a company's ability to attract debt capital, and in extreme cases, whether the company can access debt capital at all. Credit ratings also impact the pricing (i.e. cost) and contractual terms at which a company may issue debt securities. This affects the cost of capital and, for regulated utilities, the rates customers must pay for utility service. Similar to a residential homebuyer with a better credit score, a better credit rating typically enables a utility to obtain debt capital at a lower cost. This lower cost for debt capital results in lower rates for customers.

Q. **How are credit ratings determined?**

A. The three credit rating agencies that rate OG&E's debt are Standard and Poor's Ratings Services ("S&P"), Fitch Ratings, and Moody's Investor Services ("Moody's"). In assessing a company's ability to meet its financial obligations, these rating agencies generally - but each to varying degrees - consider both qualitative factors affecting a company's business risk and quantitative factors affecting its financial risk.

Q. **How do a company's credit metrics affect its credit ratings?**

A. Credit metrics factor significantly into the credit rating agencies' evaluations of a company's credit profile and the rating agencies' assignment of credit ratings. The credit rating agencies generally deem strong credit metrics are necessary to maintain investment grade credit ratings.

Q. **What is OG&E's current issuer credit ratings?**

A. OG&E has senior long-term debt ratings of A3, A-, and A for Moody's, S&P, and Fitch, respectively. All of those ratings currently have stable outlooks.

Q. **Does OG&E's credit rating and its ability to raise capital during Winter Storm Uri demonstrate it is reasonable to use the Company's actual test year ending capital structure for ratemaking purposes?**

A Yes. As this testimony has demonstrated, OG&E's actual test year capital structures – which have been historically used by the Commission for ratemaking purposes – help to ensure OG&E can maintain the necessary financial profile to weather significant adverse market conditions and extraordinary events. Imposing a capital structure that is different than the actual test year capital structure has a relatively small impact on customer bills now, but it could increase the cost on customers in the future by increasing the cost to secure new debt or equity at crucial moments. In my opinion, the risk is not worth the reward.

OG&E'S PROPOSED RETURN ON EQUITY IS REASONABLE

Q. **What Return on Equity ("ROE") is OG&E seeking in this proceeding?**

A. OG&E is seeking a 10.5% ROE in this proceeding. This ROE is based on OG&E witness Bulkley's recommendation, which is calculated to fairly repay investors and maintain OG&E's credit strength, is based on current market conditions, and will attract the capital required for OG&E's investments.

Q. **Why is a reasonable ROE determination important?**

A. Investing in infrastructure is a long-term commitment that typically serves customers for many decades. Stable and predictable authorized ROEs are important to investors who are committing a significant amount of capital to these investments. In exchange for this commitment of capital, investors require adequate and stable returns over the life of these investments. The financial community's perception of our ability to earn a fair rate of return drives the cost of funding those capital investments. Uncertainty around earning a reasonable ROE has an adverse impact on the Company's ability to have a clear long-term capital plan.

Investors have many options when it comes to investing their capital, and OG&E must compete with other investment opportunities of comparable risk for that capital. A reasonable authorized ROE is a key factor in keeping our cost of capital from escalating. A reasonable ROE is also needed to obtain new financing and maintain a company's financial integrity, which helps keep debt costs low, and therefore benefits customers though lower rates. An authorized ROE affects a company's cash flows and credit metrics and indicates regulatory support in the jurisdiction in which it operates. A reasonable ROE gives investors confidence in investing in that regulatory environment because it supports a utility's ability to attract capital efficiently. It is essential that the process of determining the allowed ROE results in a ROE that provides stable, predictable, and adequate returns that are needed to attract the investment necessary to provide quality, reliable service to customers.

Q. Does the State of Oklahoma benefit when Oklahoma utilities have an opportunity to earn reasonable ROEs?

A. Yes. The investment community closely follows the business climate in Oklahoma, including regulatory actions. The practical impact is that awarding a reasonable ROE sends a positive message to the investment community while a lower ROE sends a negative message. Prudent investors do not expect ROEs that are higher than appropriate at the expense of customers since that would not be sustainable. At the same time, investors are not interested in providing capital for below market returns.

Q. What happens if the Commission authorizes an ROE that is below market expectations?

A. As witness Bulkley explains in her testimony, if a utility is authorized a ROE below the level required by equity investors, the utility or its parent will find it difficult (and more expensive) to access equity capital. Investors will not provide equity capital at the current market price if the authorized return on equity is below the level they require given the risks of an equity investment in the utility — rather, they will put their capital elsewhere. The ultimate effect increases the cost from both debt and equity financing, thus increasing the cost to customers for utility investments.

Q. Is the authorized ROE for vertically integrated electric utilities thus far through 2023 higher than the Company's existing authorized ROE?

A. Yes. As discussed by Company witness Bulkley, interest rates have increased significantly over the past two years, and that is driving an increase in the cost of equity for utilities. According to S&P Global Regulatory Research Associates' Major Energy Rate Case Decisions Report, released November 1, 2023, the average authorized ROE for vertically integrated electric utilities through September 30, 2023 has been 9.74%, which is greater than OG&E's currently authorized ROE of 9.50%. The 2023 average authorized ROE is similar to the 9.75% average for the calendar year 2022 and is an increase from the 9.70% average for the calendar year 2021, and the 9.55% average for the calendar year 2020.

Q. **Can you summarize your recommendation to the Commission?**

A. Yes. I am requesting the Commission utilize the Company's actual test year capital structure of 53.5% equity and 46.5% debt as well as Company witness Ann Bulkley's recommended 10.5% ROE to set the Company's rate of return in this proceeding.

Q. **Does this complete your direct testimony?**

A. Yes.

AFFIDAVIT

STATE OF OKLAHOMA)
)
COUNTY OF OKLAHOMA)

On the 28th day of December 2023, before me appeared Charles B. Walworth, to me personally known, who, being by me first duly sworn, states that he is the Treasurer for Oklahoma Gas and Electric ("OG&E") and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge, and belief.

Print: Charles B. Walworth

Signature ____________________

Subscribed and sworn to before this 28th day of December, 2023.

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Notary Public

My commission expires: 10-17-2026

Seal

HARRISON L. BURTON
NOTARY
14009452
EXP. 10/17/26
PUBLIC
STATE OF OKLAHOMA