

BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF)
OKLAHOMA GAS AND ELECTRIC COMPANY)
FOR AN ORDER OF THE COMMISSION) CAUSE NO. PUD 201100087
AUTHORIZING APPLICANT TO MODIFY ITS)
RATES, CHARGES, AND TARIFFS FOR RETAIL)
ELECTRIC SERVICE IN OKLAHOMA)

Direct Testimony

of

Julie M. Cannell

on behalf of

Oklahoma Gas and Electric Company

July 28, 2011

Julie M. Cannell
Direct Testimony

1 Q. **Please state your name, address, and occupation.**

2 A. My name is Julie M. Cannell. My business address is P.O. Box 199, Purchase, New York
3 10577. I am the president of my own advisory firm, J.M. Cannell, Inc.
4

5 Q. **Please describe your professional and educational background.**

6 A. My firm, J.M. Cannell, Inc., provides investor-related advisory services to electric utility
7 companies and other firms and organizations with an interest in the industry. Prior to
8 establishing my firm in February 1997, I was employed by the New York-based
9 investment manager, Lord Abbett & Company, from June 1978 to January 31, 1997.
10 During my tenure with Lord Abbett, I was a securities analyst specializing in the electric
11 utility and telecommunications services industries. A securities analyst is tasked with
12 understanding in depth the fundamentals of an industry and the companies that comprise
13 it. While at Lord Abbett, I also was portfolio manager of America's Utility Fund, an
14 equity utility mutual fund, for which the firm was a sub-advisor; portfolio manager of
15 numerous institutional equity portfolios; and co-director of Lord Abbett's Equity
16 Research Department.

17 My educational credentials include a B.A. from Mary Baldwin College, M.Ln. from
18 Emory University, and M.B.A. from Columbia University. I am also a Chartered
19 Financial Analyst (C.F.A.).

20 I have been a member of the Wall Street Utility Group, an organization of security and
21 credit rating analysts having an expertise in the utility industry, for over thirty years.
22

23 Q. **Have you previously testified on the perspective of investors before utility
24 commissions?**

25 A. Yes, I have. I have submitted pre-filed testimony on behalf of investor-owned utilities
26 before Public Service or Public Utility Commissions in the states of Arizona, Colorado,
27 Connecticut, Kansas, Maryland, Massachusetts, Minnesota, Missouri, Nevada, New
28 York, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia,

1 Washington, and Wisconsin. The details of my participation in regulatory proceedings
2 are provided in Exhibit JMC-1.

3
4 **Q. Have you previously testified before this Commission?**

5 A. Yes. I submitted direct testimony to the Oklahoma Corporation Commission (“OCC” or
6 “Commission”) in Dockets PUD 200600285 in 2007 on behalf of the Public Service
7 Company of Oklahoma and PUD 200500151 in 2005 on behalf of Oklahoma Gas &
8 Electric Company.

9
10 **Q. Have you had additional regulatory experience?**

11 A. Yes. As a consultant to the Edison Electric Institute, I was extensively involved between
12 2004 and 2009 in an ongoing initiative geared toward fostering and improving
13 communications between state regulators and the investment community. This effort has
14 centered on a series of forums held throughout the United States bringing together these
15 two constituencies, sponsored by the Edison Electric Institute and facilitated by Gee
16 Strategies president Robert Gee, former chairman of the Texas Public Utilities
17 Commission. In addition to helping structure these dialogues, my role was to moderate
18 panel discussions of equity and debt security analysts.

19 I have also conducted several studies of investor perceptions of regulatory issues.
20 Further, I have written articles addressing the implications for utilities and state
21 regulators of various topical issues, including the current electric industry capital
22 expenditure cycle and the financial crisis. Most recently, I authored an article about the
23 views of chief financial officers of midcap utilities on various industry topics.

24
25 **Q. On whose behalf are you providing testimony in this proceeding?**

26 A. I am providing Direct Testimony on behalf of Oklahoma Gas & Electric Company
27 (“OG&E” or “the Company”).

28
29 **Q. What is the scope of your testimony?**

30 A. I will address the perspective of investors in regard to the Company’s rate proposal and
31 will provide comments on several areas: (1) investors’ perspective of risk due to the

1 investment commitments currently being undertaken by electric utilities in general and
2 the Company in particular; (2) investors' perception of risk as impacted by current
3 macroeconomic conditions; (3) investors' perceptions of the Oklahoma regulatory
4 environment and how those perceptions affect the Company's ability to access capital
5 and its overall financial health; and (4) investors' expectations for OG&E's return on
6 equity ("ROE").

7
8 **Q. What in your experience allows you to provide testimony about investors'**
9 **perspectives and expectations?**

10 A. As a securities analyst, I specialized in the electric utility industry and the individual
11 companies comprising it. And as a portfolio manager, I applied that knowledge, along
12 with investment fundamentals, in making investment decisions on behalf of institutions
13 and individual investors. My experience has given me familiarity with the information
14 and tools that investors use in making decisions with respect to expected ROEs.
15 Moreover, I have reviewed the various reports of security and credit rating agency
16 analysts, which have addressed the Company and its current regulatory situation.
17 Further, I have familiarized myself with the Company's fundamentals and its planned
18 investment levels.

19
20 **Q. As a securities analyst or portfolio manager, did you follow the Company?**

21 A. Yes, I did. In my former positions at Lord Abbett, I became very familiar with OG&E,
22 as Lord Abbett maintained holdings in the common stock of the Company or its parent,
23 OGE Energy ("OGE"). Also, as noted previously, after I left Lord Abbett, I filed
24 testimony representing the investor perspective on OG&E's behalf in its 2005 general
25 rate case.

26
27 **Q. Please describe how your testimony is organized.**

28 A. There are four parts to my testimony.

29 **I. Investors' requirements for increased returns in utility investments.** This
30 section discusses the investment risk of electric utilities; specifically, why the current
31 construction cycle has increased the risk of investing in the industry. It also addresses

1 how regulatory risk has risen due to this higher capital spending and how this impacts
2 OG&E in particular.

3 **II. Investors' perception of risk caused by the current macroeconomic**
4 **environment.** This section discusses the elevated risk created by the global economic
5 crisis.

6 **III. Investors' expectations for and perceptions of OG&E, Oklahoma regulation,**
7 **and the current proceeding.** This section focuses on who investors are, how they
8 actually make their decisions, a review of the investment community's perceptions of the
9 Company and of Oklahoma regulation. This review is based on a number of recent
10 publications in which investment analysts discuss their perceptions of the Company and
11 its regulatory environment.

12 **IV. Investor expectations for return on equity for OG&E.** This section discusses
13 how investors would view the Company's request for an authorized ROE of 11.0%.

14
15 I. INVESTORS' REQUIREMENTS FOR
16 INCREASED RETURNS IN UTILITY INVESTMENTS

17 **Q. Please explain why the investment community's view of an electric utility's stock is**
18 **important to the utility and its customers.**

19 **A.** Electric utilities are in the business of providing their customers with safe, reliable, and
20 efficient service. This requires extensive investment in distribution and transmission
21 infrastructure, which makes the electric utility business capital-intensive. Investors
22 provide the capital necessary to maintain and expand a utility's infrastructure, which in
23 turn enables utilities like the Company to provide safe, reliable, and efficient service to
24 customers.

