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. PUD 2023-000087
RATES, CHARGES, AND TARIFFS FOR RETAIL	)	
ELECTRIC SERVICE IN OKLAHOMA	)	

Rebuttal Testimony

of

Charles B. Walworth

on behalf of

Oklahoma Gas and Electric Company

May 17, 2024

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. **Are you the same Charles B. Walworth who filed Direct Testimony in this Case on December 29, 2023?**

A. Yes.

Q. **What is the purpose of your Rebuttal Testimony?**

A. The purpose of my testimony is to rebut portions of the Responsive Testimony of Public Utility Division ("PUD") witnesses Cody Alsup and Geoffrey M. Rush, Attorney General ("AG") witnesses J. Randall Woolridge and Greg J. Matejcic, Federal Executive Agencies ("FEA") witness Christopher C. Walters, and Oklahoma Industrial Energy Consumers ("OIEC") witness David J. Garrett.

RISK, ROE, AND CAPITAL STRUCTURE

Q. **In his Responsive Testimony, Mr. Rush states utilities have "much lower risk" than the rest of the market.[1] Is this accurate?**

A. No. There are many significant risks today that specifically affect utilities, making them a much riskier investment than in the past. Mr. Rush also states that higher risk utilities deserve a higher return and refers to both company-specific risk and market risks as two types of risks that must be assessed when determining the appropriate ROE. However, Mr. Rush never identifies any OG&E-specific risks. When asked to identify the Company-specific risks he refers to in his testimony, Mr. Rush stated that listing potential

[1] Responsive Testimony of Geoffrey M. Rush, page 16, lines 1 – 3.

risks is “inherently subjective,” would be speculative, and is “not relevant” information.[2] It is extremely concerning that the Public Utility Division’s designated expert on utility risk believes that opining on an Oklahoma utility’s specific risk is “subjective,” would be speculative, and “not relevant” information. It is also particularly concerning since Mr. Rush says that company-specific risks should be assessed, but then apparently did not assess them and considers them not relevant.

With regard to market risks, as discussed in the Rebuttal Testimony of OG&E witness Bulkley, the share prices of the companies included in Ms. Bulkley’s proxy group have declined since the Company’s last rate proceeding as a result of inflation and the recent significant increase in interest rates. Thus, the recent changes in market conditions have affected electric utilities. The changes indicate increased risk for electric utilities and a higher cost of equity than at the time of the Company’s last rate proceeding.

Q. **What are some of the risks OG&E faces today?**

A. OG&E and many other utilities face multiple significant risks, including environmental regulatory risk, cost exposure to early retirements, generation resource adequacy requirement risk, and wildfire risk. First, there is uncertainty regarding new environmental regulations. New EPA regulations could force utilities including OG&E to make costly investments in existing and future coal and gas plants.[3] The uncertainty surrounding these rules and the investments required to comply with them may impair utility earnings in the near future. Utility investors must now also consider whether assets that are supposed to have useful lives of 30 to 65 years will be shortened significantly by these regulations. While investors expect a full recovery of and on the investments made by utilities in their electric infrastructure, some state regulatory authorities – including the Oklahoma Corporation Commission – in certain circumstances do not allow a full return for assets which have been retired earlier than expected as a result of compliance with environmental regulations that are outside the control of utilities.

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2 PUD Response to Data Request OG&E-PUD 2-7.

3 Hiller, Jennifer: “New EPA Emissions Rules Squeeze Coal Plants” Wall Street Journal, April 25, 2024.

The potential for early plant closure and the risk to expected returns is compounded by the additional risk of evolving resource adequacy rules being developed by FERC-regulated Regional Transmission Organizations ("RTO"). Utilities like OG&E are facing the prospect of having to retire existing capacity early to meet EPA regulation while simultaneously needing to add incremental capacity to meet year-round electric demand caused by resource adequacy rules, all while also meeting continuing growth on the Company's system. OG&E witness Kelly Riley elaborates on OG&E's environmental and resource adequacy risks in detail in her Rebuttal Testimony.

