BEFORE THE CORPORATION COMMISSION 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 RATES, CHARGES, AND TARIFFS FOR RETAIL ELECTRIC SERVICE IN OKLAHOMA	**CAUSE NO. PUD 201700496**

Summary of
Responsive Testimony of

Christopher C. Walters

Senior Consultant

Brubaker & Associates, Inc.

On behalf of

Federal Executive Agencies

May 7, 2018

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Consultant, Brubaker & Associates, Inc.
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My name is Chris Walters, and I am employed at Brubaker & Associates, Inc. ("BAI"). I have been employed by BAI for more than seven years and my current title is Senior Consultant. I filed testimony in response to the application of Oklahoma Gas & Electric Company ("OG&E" or "Company") filed in the captioned cause. I hold a Bachelor of Science degree in economics and finance from Southern Illinois University Edwardsville and a MBA from Lindenwood University. I have also earned the Chartered Financial Analyst ("CFA") designation from the CFA Institute. I have previously sponsored expert testimony on the cost of equity, capital structure, and financial integrity.

In my responsive testimony, I specifically addressed return on common equity currently required by investors for OG&E. I also comment on OG&E's requested capital structure, OG&E's embedded cost of debt, the indicated jurisdictional retail credit metrics produced using my recommended return on equity, and the direct testimony of Company witness Dr. Morin.

To begin my analysis of an appropriate return on equity for OG&E, I described the declining trend in authorized returns on equity for electric utilities, the current market outlook for regulated electric utilities, and the performance of utility stocks over the last several years relative to the S&P 500. I also show that utilities have been able to fund very large capital programs. I also provided comments on the Federal Reserve's monetary policy and current outlooks for changes in interest rates. I concluded that the data shows regulated electric utilities are still being embraced by market participants and have access to capital at reasonable prices.

I next describe the market's assessment of the investment risk of OG&E as provided by reports published by credit ratings agencies, and note that OG&E's ratings at S&P are being somewhat influenced the lack of insulation measures and its affiliation with Enable. I then explained that OG&E could have altered its capital structure since the Commission's Order from OG&E's previous rate case to avoid a possible hypothetical capital structure from this rate case. I also show that OG&E's 53.3% common equity ratio is unreasonable compared to what is being authorized for other utilities. This capital structure also produces an adjusted debt ratio that is well below other utilities with an A- bond rating.

Next, I explain that OG&E's embedded cost of debt of 5.32% is being heavily impacted by two senior bond issuances that are set to mature in the next nine months. Specifically the $250 million 6.35% issue that matures in September 2018, and the $250 million 8.25% issue that matures in January 2019. I recommend the Commission to require OG&E to update its embedded cost of debt to reflect the actual cost to refinance the September 2018 issue.

I then describe what is meant by a "utility's cost of common equity." I explained that a utility's cost of common equity is the return investors require on an investment in the utility. Investors expect to achieve their return requirement from receiving dividends and stock price appreciation. I also explained that, in general, determining a fair cost of common equity for a regulated utility has been framed by two hallmark decisions of the U.S. Supreme Court known as the Hope and Bluefield Standards.

Because the cost of equity is not directly observable, and OG&E is not a publicly traded company, a proxy group of comparable risk is needed to estimate the cost of equity for OG&E. I adopted Dr. Morin's proxy group with three exceptions: I excluded Westar for its continued active merger with Great Plains Energy, Fortis for being based in Canada, and Emera for being based in Canada as well as not being included in Value Line's universe of Electric Utilities. I then compared OG&E to my proxy group and concluded that the results of my cost of equity models will reasonably, if not conservatively, estimate the cost of equity for OG&E.

Next, I describe my application of, and results from, several market-based models that I used to estimate the cost of equity for OG&E. The models I relied on to estimate the cost of equity for OG&E include three variations of the Discounted Cash Flow ("DCF") model, two versions of the risk premium model, and a Capital Asset Pricing Model ("CAPM"). I concluded that the results of my DCF analysis indicated a cost of equity of 9.1%, my risk premium analysis indicates a cost of equity of 9.6%, and my CAPM indicates a cost of equity of 9.4%.

Based on these results, I recommended the Commission authorize a return on equity of 9.35% for OG&E. My recommendation is the midpoint of my recommended range of 9.1% to 9.6%. To support my recommendation, I show that a return on equity of 9.35% will support the financial integrity of OG&E, even after accounting for the reduction to OG&E's cash flows as a result of the reduced depreciation expense recommended by my colleague, Mr. Brian Andrews.

Next, I discussed the unreasonableness of Company witness Dr. Morin's recommended return on equity of 9.9% and the analysis he relied on to support that recommended return on equity. I explain that Dr. Morin's return on equity estimates are not reasonable and that his estimated return on equity is overstated and should be rejected. I explained that Dr. Morin's analyses produce excessive results for various reasons, including the following: (1) he inflates his cost of equity estimates by approximately 20 basis points for hypothetical flotation costs; (2) his DCF is heavily influenced by his inclusion of Canada-based companies; (3) his CAPM is based on long-term treasury bond yields that are too far into the future; (4) he incorrectly relied on an adjusted beta in his empirical CAPM and (5) his Risk Premium analyses are based on inflated equity risk premiums.

I show that after reasonable corrections to Dr. Morin's analyses, his results would fall in the range of 8.7% to 9.3%. These results show that my recommended return on equity of 9.35% is reasonable for OG&E at this time.