25 The terms on which the Company is able to obtain that capital have a direct and
26 measurable impact on customers and the amounts they pay for electric service. For
27 example, if credit rating agencies such as Moody's Investors Service (Moody's),
28 Standard & Poor's (S&P), or Fitch Ratings (Fitch) believe that the utility's revenues will
29 be diminished by adverse business or regulatory decisions, those rating agencies could
30 lower their credit ratings for the utility, which would raise the cost of debt. And, because

1 the cost of debt is a component of the weighted average cost of capital, the increased
2 costs of capital would eventually be passed on to customers in the form of higher rates.

3 The same is true for equity investors. If individual or institutional investors believe that
4 the return they are offered is too low in light of the risk involved, they will either sell
5 their stock or elect not to purchase the stock, which generally drives the stock price
6 down. Although lower stock prices would appear at first blush to be a concern only to
7 investors, they also affect customers. When a utility has to go to the equity markets to
8 obtain capital, a low stock price requires it to issue more shares of stock to obtain the
9 same amount of money than it would have received for fewer shares if the per share price
10 had been higher. The resulting increase in the number of shares outstanding requires
11 more dollars to be expended toward dividends, resulting in less retained earnings for
12 reinvestment in the company.

13 The corollary is that when investors believe that they are investing in a company where
14 regulation is fair, consistent, and provides a reasonable rate of return, those investors
15 charge less for their capital. And when debt and equity investors demand less for their
16 capital, utility rates remain lower and utilities have more ready access to the capital
17 markets. Thus, a utility and its customers have a shared interest in meeting the
18 expectations of investors and credit rating agencies. Regulators share this interest as
19 well, because fair treatment of one utility decreases the costs of capital for all utilities in
20 that regulatory jurisdiction.

21
22 **Q. Are you suggesting that the Commission's decisions should be dictated by investors?**

23 **A.** Not at all. I realize that the OCC must apply the law to the facts that are demonstrated to
24 it and that it must balance the interests of investors and customers. My point is that the
25 Commission's decision on rate of return is not simply a zero-sum game. If the rate of
26 return strikes an appropriate balance between the utility and customers, both benefit.

27
28 **Q. Can you briefly describe your understanding of the applicable legal standard with
29 respect to a utility's reasonable return on equity?**

30 **A.** Yes. The U.S. Supreme Court addressed this issue in its *Bluefield* and *Hope* decisions.
31 These decisions held that a public utility is entitled to a return on equity adequate to

1 assure confidence in the financial soundness of the utility, to maintain its credit, and to
2 enable it to attract the capital necessary to operate its business on reasonable terms
3 compared to firms of similar risk.
4

5 **Q. How has the risk of investing in electric utilities changed in recent years?**

6 A. The predictability of the electric utility industry's earnings, across the sector, was
7 undermined in the last ten to fifteen years by the restructuring of the industry that has
8 taken place in many parts of the country. Moreover, during the past several years, it has
9 become clear to investors and others that the industry is now in a period of significant
10 capital expenditures that is likely to last for some time. This new construction cycle
11 reflects the need utilities in general have to replace aging infrastructure; to meet new
12 environmental requirements and expectations; to address the need for grid enhancements,
13 including those associated with interconnecting renewable resources; to provide
14 technological advancements such as smart grid technologies; and to add new base-load
15 and intermediate generation resources to meet growing customer needs. The resulting
16 increase in capital expenditures from all of the investments set forth above means that
17 utilities will be more active in capital markets and, therefore, will be more exposed to the
18 risks and uncertainties in those markets. OG&E's levels of capital expenditures are
19 certainly consistent with this pattern.

20 Electric utilities will also be more exposed to regulatory risks, since a significant
21 expansion of capital spending by electric utilities usually results in rate proceedings to
22 recover the costs associated with that capital. As a result, regulatory exposure has become
23 a key focus for investors as utilities face a series of rate cases in order to recover the
24 required costs they are incurring to supplement and replace aging infrastructure, to meet
25 environmental requirements, and to meet other costs. These risks are in addition to the
26 other risks posed by the technological, economic, environmental and other policy
27 changes that also affect the industry. It is because of these increased risks that investors
28 no longer perceive electric utilities as a group as being the "safe havens" they once were.

1 Q. **Have investors' goals for utility investments changed in response to these increased**
2 **risks?**

3 A. No. Investors' goals for electric utility investments have not fundamentally changed.
4 They still look to electric utilities primarily as defensive investments, and still look for
5 stable performance and regular dividends as the reason to invest in electric utilities. But
6 investors also understand that the investment risk in electric stocks has risen significantly,
7 and their expectations of returns have changed accordingly.

8 In the end, investors have a very large universe of stocks from which to select; with few
9 exceptions, they have no requirement to own electric utility stocks. To the extent that
10 they do invest within the utility sector, investors must be discriminating in their stock
11 selection. Accordingly, as will be discussed later, utilities with strong financial metrics
12 operating in constructive regulatory environments will have stronger investment appeal
13 than utilities with weak metrics and less favorable regulation.

14

15 Q. **How do investors view state regulation in the context of a major capital expenditure**
16 **cycle?**

17 A. Nationally, in the past several years, rate case filings in the electric industry have become
18 much more frequent. From an investor's perspective, each regulatory proceeding
19 introduces a period of uncertainty for a utility. Among the unknowns are the ROE the
20 company will be allowed to earn, the equity base on which that return can be earned, the
21 extent to which costs—both historical and future—can be recovered, and the degree to
22 which the rate case will prompt a negative regulatory reaction. In other words, the
23 utility's future earnings power is thrown into question until the case is decided. Because
24 that earnings power is the basis for an investment in the company, the stability and
25 constructiveness of state regulatory policies are critical concerns to investors.

26

27 Q. **Please address how investors assess the specific risks the Company is facing in**
28 **relation to the new capital investment cycle.**

29 A. Investors understand that OG&E is involved in the industry-wide construction and capital
30 investment cycle. Through 2016, the Company has a capital expenditure budget of \$3.5
31 billion. During this period, both OG&E and its parent will need to access the capital

1 markets and thus will be exposed to market vicissitudes and pricing levels. It bears
2 mention that the Company's capital budget does not incorporate potential spending
3 related to environmental compliance. Because pending environmental mandates are not
4 yet finalized, the level of additional future spending cannot be accurately assessed at this
5 point in time. But it is fair to say that the magnitude will be large.

6
7 **Q. Does the Company face further risks?**

8 A. Yes. With its planned capital spending, it is clear that OG&E will face regular rate cases.
9 Recovery of the substantial costs of maintaining, renewing, expanding, and replacing a
10 mature utility infrastructure is likely to require base rate cases routinely during the
11 coming years.

12
13 **Q. Is OGE's small market capitalization a factor in its having market access?**

14 A. Yes, it is. OGE is considered a mid-cap company. Because of the lower level of available
15 liquidity in such a utility, many institutions have policies against owning its securities.
16 This potentially limits the number of institutional investors who elect to follow the
17 company and its subsidiaries. From those investors' perspective, it may be easy to
18 establish an investment position in a mid-cap company, but unwinding the position can
19 pose a formidable challenge because it is often difficult to find buyers when needed. In
20 other words, it can be extremely difficult to transact in a company with a thinner market
21 capitalization. Additionally, as merger and acquisition activity continues in the utility
22 industry, larger companies almost by definition have more buying power in the
23 marketplace, layering on an added impediment to mid-cap utilities seeking to raise
24 capital.