Another significant risk concerning investors today is wildfire risk. Given the recent serious impacts of wildfires attributed to utilities in California, Oregon, Hawaii, Colorado, and Texas,[4] investors are becoming wary about putting their money into small cap western utilities, such as OG&E. In his annual letter to Berkshire Hathaway, Warren Buffett wrote:

> *…the regulatory climate in a few states has raised the specter of zero profitability or even bankruptcy (an actual outcome at California's largest utility and a current threat in Hawaii). In such jurisdictions, it is difficult to project both earnings and asset values in what was once regarded as among the most stable industries in America." Mr. Buffett goes on to say that "it may be many years until we know the final tally from [Berkshire Hathaway Energy's] forest-fire losses and can intelligently make decisions about the desirability of future investments in vulnerable western states. It remains to be seen whether the regulatory environment will change elsewhere. Other electric utilities may face survival problems resembling those of Pacific Gas and Electric and Hawaiian Electric.*

Q. **Are there other risks facing OG&E and other electric utilities?**

A. Yes. There continue to be growing cyber and physical security threats. Events over the past several years have highlighted to investors that physical and cyber risks exist when operating an expansive energy network such as an electric utility. Recent examples include substations attacked to the point of failure (*e.g.*, North Carolina, Washington State, California, etc.) and the electronic disruption of a delivery system (Colonial Pipeline).

[4] Blunt, Katherine: "Wildfires Make Utilities a Tricky Investment. Just Ask Warren Buffett." Wall Street Journal, April 8, 2024.

Utilities like OG&E invest in the prevention, detection, and response to cyber and physical security events, but it brings one more uncertainty in an ever-increasing list for investors to consider.

Q. **Is the risk of wildfires a problem only affecting California and west-coast utilities?**

A. No. Last year a Colorado wildfire was at least partially caused by sparks from a power line.[5] Recently a utility acknowledged its equipment most likely ignited the Smokehouse Creek fire in the Texas panhandle.[6] It is clear that the risk of wildfires is not limited to the west coast.

Q. **Please explain how wildfire risk specifically impacts OG&E.**

A. Much of OG&E's service territory in Oklahoma is in the "relatively moderate" risk zone for wildfires according to FEMA.[7] The Smokehouse Creek fire, which occurred approximately 10 miles from OG&E's distribution assets, highlights this risk for the Company. Investors are concerned about this risk of wildfires, as evidenced by the following statement from Fitch:[8]

> *More frequent and significantly larger, more destructive wildfires in recent years, especially in the Western U.S., expose utilities operating in the region to wildfire activity and higher overall business risk. Fitch believes the recent Smokehouse Creek Fire's proximity to OG&E's service territory, underscores wildfire risk in the region.*

Additionally, in a recent report referencing the Smokehouse Creek fire, S&P Global Ratings states it "highlights potential physical risk exposure to OGE's service territory that may become more frequent and severe…"[9] This clearly demonstrates that the potential of

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5 "Colorado's most destructive wildfire caused by embers from old fire, sparks from power line." https://www.yahoo.com/news/authorities-reveal-results-investigation-colorados-043730683.html

6 Penn, Ivan: "Utility-Caused Wildfires Are Becoming a National Problem." New York Times, March 22, 2024.

7 FEMA National Risk Index: https://hazards.fema.gov/nri/map

8 Fitch Rating Action Commentary, May 2, 2024. https://www.fitchratings.com/research/corporate-finance/fitch-affirms-oge-oklahoma-gas-electric-long-term-idrs-outlook-stable-02-05-2024

9 S&P Global Ratings Tear Sheet: "Texas Panhandle Wildfires Highlight Potential Exposure For OGE Energy's Service Territory," March 5, 2024.

destructive wildfires impacts the risk assessed by the market that is specific to the utility industry and OG&E.

Q. Do you believe that these risks associated with environmental compliance, generation resource adequacy, wildfire and other risks warrant a higher ROE?

A. Yes. OG&E competes for capital and must continue to be attractive to the investment community. These risks create headwinds that OG&E must overcome when attracting investors; investors who may choose to invest in less risky and far bigger utility companies. As I noted in my Direct Testimony, OG&E may be the single largest electric utility in Oklahoma, but OG&E is now one of the smallest investor-owned utilities in the country. While many utilities are part of a much larger corporation that can help them navigate significant negative events associated with these risks, OG&E does not have that luxury and thus its investors must be compensated for taking on that higher level of risk. OG&E must compete with much larger utilities with diversified geographic, jurisdictional, and business portfolios <u>during a time of increased risk and uncertainty within the industry</u>. A higher ROE helps OG&E face those headwinds and ensure that it will continue to attract investment at reasonable terms.