25
26 **Q. You've discussed the mounting risks you see the Company facing. Do those risks
27 have the potential to reduce its earnings and cash flow streams and increase their
28 volatility?**

29 A. Yes, they could, due to the fact that the foregoing factors are in large part beyond
30 OG&E's control. Where risk factors are more clearly within the Company's control,
31 investors can evaluate the importance and effect of those risks based on their assessment

1 of the strength of the Company's management, and guidance about how OG&E plans to
2 mitigate or avoid the risks in question. In this case, the nature of the risk is such that the
3 Company's investors have little guidance and more uncertainty. Uncertainty leads to
4 investor concern and demands for higher investment returns.

6 II. THE MACROECONOMIC ENVIRONMENT

7 Q. **What macroeconomic challenges are utilities facing at the present time?**

8 A. The United States and, indeed, the world economies are, or have been, in recession and
9 grappling with a very serious financial crisis. While few industries are untouched by
10 these circumstances, utilities are particularly vulnerable because of their capital-intensive
11 nature and the magnitude of the construction expenditures they now face.

13 Q. **How has the financial crisis affected the industry?**

14 A. With the demise of a number of investment and commercial banks, coupled with the
15 significant weakening of surviving institutions, access to capital after the onset of the
16 crisis was initially difficult for most companies and impossible for others. Indeed, for a
17 period of several weeks in September 2008, the debt markets were completely closed to
18 any company. While some stability has returned to the capital markets, the
19 unprecedented volatility and uncertainty that has characterized the markets since the fall
20 of 2008 negatively impacted the terms and increased the cost of capital
21 In this environment, set in the context of rising capital expenditures for the industry at
22 large and the Company specifically, it is important that the Commission recognize that
23 investors require a level of return that reflects the increased level of risk.

25 Q. **What are the regulatory implications of this financial crisis?**

26 A. The current environment presents a distinct challenge to the utility industry. The industry
27 must retain access to capital on reasonable terms during this period of market uncertainty
28 in order to provide safe and reliable service to customers. This will require balanced and
29 consistent regulation. Maintaining a solid regulatory compact will be critical.

1 Q. **Please elaborate.**

2 A. The regulatory compact means that utilities will take the risk to invest in the
3 infrastructure and assets needed to provide safe, reliable, and efficient electric service,
4 and that regulators will support that investment by providing timely recovery of costs,
5 reasonable returns on prudently invested capital, and regulatory treatment that, in general,
6 is fair, predictable and balanced. It does not involve favoring any one group of interested
7 parties in the regulatory process over others, but recognizes the key relationship between
8 investment of capital by the utility, and the need for recovery of operating costs, capital
9 and returns to support prudent investment.

10

11 Q. **Are the Company's current credit ratings cause for concern in its obtaining access
12 to the capital markets?**

13 A. Yes. As previously discussed, the turmoil in the financial markets has resulted in no
14 company—no matter how financially strong—having carte blanche access to debt and
15 equity financing. The stronger the company, the better the odds that financing would be
16 available, but there are no guarantees. As will be discussed later, all three credit rating
17 agencies currently have a stable outlook on the Company. However, a variety of
18 circumstances, including a lack of regulatory support, could cause that perspective to
19 change negatively.

20

21 Q. **What factors suggest that improvement may still be slow to come in the economy,
22 with attendant negative implications for the markets?**

23 A. News sources contain articles on almost a daily basis conveying that the economy is still
24 in a recovery mode and the opportunity for additional shocks to the system exists. For
25 example, the Federal Reserve Board's recent continuation of its accommodative
26 monetary policy, heretofore an important stabilizing force in the markets, is serving to
27 foster increased concerns about the mounting size of the federal deficit as well as its
28 impact on the dollar relative to other currencies. Indeed, as its current program of
29 Quantitative Easing (QE2) drew to a close in June, the Federal Reserve Board
30 acknowledged that it would be faced with a delicate balancing act of maintaining a weak
31 but rebounding economy while not fueling inflationary pressures in the process. And as

1 was vividly demonstrated in the November 12-13, 2010 meeting of the G-20 nations in
2 Seoul, Korea, foreign countries are highly disturbed about the impact that the U.S.’
3 accommodative monetary policy is having on the level of the dollar versus other
4 currencies.

5 Another major problematic area is commercial real estate, which has billions of dollars of
6 loans coming due and limited prospects of repayment. A crisis in this area could
7 exacerbate ongoing problems in the already weak banking sector. And the possibility of
8 markets being disrupted by unanticipated events from around the world always exists.
9 For example, serious concerns exist over the sovereign debt of some of the European
10 nations - Spain just months ago, and Greece, Ireland and Portugal currently. In tandem
11 with these debt worries is the significant question of whether the Euro market will
12 survive. In short, given the unstable economic and political backdrop that still exists
13 globally, there are numerous possibilities for circumstances and/or events that could
14 plunge the financial markets back into a crisis mode. In sum, substantial risk still exists.

15
16 III. INVESTORS’ EXPECTATIONS FOR AND PERCEPTIONS OF OG&E,
17 OKLAHOMA REGULATION AND THE CURRENT PROCEEDING

18 Q. **Why is the perception of regulatory climate of such importance to investors?**

19 A. Equity investors today still seek companies that can offer stability in earnings and
20 dividends. Fixed income investors look for stable and adequate cash flows to ensure
21 payment of principal and interest when due, as indicated by stable credit ratings. The
22 ability to pay dividends and sustain credit ratings is directly related to the consistency and
23 sufficiency of a utility’s earnings, which depend in large part on how the utility is
24 regulated and managed. If there is uncertainty about whether regulation will allow a
25 utility the opportunity to earn a reasonable return in future years, then that lack of
26 predictability will lead investors to avoid holding investment positions in the utility, all
27 other things being equal.

28 As a result, investors selecting electric utility stocks today place a very high value on
29 consistent and constructive regulation. And, with a new round of base rate case filings
30 underway in the industry, the quality of regulation is receiving increased investor
31 scrutiny.

1 Q. **In your experience as an analyst and portfolio manager, could a perceived change in**
2 **a company's regulatory climate affect your investment opinion?**

3 A. Absolutely. During my tenure as an institutional investor, a utility's regulatory
4 environment was a critical factor in my assessment of its investment attractiveness. An
5 adverse regulatory decision could be a key determinant in my recommendation or
6 decision to sell a stock already owned or not to make an investment in one under
7 consideration.

8

9 Q. **Who are typical investors in utility stocks?**

10 A. There are two kinds of investors: individuals, who generally seek stability and income
11 from their utility holdings, and institutions, which generally seek total return (*i.e.*, price
12 appreciation plus dividend income) from their utility investments.

13

14 Q. **Please provide more detail on individual investors.**

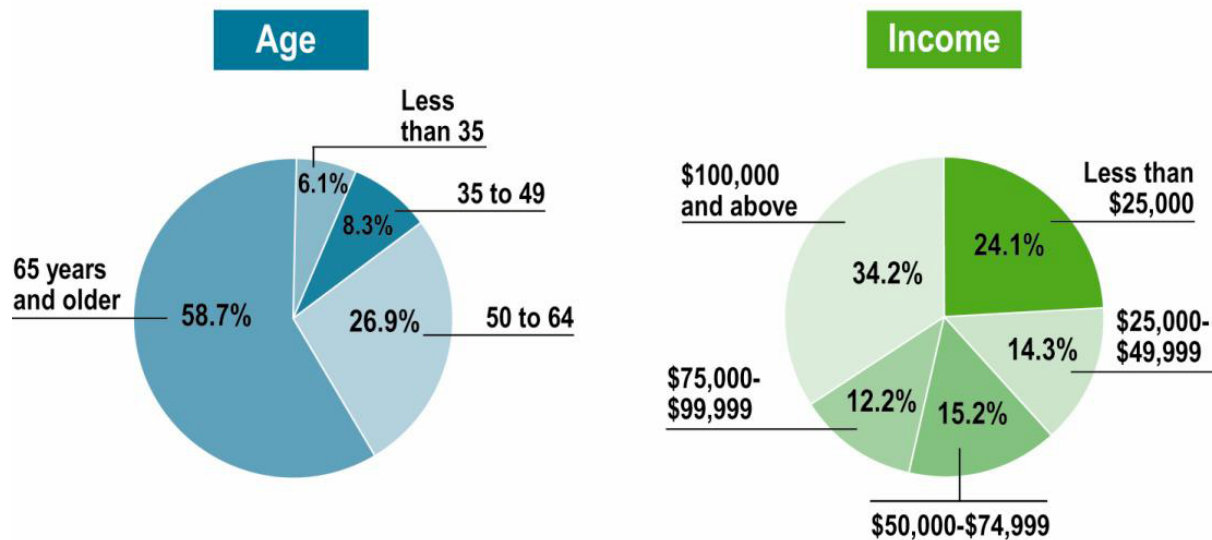
15 A. Individuals can own stocks through two avenues: either outright in his or her own name,
16 or through a variety of institutional vehicles. In the latter option, which will be discussed
17 later, a person purchases shares in a mutual fund or other investment vehicle, or has a
18 direct interest in a pension fund that is managed by professional or institutional investors.
19 As noted previously, individual investors typically seek stability and income in their
20 utility holdings. According to a recent study authored by Ernst & Young¹, the individual
21 who directly owns utility stocks is older and not in the highest income bracket. Using the
22 Internal Revenue Service's Statistics of Income on tax returns with qualified dividends
23 and information from a variety of sources on investors' portfolio holdings, Ernst &
24 Young estimated the age and income distribution from direct investors in utility stocks in
25 2007 as illustrated in Chart 1.

¹ Ernst & Young. The Beneficiaries of the Dividend Tax Rate Reduction; A Profile of Utility Shareholders.
Prepared for the Edison Electric Institute and the American Gas Association. January 2010.

1

Chart 1

Tax Returns with Qualified Dividends from Direct Utility Stocks, 2007



2

3 As the foregoing charts illustrate, 86% of the outright owners of utility stocks are aged 50
4 and older; 59% are aged 65 and older; 66% have incomes of less than \$100,000; and 38%
5 have income less than \$50,000. This data suggests that the typical owners of utility stocks
6 are older individuals who hold utilities to supplement their retirement income.

7

8 **Q. What are the implications of these demographics for individual investors in utility**
9 **stocks?**

10 **A.** Because the vast majority of utility individual shareholders are older and desirous of
11 supplemental income, it is important for utilities to produce strong earnings that can
12 support the dividend income that these holders need.

13

14 **Q. Turn now, please, to institutional investors. Has the investment industry itself**
15 **changed in recent years?**

16 **A.** Yes. In recent years, institutional investors and hedge funds have grown dramatically in
17 the amount of capital they control. Accordingly, these investors have had a significant
18 impact on the speed with which the market reacts to unfavorable developments. As

1 discussed below, institutional investors are more likely to react to bad news because they
2 are much more focused on taking quick action to preserve the return of their overall
3 investment portfolio. This has led the market to be much more reactive and much less
4 forgiving than it may have been in the past. In the context of a regulatory decision,
5 investors will not necessarily wait, as they would have in the past, to see how the
6 ramifications of a decision might play out. Rather, they simply sell their shares if a
7 regulator's decision runs counter to their expectations.

8
9 **Q. Why are institutional investors of such importance generally?**

10 A. Because of the sheer size of their investment positions, institutions can effectively direct
11 the course of individual securities, and sometimes can move the market as a whole.
12 Institutional investors include financial institutions such as: various types of public
13 retirement funds, mutual funds, investment companies, insurance companies, and
14 commercial and investment banks. They approach the investment selection process from
15 the standpoint of a portfolio. An investment portfolio is a collection of stocks selected to
16 achieve the highest possible return within a commensurate level of risk. Therefore,
17 institutional investors keep electric utilities in their portfolios only when such stocks
18 contribute to achieving the desired risk/return relationship.

19 It should be remembered that, generally, the customers of institutional investors are
20 individuals and it is they who ultimately gain or suffer loss from changes in the value of
21 the institution's investments. Anyone who has a stake in a retirement plan, owns a mutual
22 fund, has a trust fund, or pays insurance premiums, for example, is directly or indirectly a
23 client of an institutional investor. But the individuals who make the decisions concerning
24 these investments are paid money managers. Their need to focus on the overall
25 performance of their investment portfolios so as to fulfill their responsibilities to the
26 clients they serve has a great deal to do with how these institutional investors react to
27 developments in the market.

28
29 **Q. Are institutional investors important to OG&E?**

30 A. Yes. Institutional investors today hold roughly 54% of parent company OGE's total
31 common shares. Such investors warrant significant attention due to their ability to

1 change dramatically the market for OGE shares. Because institutional investors own
2 large blocks of shares relative to the volumes typically traded, their activity in moving in
3 or out of the company's shares is often noticeable as a significant change in the price and
4 volume of shares being traded for the company. This change may be picked up by other
5 institutional investors, by the investment community in general, and eventually by
6 individual investors. These other entities will then look to see what is driving this trend
7 in the stock and whether the trend is likely to continue or disappear. If they see support
8 for the trend, they may follow the lead of the firms that initially began to move the
9 market, and by following the leaders, the late movers may further strengthen the trend.

10
11 **Q. Why might an institutional investor choose not to hold investments in a particular**
12 **electric utility?**

13 A. Several factors might be drivers. First, institutional investors have fiduciary
14 responsibilities. For example, managers of pension assets fall under Federal ERISA
15 laws, which mandate that a portfolio manager's decisions meet the so-called "prudent
16 man" standard. That is to say, he or she is expected not to make investment decisions
17 that are unduly risky or to retain stocks that are unduly risky given the investment goals
18 of the portfolio and the function of the stock within it.

19 In addition, institutional investors have performance pressures. It is not enough for
20 stocks in a portfolio simply to increase in value. Rather, relative performance is what
21 counts. Investment performance is gauged against the returns earned by a market proxy
22 (such as the Standard & Poor's 500 Index) or a peer group of investments (*i.e.*, those with
23 a similar style, such as value, growth, growth & income, small cap, etc.). Mutual fund
24 rating organizations such as Morningstar track and publicize the relative performance for
25 mutual funds, while various pension consultants perform the same service for their client
26 organizations.

27
28 **Q. What happens when an institutional investor underperforms?**

29 A. The results can vary, but, eventually, underperformance will result in lost business and
30 personnel changes. Mutual fund shareholders can sell their fund shares. A pension plan
31 sponsor can fire the professional investor or reduce the assets under its investor's

1 management. And, of course, poor performance also disadvantages the individual who
2 has entrusted his monies to the institution for management.