Furthermore, it is imperative that OG&E be awarded a competitive ROE in order for investors to be compelled to invest in the state of Oklahoma. OG&E, like many other electric utilities in the United States, must continue to invest in new generation, transmission, and distribution infrastructure in order for Oklahoma to remain a vibrant economic engine with strong communities. Key to OG&E fulfilling its obligations to safely and reliably serve Oklahomans is the ability to attract capital. As noted below, with the national average for recently awarded ROEs for vertically integrated electric utilities being 9.79%,[10] OG&E would be expected to be awarded an ROE of at least that level to attract the needed capital for the future of the state electric infrastructure.

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[10] S&P Global, RRA Regulatory Focus, Quarterly Update on Decided Rates Cases, April 19, 2024.

Q. **Contrary to the Responsive Testimony of PUD witness Rush and others, do current interest rates also indicate that OG&E should be awarded a higher ROE than outlined in their responsive testimonies?**

A. Yes. 30-year treasury rates today are higher today than they were on average over the period of 2009 – 2011. According to the Historic Electric Utility Rate Cases referenced by Mr. Rush,[11] awarded ROEs in 2009 – 2011 ranged from 10.29% to 10.52%. During that time period, OG&E's authorized ROE was 10.75%, compared to today's authorized ROE of 9.50%. In fact, from 2008 – 2011, when treasury rates were generally in the range of 2.5% – 4.5%, PUD, the AG, and OIEC all recommended ROEs ranging from 9.50% to 10.88%.[12] In this case, these parties' recommendations range from 9.0% to 9.5%. It seems disingenuous for intervenors to recommend a *lower* ROE today, when OG&E is facing increased risks and higher interest rates than it was in the early 2010s.

Q. **Is it reasonable to compare OG&E's authorized ROE to all U.S. electric utilities, including wires-only distribution utilities that do not have electric generation?**

A. No. OG&E is a vertically integrated electric utility, which means it owns and provides generation, transmission, and distribution functions to its customers. Investors therefore evaluate the risk of OG&E differently than they would for a distribution-only utility. Distribution-only utilities do not face the same types of risks as OG&E, such as the resource adequacy and environmental risks I described above. In the 12 months ending March 31, 2024, utilities comparable to OG&E are receiving an average awarded ROE of 9.79%.[13] Mr. Rush and other ROE witnesses only provide historical comparisons of ROEs for all investor-owned electric utilities rather than comparing OG&E's ROE to similarly situated utilities. OG&E's current authorized ROE is below average and yet Mr. Rush recommends lowering it further without adequately explaining why OG&E has "low risk."

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11 Responsive Testimony of Geoffrey M. Rush, page 16, unlabeled table.

12 Cause Nos. PUD 2008-00144, 2008-00398, 2009-00110, 2010-00050, 2011-00082, 2011-00087.

13 S&P Global, RRA Regulatory Focus, Quarterly Update on Decided Rates Cases, April 19, 2024.

Q. **Pointing to OG&E's credit ratings, AG witness Dr. Wooldridge states "[t]he investment risk of OGE is Below the Average of the Electric and Bulkley Proxy Groups."[14] Do you agree?**

A. No. OG&E's strong credit ratings cannot be used to justify a lower ROE, because lowering OG&E's ROE would negatively impact the Company's credit ratings. Further, OG&E witness Bulkley testifies how the use of credit ratings is inadequate in assessing business risks of the Company relative to the proxy group.

CAPITAL STRUCTURE

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 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. **Do customers benefit from OG&E's capital structure during unusual market events?**

A Yes. As I explained in my Direct Testimony, 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 hypothetical capital structure that is different than the actual test year capital structure has the potential to increase the cost on customers in the future by increasing the cost to secure new debt or equity at crucial

[14] Responsive Testimony of J. Randall Wooldridge, page 10, lines 18 – 19.

moments.