3
4 **Q. How long a period does an institutional investor have before performance becomes
5 an issue?**

6 A. Again, it can vary. But there is little argument that institutional investors no longer have
7 the luxury of a long time horizon in which to show performance. Investors need and
8 want results. And, with the public visibility that investment results now have (through
9 organizations such as Morningstar and the various pension consultants) and the resulting
10 performance pressure, most investment organizations are now operating with a much
11 shorter time horizon than in years past. Generally speaking, a long investment time
12 horizon today can be as short as 12-18 months. So, a stock that is unlikely to perform
13 within the prescribed time horizon is usually not attractive for purchase or continued
14 investment by an institutional investor.

15
16 **Q. What does this mean for investments in regulated utilities specifically?**

17 A. This shortened time frame means that if there is bad news, institutional investors are
18 more likely to react quickly. In the instance of a rate proceeding, these investors are
19 unlikely to wait to see what the outcome of the next rate decision will be. That would
20 represent an opportunity cost to them. Rather, institutional investors would be more
21 prone to sell their shares on the news of an adverse regulatory outcome. As discussed
22 earlier, this would not be good for customers either, due to higher debt costs and less
23 retained earnings for reinvestment.

24
25 **Q. How have you gauged investors' perceptions of the issues in this proceeding?**

26 A. To supplement my own knowledge of the industry and OG&E, I have reviewed various
27 reports related to the Company and its parent written by investment analysts. A clear
28 picture of investors' perceptions emerges from these reports, which is in keeping with my
29 own views.

1 Q. **Please discuss investors' general views of regulation.**

2 A. One of the key factors analysts use to evaluate the quality of a regulatory climate is the
3 consistency of a commission's decisions. Investors value certainty and predictability; a
4 lack of consistency in a commission's actions or decisions serves to increase the
5 investment risk associated with a utility. Where there is a predictable track record of
6 regulatory decisions and actions, investors are able to anticipate reliably the future
7 actions of a commission. That reduces risk and supports reasonable valuations—*i.e.*, the
8 market supports a higher price for the Company's stock and a lower interest rate on
9 bonds, which decreases a company's cost of capital.

10 In a study I prepared in 2005 for the Edison Electric Institute on investors' perceptions of
11 state regulation,² respondents were asked to cite the regulatory factors they felt
12 characterized a constructive environment, as well as those that characterize a non-
13 constructive environment. On the positive side of the ledger, one of the most important
14 considerations for investors was a regulatory climate that is "fair, stable, predictable, and
15 consistent." There is little doubt that in this time of relative market uncertainty, investors
16 are even more focused on the regulatory climate. Consequently, it is very important that
17 investors perceive that a utility will receive regulatory treatment consistent with these
18 characteristics.

19
20 Q. **Is regulatory consistency of particular importance to a utility such as OG&E, whose
21 parent has a smaller market capitalization than many companies?**

22 A. Yes, it is. As discussed previously, OGE's characterization as a mid-cap company due to
23 its lower level of available liquidity places it at a disadvantage relative to larger
24 companies in raising capital. Because of limited available liquidity and a lesser degree of
25 market clout and visibility, smaller-sized companies almost by definition must work
26 harder to capture the attention and interest of investors. Accordingly, mid-caps are
27 frequently held to higher investment standards; an error in analytical judgment can have
28 farther-reaching ramifications than in a larger cap company. This is particularly true in
29 terms of investors' assessment of regulatory consistency and quality. Because regulators
30 have the ability to determine largely the earnings power of a utility, and thus its dividend-

² J.M. Cannell, Inc. State Utility Regulation: As Assessment of Investor Perceptions. Prepared for the Edison Electric Institute. August 2005.

1 paying capacity, investors tend to look more closely at the quality of regulation for a mid-
2 cap utility. If such a company's regulatory environment is deemed to be inconsistent,
3 investors would be particularly inclined to look elsewhere for an investment opportunity:
4 the margin of error is simply less for mid-cap utilities.

5
6 **Q. Turn now to the viewpoint of credit rating agencies. Please comment on how the**
7 **agencies perceive the Company and its regulatory situation.**

8 A. OG&E's credit ratings are all investment grade. S&P's corporate credit rating on the
9 Company is BBB+; Moody's issuer rating is A2; and Fitch's is A+. All three agencies
10 have a stable outlook on the Company.

11
12 **Q. What role do credit agencies play in investors' expectations?**

13 A. In the wake of financial disasters, bankruptcies, and the ensuing severe erosion in
14 investor confidence that began early in this decade, credit issues became critically
15 important not only to fixed income investors, but also to equity investors. While credit
16 downgrades initially impacted only the most troubled companies, a spillover effect soon
17 was experienced by healthy utilities. Part of this was due to the fact that the rating
18 agencies came under harsh criticism that they had failed to detect problems early enough
19 in companies such as Enron Corp. As a result, they began to heighten their scrutiny of all
20 entities under their watch and became far more proactive in making rating changes. As
21 well, "headline risk" began to come into play, as investors worried that—when credit
22 problems in an industry are in the headlines—any company in the sector could be
23 vulnerable to a downgrade. Thus, equity investors now closely watch the actions of the
24 credit agencies, because any change in ratings can signal underlying problems and have a
25 significant impact on a company's stock price.

26
27 **Q. Why is having an investment-grade credit rating important?**

28 A. The higher the credit rating, the greater the access to debt capital and the less it costs to
29 borrow. In turn, lower borrowing costs translate into lower customer rates. When a debt
30 rating nears or enters non-investment grade or "junk" status, interest costs begin to rise
31 significantly because lenders need a higher return as compensation for the much higher

1 risk they are incurring. It bears mention that credit rating downgrades occur more readily
2 than do upgrades. Further, when a credit rating is officially non-investment grade, many
3 financial institutions are no longer permitted to hold the bonds of the company in
4 question. That company's debt is considered to be unsafe and thus unfit for inclusion in
5 conservative investment portfolios.

6
7 **Q. Please comment on the impact a non-investment grade credit rating has on market**
8 **access.**

9 A. When a company is rated below investment grade, not only does it have to pay more for
10 its debt, but its access to the credit markets is also fragile and uncertain. This is
11 particularly true during times of heightened market instability, when investors tend to
12 gravitate toward investments that are of a higher quality and thus perceived to be safer.
13 Unfortunately, it is often during tumultuous periods that a company's need for credit is
14 heightened, and it is at just those times that the credit spigot can be closed off. In more
15 extreme situations, that lack of credit availability can cause a company's financials to
16 spiral out of control, potentially resulting in bankruptcy.

17 The impact of a non-investment grade credit rating or the worst-case setting of a
18 bankruptcy has a very deleterious impact on ratepayers. Because financing expense is a
19 legitimate cost of service, customer rates must rise to reflect those higher costs. But,
20 equally important, the company operations can be negatively impacted if a company is
21 forced to take measures to conserve available cash.

22
23 **Q. Why is a utility's regulatory environment important to the rating agencies?**

24 A. The rating agencies appraise companies on the basis of creditworthiness. Rating agencies
25 also evaluate current financial soundness and attempt to discern how that might change in
26 the future. One of the key factors in assessing a utility's financial picture is the
27 regulatory climate in which the company operates, because regulators influence the
28 utility's capital structure and establish allowed returns that may be earned on that capital.
29 Thus, a regulatory environment characterized by consistency and predictability is one that
30 lends itself to a company's having a sounder financial base. Conversely, a regulatory

1 situation defined by a lack of stability can have a deleterious impact on a utility’s credit
2 profile.

3
4 **Q. Please discuss Moody’s rating on OG&E.**

5 A. The agency’s assessments fit within the framework of its ratings method, in which the
6 key factors it examines in its ratings are articulated and quantified.³ Regulation is clearly
7 of paramount importance: “regulatory framework” and “ability to recover costs and earn
8 returns” each carry a 25% weighting. The other ratings factors are diversification (10%)
9 and financial strength and liquidity (40%).

10
11 **Q. Please elaborate on Moody’s views regarding “regulatory framework.”**

12 A. Moody’s notes that “the predictability and supportiveness of the regulatory framework”
13 in which a utility operates is a “key credit consideration.” The agency said it examines
14 various factors of a regulatory environment, including “how developed the regulatory
15 framework is; its track record for predictability and stability in terms of decision making;
16 and the strength of the regulator’s authority over utility regulatory issues. A utility
17 operating in a stable, reliable, and highly predictable regulatory environment will be
18 scored higher on this factor than a utility operating in a regulatory environment that
19 exhibits a high degree of uncertainty or unpredictability.”⁴

20
21 **Q. What about the second regulation-related factor, “ability to recovery costs and earn
22 returns”?**

23 A. Moody’s states “the ability to recover prudently incurred costs in a timely manner is
24 perhaps the single most important credit consideration for regulated utilities, as the lack
25 of timely recovery of such costs has caused financial stress for utilities on several
26 occasions.” The agency pointed to the fact that regulatory disputes which ended in
27 insufficient or delayed rate relief were a factor in four of the six major investor-owned
28 utility bankruptcies in the U.S. over the last 50 years. Moody’s also opined that
29 “currently, the utility industry’s sizeable capital expenditure requirements for

³ Moody’s Electric Service, “Rating Methodology: Regulated Electric and Gas Utilities.” August 2009.

⁴ Ibid.

1 infrastructure needs will create a growing and ongoing need for rate relief for recovery of
2 these expenditures at a time when the global economy has slowed.”⁵

3 **Q. What specific factors drive Moody’s ratings of OG&E?**

4 A. Moody’s identifies four factors⁶:

- 5 • Stable electric utility operation
- 6 • Reasonable regulatory environment
- 7 • Credit metrics in line with rating category
- 8 • Primary source of cash flow for parent
- 9 • Sizeable investments planned for wind power, transmission, and environmental
10 controls

11
12 **Q. Please elaborate on the agency’s views of the drivers.**

13 A. In discussing OG&E’s stable regulatory utility business, the first and second factors
14 noted above, Moody’s explains that its rating on the Company incorporates the agency’s
15 belief that OG&E “will continue to operate long-term as a relatively stable regulatory
16 electric utility with reasonable, albeit seasonal, cash flows to support its operations.” The
17 agency further notes that a company’s regulatory environment constitutes a significant
18 weighting in its ratings, and it views the two state commissions with jurisdiction over
19 OG&E—Oklahoma and Arkansas—“as being generally supportive.”⁷

20 Addressing the fifth ratings driver, a large capital spending program, Moody’s states that
21 investment in new regional wind and transmission projects is a key component of
22 OG&E’s prospective growth strategy. Beyond those growth projects, though, the agency
23 sounds a cautionary note related to OG&E’s sizeable coal fleet. Moody’s opines that
24 investment in new environmental controls related to the coal fleet could cause longer-
25 term pressures. Further, the agency observed that the Company’s current capital plan
26 does not incorporate costs related to potential CO₂ regulations, which it thinks likely will
27 increasingly become a larger issue for coal-burning utilities like OG&E.

⁵ Ibid.

⁶ Moody’s Investors Service. “Credit Opinion: Oklahoma Gas & Electric Company.” December 11, 2009.

⁷ Ibid.

1 Q. **Has Moody’s offered additional thoughts on OG&E and its regulatory**
2 **environment?**

3 A. Yes. Last Fall, in affirming its ratings on OGE and its subsidiaries, including OG&E,
4 Moody’s emphasized its expectation that the Company will continue to operate in a
5 favorable regulatory climate in Oklahoma:

6 In affirming the rating we incorporate a view that OG&E will remain
7 conservatively capitalized and will continue to be afforded supportive regulatory
8 treatment in Oklahoma. There is an elevated capital spending plan at the utility
9 over the next several years with an emphasis on new transmission and wind
10 generation which is expected to weaken its credit metrics somewhat.⁸
11

12 Q. **What is Standard & Poor’s perspective on the Company?**

13 A. Because of its practice of consolidating ratings within a corporate family, the agency’s
14 discussion of OG&E involves considerations rated to the utility’s parent. S&P stated:

15 “The ratings on electric utility Oklahoma Gas & Electric Co. (OG&E) are based on
16 the consolidated credit profile of its parent, diversified energy company OGE
17 Energy Corp.” In turn, the agency explained: “OGE Energy’s consolidated credit
18 profile consists of the strength and stability of its regulated utility, OG&E, whose
19 business risk position is characterized as ‘excellent.’”⁹
20

21 Q. **Does S&P offer opinion about the Company’s regulatory environment?**

22 A. Yes. Like Moody’s, S&P pointed to a need for constructive regulation to support a
23 robust construction spending program, given the heavy external funding needs:

24 The utility is involved in an extensive multiyear capital expansion program that
25 concentrates on transmission and distribution betterments, renewable energy,
26 including various wind generation projects, and deployment of a Smart Grid
27 program. Hence, construction expenditures will accelerate, necessitating reliance
28 on external capital. Accordingly, continued conservative financing, constructive
29 regulatory treatment and credit supportive actions by management will be
30 essential to support key financial metrics at levels suitable for current ratings.¹⁰
31

32 As to specific opinion of the Oklahoma regulatory environment, S&P describes it as
33 being “Credit Supportive.”

⁸ Moody’s Investors Service. “Announcement: Moody’s Affirms Ratings of OGE Energy, Enogex and OG&E; Outlook Stable.” October 6, 2010.

⁹ Standard & Poor’s. “Oklahoma Gas & Electric Company.” October 7, 2010.

¹⁰ Ibid.

1 Q. **Its positive opinion of Oklahoma regulation notwithstanding, did the agency express**
2 **any concern in that regard?**

3 A. Yes. S&P, in discussing the outlook for OG&E's ratings, expressed expectations for
4 steady financial performance and that capital needs continued to be funded
5 conservatively. But it cautioned that the ratings to be lowered due to several factors, the
6 first one of which is "if future rate relief is insufficient."

7
8 Q. **Please discuss Fitch's opinion of the Company and its regulatory climate.**

9 A. In June 2010, the agency downgraded OG&E's ratings by one notch to reflect downward-
10 trending credit metrics resulting from the Company's heavy capital expansion program.
11 In discussing the robust level of expenditures, Fitch noted that OG&E "enjoys
12 constructive regulatory treatment for these investments and has minimal regulatory lag
13 once these projects become operational."¹¹

14
15 Q. **What other opinions did Fitch express in regard to OG&E's regulatory situation?**

16 A. The rating agency pointed to two regulation-related elements as being key ratings drivers
17 for the Company:

- 18 • Constructive regulatory environment and recent history of settlements in rate
19 proceedings.
- 20 • Preapproval recovery riders for any large-scale construction/acquisition that provide
21 OG&E an ability to earn a return on these investments without material regulatory
22 lag.