Q. **Has the Commission determined OG&E's capital structure to be just and reasonable in past cases?**

A. Yes. I do not recall a case during my twenty-year tenure with OG&E when the Commission did not set rates based upon the Company's actual capital structure under which OG&E operates and serves customers. This includes the three general rate cases OG&E has completed since the Commission ordered the Company to "further evaluate adjusting its equity to debt ratio…" in OG&E's 2015 general rate case.[15]

Q. **Is the Commission's decision on capital structure critical to ensuring the financial health and stability of OG&E?**

A Yes. In fact, OIEC witness Mr. Mark Garrett makes my point when addressing another point in his Responsive Testimony when he states,[16]

> *Customers must be able to rely on the Commission to be consistent on important issues such as this. Stability, consistency, and predictability are fundamental attributes in our system of law. These attributes allow people to conduct their lives more efficiently. Here, these attributes allow customers, especially large industrial customers, to rely on prior precedent and organize their business decisions accordingly.*

I would say this reasoning is equally true with respect to OG&E and its capital structure. OG&E has relied on the consistency of prior Commission decisions to ensure the lowest reasonable borrowing costs for its customers, and reversing course now could prove costly to the Company's ability to borrow at reasonable rates in the future.

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15 Final order 662059, Cause No. PUD 201500273, page 5.

16 Responsive Testimony of Mark E. Garrett, Cost of Service and Rate Design Issues, pg. 10.

BOARD OF DIRECTORS' COMPENSATION, INSURANCE, AND INVESTOR RELATIONS

Q. **AG witness Greg J. Matejcic and OIEC witness Mark E. Garrett recommend 50% disallowance of cash compensation and 100% disallowance of equity compensation for OG&E's board of directors. Is this a reasonable adjustment?**

A. No. All companies, especially publicly traded companies, must have proper governance. This is not an optional expense for OG&E, it is required. The Board ensures the Company is governed, operated, and overseen appropriately to the benefit of both shareholders and customers. OGE Energy Corp cannot refuse to compensate its Board because it requires the active participation and input of highly skilled individuals with the requisite knowledge to oversee executive leadership of the Company. For instance, OGE Energy Corp's Board is comprised of individuals that are formerly or actively Chief Executive Officers of large, multi-national, publicly held companies. Other members include the executive leadership of large accounting firms, information technology companies, and regulated industries. Just as with OG&E's own workforce, compensation is necessary to attract and retain the talent necessary to properly govern the business.

Q. **Likewise, AG witness Greg J. Matejcic and OIEC witness Mark E. Garrett recommend 50% disallowance of Directors and Officers ("D&O") Liability Insurance. Is this a reasonable adjustment?**

A. No. Again, this is a required expense for OGE Energy Corp as a publicly traded company. OGE Energy Corp would not be able to even have a Board if it did not pay for D&O insurance because its Directors and Officers would be fully exposed to liability, a situation not dissimilar to driving a car without insurance. I am not aware of a single publicly traded company that can or would operate without proper D&O insurance. Disallowing any portion of this expense from rates is akin to disallowing prudently incurred property insurance policy costs the Company incurs. Both policies protect the Company and its customers from significant financial burdens that could result from adverse events.

Q. **PUD witness Cody Alsup, AG witness Greg J. Matejcic, and OIEC witness Mark E. Garrett all recommend 50% disallowance of Investor Relations Expense. Is this disallowance reasonable?**

A. No. Investor Relations costs are not only necessary, but critical in ensuring access to debt and equity capital, obtaining favorable terms under which that capital is acquired, and maintaining credit ratings that allow OG&E to access capital at a reasonable price. Investor Relations is therefore critical in ensuring the lowest reasonable rates for customers and is a normal and proper expense necessary for the operations of our business.

In his Responsive Testimony, Mr. Garrett claims that since there are "hundreds of local gas and electric utilities nationwide owned by cities, counties, and tribal nations which do not maintain an investor relations function these expenses are not a necessary and required cost for the provision of utility service."[17] By trying to frame the argument this way, Mr. Garrett completely ignores the investor-owned segment of utilities, for which it is absolutely a necessary business expense.