23 Fitch also stated that, should other favorable regulatory mechanisms such as cash
24 recovery of capital costs during construction work in progress be implemented, the
25 agency would view those as being credit enhancing.¹²

26
27 Q. **What inferences do you draw from the credit rating agencies' views of OG&E and**
28 **its regulatory environment?**

¹¹ Fitch Ratings. "Oklahoma Gas & Electric Company." July 20, 2010.

¹² Ibid.

1 A. All three agencies share similar opinions about the Company and its circumstances. The
2 firms all consider Oklahoma regulation to be constructive, with both Moody's and Fitch
3 pointing to that factor as being a key determination in their respective credit ratings on
4 OG&E. The agencies are also acutely aware of the magnitude of OG&E's construction
5 program and how imperative it will be for the supportive regulatory climate to continue
6 so as to maintain the Company's financial health. Indeed, Fitch already lowered
7 OG&E's ratings by one notch due to credit metrics that are already showing a downward
8 trend. S&P pointed to the need OG&E will have to access the capital markets during the
9 expansion program. In sum, while the agencies have a stable outlook on the Company at
10 the present time, they universally caution that supportive regulatory treatment must be
11 sustained during the prospective period of capital intensity for OG&E's ratings to remain
12 as they are now.

13
14 **Q. Please turn your attention now to the opinions of equity investors. How do they
15 view the Company and its parent?**

16 A. Analysts have a positive opinion of OG&E and OGE, with a number of investment firms
17 having a "Buy" recommendation on the stock. Investors are aware that the Company
18 provides almost three-quarters of OGE's earnings, with that level of contribution
19 expected to continue into the future. Investors point to the robust capital expenditure
20 program underway at OG&E, which should propel rate base growth at levels well above
21 industry average levels. As Wellington Shields & Co. notes,

22 In our view, OGE should demonstrate substantial regulated earnings growth from
23 renewable wind generation and considerable planned transmission investments
24 over the next few years in addition to a 2011 base rate filing. ... in our opinion,
25 OGE's stock is likely to be driven largely by its visible significant regulatory
26 earnings growth over the next few years.¹³
27

28 **Q. In addition to rate base investments, what other factors do analysts consider
29 important in helping grow earnings?**

30 A. Regulation is a frequently cited factor.

¹³ Wellington Shields & Co. LLC. "OGE Energy Corp." February 22, 2011.

1 Q. **Please elaborate.**

2 A. As noted previously, regulation is a critical element in determining the return on equity a
3 utility is permitted. Not only is the absolute level of ROE important, but also the
4 likelihood that the allowed return can actually be achieved. There are a number of factors
5 that can cause a large gap between allowed and earned ROE levels. These include, but
6 are not limited to, a heavy capital expenditure program; utilization of an historic test year
7 in rate cases; lack of enabling regulatory mechanisms; an inadequate capital structure;
8 and other financial and accounting practices.

9

10 Q. **Can you be more specific about investors' views regarding the Company's**
11 **regulatory situation?**

12 A. Yes. In addressing the subject of regulation as it pertains to OG&E and its parent OGE,
13 analysts hold a uniform view that Oklahoma regulation is supportive. The word used
14 consistently to describe the Company's regulatory environment is "constructive."

15

16 Q. **Why do investors consider the Oklahoma regulatory climate to be constructive?**

17 A. As noted previously, investors value consistency and fairness in a commission's
18 decisions. The Oklahoma Corporation Commission has demonstrated these
19 characteristics in its interactions with the Company. For example, as Ladenburg
20 Thalmann notes:

21 We continue to view the OG&E Utility as relatively high quality considering
22 constructive regulatory environment supported by history of approved trackers
23 that reduce regulatory lag, recent rate case settlements, above 50% equity ratio
24 embedded in rates, attractive ROEs, positive load growth despite uncertain
25 economy, ongoing cost controls, solid credit profile (cash flow, coverage,
26 leverage).¹⁴

27

28 Barclays Capital, which ranks state commissions using six metrics aimed at defining
29 "risks inherent in particular jurisdictions" and which "correspond closely to the
30 differences ... in the relative cost of capital from region to region" states that it views the

¹⁴ Ladenburg Thalmann. "OGE Energy; Company Update – Raising P –T to \$42 from \$39 and Reiterating BUY." April 16, 2010.

1 Oklahoma Corporation Commission as “among the more constructive commissions.”¹⁵

2 The investment firm further states:

3 At OG&E we remain confident around rate base growth opportunities – primarily
4 in the form of transmission – and we view the Commission as balanced and
5 constructive on key issues, including the potential need for environmental
6 retrofits, and progressive in their approach to utility regulation as it relates to
7 energy efficiency.¹⁶

8
9 And, BMO Capital Markets, in commenting on OG&E’s regulatory situation, observes:

10 “Constructive Regulatory Relationships Support Investment Strategy.”¹⁷

11
12 **Q. In addition to the Commission’s consistent approach to regulation, what other**
13 **factors do investors value in regard to OG&E?**

14 A. Any utility undertaking a major investment program faces the possibility of experiencing
15 regulatory lag, wherein costs are incurred before the receipt of corresponding revenues.
16 This causes the utility to under-earn its allowed return, sometimes to a sizeable degree.
17 In the Company’s instance, the Commission, recognizing the large capital expenditures
18 that lay ahead for OG&E, authorized various regulatory mechanisms to help mitigate that
19 lag. Comments from both Wunderlich Securities and Barclays Capital capulize the
20 import of this assistance:

21 The OCC has allowed rate riders to increase customer rates between rate cases to
22 reflect major asset additions to rate base. This was done with the Redbud power
23 plant acquisition in September 2008 and a similar rider will be put in place once
24 the OU Spirit wind farm enters commercial operation later this year. As
25 evidenced by these practices, the company has constructive regulation.¹⁸

26 - - - - -

27 Our meetings with representatives of the Oklahoma Corporation Commission
28 underscored a fair and balanced approach to ratemaking. Cost recovery rider
29 treatment in Oklahoma has minimized regulatory recovery lag from historical test
30 year for ratemaking purposes; and legislation (HB 1910) supports recovery for
31 generation and environmental-mandated capital expenditures.¹⁹

¹⁵ Barclays Capital. “OGE Energy Corp. Initiation of Coverage: ‘Come and Listen to a Story...’” August 25, 2009.

¹⁶ Barclays Capital. “OGE Energy: More Good Things to Come.” April 12, 2011.

¹⁷ BMO Capital Markets. “OGE Energy. Notes from the Road: Infrastructure Investment Drives Outlook.” June 21, 2010.

¹⁸ Wunderlich Securities. “OGE Energy Corp. Initiating Coverage With a Buy – An Under-Appreciated Story.” June 17, 2009.

¹⁹ Barclays Capital, April 12, 2011, op. cit.