Q. **PUD witness Cody Alsup states that investor relations "expenses are dues related to investment advisement and membership services."[18] Is this an accurate statement?**

A. No, it is not accurate. There are three main segments that make up the vast majority of OG&E's Investor Relations expense. The largest segment is the New York Stock Exchange ("NYSE") listing fee. This is not a due or membership, rather it is a required listing fee for any publicly traded company that is listed on the NYSE. OGE Energy Corp cannot choose to not pay this expense, and the listing fee is required for any company that is listed in the NYSE, regardless of whether or not it is a regulated entity. The second largest segment is the cost associated Computershare, OGE's transfer agent. Computershare is responsible for many services that are required for an investor-owned utility, including account maintenance for registered shareholders, issuing shares, dividend services (such as, mailing and paying dividends), and the maintenance of the dividend

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17 Responsive Testimony of Mark E. Garret, Revenue Requirement Phase, pg. 49.
18 Responsive Testimony of Cody Alsup, pg. 12.

reinvestment plan, which allows shareholders to reinvest their dividends in OGE shares. The third largest segment is costs paid to Broadridge, who the Company utilizes for annual proxy services required as part of conducting annual shareholder meetings.

Together, these three categories of costs constitute the vast majority of the proposed disallowed investor relations expenses. Investor Relations expenses are a required cost of the equity component of OG&E's allowed cost of service and those expenses include annual expenses to be listed on a stock exchange, expenses paid to transfer agents, and expenses paid to proxy service providers. These are not dues but are reasonable and necessary expenses that are required for OG&E to operate as a company and raise the necessary capital to build and maintain the electric system.

Q. **Are PUD, the AG, and OIEC consistent in recommending disallowances for investor relations expenses?**

A. No. The same three witnesses that recommend a disallowance for investor relations in this case filed testimony or participated in the review of Case No. PUD 2024-000010, which is Oklahoma Natural Gas Company's ("ONG") annual Performance Based Rate filing.[19] One business day after filing recommendations in this case, all three parties filed testimony in ONG's case, and not one of these witnesses recommended a disallowance for Investor Relations expenses for ONG. In addition, PUD did not point to a single instance in which it recommended this disallowance before,[20] and their recommendation appears to be based upon a misunderstanding of the nature of OG&E's Investor Relations expense.

Q. **Have these items been disallowed for OG&E in previous rate cases?**

A. No. I am not aware of any instance in which the Commission disallowed any portion of OG&E's Board of Director's compensation, D&O insurance, or investor relations expense.

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[19] Case No. PUD 2024-000010, Responsive Testimonies of Mark E. Garrett, Hannah R. Hubler, and Greg J. Matejcic. (PUD witness Cody Alsup is listed as a PUD analyst assigned to review ONG's PBR case in Ms. Hubler's Responsive Testimony).

[20] Response to Data Request OGE-PUD 2-13.

Q. **Have any witnesses presented any evidence that the Board of Directors compensation, Investor Relations expenses, and D&O insurance expenses are unreasonable or imprudent?**

A. No. No party in this case claims that any of these costs are unreasonable or imprudent expenses. No party in this case claims that OG&E is spending too much on these items. These are all necessary costs of conducting business and raising debt and equity capital for our customers to build and maintain a safe and reliable electric system, and therefore should be recovered through rates.

The Attorney General, PUD, and OIEC's arguments seem to come from an emerging belief that if any costs somehow relate to shareholders, then they are costs that should not be included in rates. That is a false narrative that should be rejected.

Board of Directors compensation, Investor Relations expenses and D&O insurance are costs of running a utility and customers benefit from 100% percent of the costs through the provision of safe, reliable, and affordable service. Recovery of these costs is part of the regulatory compact that comes with being a regulated electric utility. OG&E cannot spend only 50% of the costs in order to exist as an investor-owned, publicly traded utility and raise necessary capital just like it cannot cut 50% of its payroll costs to execute capital projects. Therefore, OG&E should be able to incur and recover these reasonable costs, especially when no party in this case has presented evidence that the costs are unreasonable or imprudent.

RECOMMENDATIONS

Q. **What are your recommendations to the Commission?**

A. I recommend 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. I also recommend the Commission reject the recommendations of OIEC and the AG to disallow portions of OG&E's Board of Director's compensation, Director, and Officer liability insurance expense, and reject the recommendations of OIEC, the AG, and PUD to disallow 50% of

Investor Relations expense. These are all required expenses, and no party has presented evidence to support that they are unreasonable or imprudent.

Q. **Does this complete your Rebuttal Testimony?**

A. Yes.