1 Q. **Given the positive opinion the investment community has of both OGE and the**
2 **Commission, why is this particular proceeding of importance?**

3 A. Assuredly, the financial community has a constructive view of the Commission, yet that
4 perspective could change. This has occurred in other states where regulation was
5 considered to be supportive, then a negative decision or series of decisions abruptly
6 altered that view. Given the very large capital expenditure program lying ahead for
7 OG&E, investors will look for the Commission to sustain its historically supportive
8 treatment of the Company in the current proceeding. Wellington Shields describes this
9 well:

10 For OGE, we worry most about regulation/legislation, interest rates and
11 commodity energy costs/prices. ...As in all electric utilities, regulatory decisions
12 are critical. The company faces a number of critical regulatory decisions over the
13 next several years that will help shape the fundamental outlook for the company.
14 The company should file a base rate case in Arkansas this month and in
15 Oklahoma in June 2011. Should these regulatory decisions be less favorable than
16 we expect, our forward fundamental outlook could prove optimistic. These three
17 critical factors should primarily determine whether OGE shares can achieve the
18 earnings, cash flow, and equity value we expect over the next few years.²⁰
19
20

21 Q. **Have investors expressed any expectations regarding the current case?**

22 A. Several analysts have noted their awareness of the case. Without knowledge of the
23 filing's particulars, some offered qualitative conjecture. For example, Wellington Shields
24 stated it believes OG&E will receive positive regulatory treatment:

25 We are raising our 2012 recurring EPS estimate to \$3.59 from \$3.50. The
26 principal changes to our expectations reflect revised assumptions for O&M, the
27 expected 2011 Oklahoma GRC and greater expectations for Enogex related to
28 growth in natural gas processing volumes/new plants, partially offset by the
29 expected delay in the Wheeler processing plant. Our estimate reflects growth
30 transmission projects, nearly a full-year of the Crossroads wind farm investment,
31 a material Oklahoma base rate increase, and a full-year Arkansas base rate
32 increase."²¹
33

34 Q. **Please summarize investors' views of the Company and its regulatory environment.**

35 A. Analysts understand that OG&E's major capital expansion program will help to grow
36 earnings to levels that are above the industry average. To that end, they know that a

²⁰ Wellington Shields, *op. cit.*

²¹ *Ibid.*

1 continuation of the supportive regulation under which the Company operates now will be
2 needed to ensure OG&E's financial health prospectively: the authorized ROE will
3 underpin earnings growth. Investors are aware of and endorse the fact that the Company
4 can utilize several options to help reduce lag that otherwise might occur in the context of
5 major construction spending. Regulation is viewed as a risk element for many utilities.
6 While the confidence investors currently have in the Oklahoma regulatory environment
7 limits their concern in this respect, it is not entirely absent. Should expectations
8 regarding the current proceeding prove too optimistic, investors' view of both the
9 Company and its parent, as well as its opinion of Oklahoma regulation, could be altered
10 negatively.

11 12 IV. INVESTORS' EXPECTATIONS FOR RETURN ON EQUITY FOR OG&E

13 **Q. How do you believe that the Company's request for an 11.0% return on equity**
14 **comports with investors' perceptions?**

15 A. Investors will evaluate any ROE authorized by the Commission in light of a number of
16 factors, including such things as the overall amount of the requested increase that is
17 granted, which bears on the Company's ability to earn the allowed ROE, and whether or
18 not there is a settlement in the case. The fact that an ROE is arrived at through settlement
19 is often seen as a positive factor for investors. In this case, the Company has filed its
20 application seeking an 11.0% ROE. This filing reflects the rising risk levels in the
21 macroeconomic and capital market environments, as well as recognition on the part of
22 both credit rating agencies and investors that company-specific risks exist. Most
23 importantly, an 11.0% authorized ROE would help maintain the Company's financial
24 health, and assist in maintaining access to the debt and equity capital markets.

25
26 **Q. Could a return on equity award that is consistent with investor expectations also be**
27 **expected to provide benefits to the Company's customers?**

28 A. Absolutely. An ROE consistent with investor expectations permits the realization of an
29 earnings stream that matches those expectations. In turn, that can improve a company's
30 stock's valuation prospects, which results in a higher stock price. Thus, when a company
31 needs to tap the equity markets for capital required to meet customer needs, it can get

1 more for its money. Said another way, each share sold brings more equity into a
2 company with the same commitment by the company to generate earnings and pay
3 dividends to support the value of that share. In regard to debt financing, an ROE
4 consistent with investor expectations would be viewed as a sign of constructive
5 regulation and would be positive for the Company's credit rating, as strong financial
6 metrics could potentially improve the existing credit ratings. Importantly, customers'
7 rates will eventually reflect this lower cost of capital.

8
9 **CONCLUSION**

10 **Q. Please summarize what bearing the opinion and expectations of investors have on**
11 **the current proceeding.**

12 A. This is a precarious time for the electric utility industry. With companies--OG&E among
13 them--facing continued high levels of construction and other costs, and requiring
14 reasonable access to the capital markets to fund those requirements, supportive regulation
15 is critical. Investors are aware of these factors, and expect the Commission to make
16 decisions in light of them that will enable the Company to meet its investment and other
17 requirements. Current market conditions, current trends in ROE awards, and OG&E's
18 increased risks support an increase in the last allowed ROE.

19
20 **Q. Does this complete your direct testimony?**

21 A. Yes, it does.

**SUMMARY OF TESTIMONY EXPERIENCE
JULIE M. CANNELL**

JURISDICTION	CASE OR DOCKET NO.	CLIENT	DATE
District of Columbia	FC1087	Potomac Electric Power (Pepco Holdings, Inc.)	2011
Maryland	9249	Delmarva Power & Light (Pepco Holdings, Inc.)	2011
Vermont	7627	Central Vermont Public Service Corporation	2010
Texas	38480	Texas-New Mexico Power (PNM Resources)	2010
Minnesota	E-015/GR-09- 1151	Minnesota P&L (Allete, Inc.)	2010
Pennsylvania	R-2010- 2161694	PPL Electric Utilities (PPL Corp.)	2010
Wisconsin	3270-UR-117	Madison G&E (MGE Energy)	2010
South Carolina	D-2009-489-E	South Carolina E&G (SCANA Corp.)	2010
Missouri	ER-2010-0036	Ameren UE (Ameren)	2010
Rhode Island	4065	Narragansett Electric (National Grid)	2009
Colorado	09AL-299E	Public Service Company of Colorado (Xcel Energy)	2009
Massachusetts	DPU 09-39	Massachusetts Electric (National Grid)	2009
Wisconsin	3270-UR-116	Madison G&E (MGE Energy)	2009
New York	08-E-0539	Consolidated Edison Company of New York (Consolidated Edison, Inc.)	2008
South Carolina	2007-229-E	South Carolina E&G (SCANA Corp.)	2007

Exhibit JMC-1

JURISDICTION	CASE OR DOCKET NO.	CLIENT	DATE
Pennsylvania	R-00072155	PPL Electric Utilities (PPL Corp.)	2007
Oklahoma	PUD 200600285	Public Service Co. of Oklahoma (American Electric Power)	2007
Arizona	E-01345A-05-0816	Arizona Utility Investors Association [Arizona Public Service docket]	2006
Texas	32093	CenterPoint Energy	2006
Pennsylvania	R-00061346	Duquesne Light	2006
Washington	UE-060181	Avista Corporation	2006
Oklahoma	PUD 200500151	Oklahoma G&E (OGE Energy)	2005
Pennsylvania	R-00049255	PPL Electric Utilities (PPL Corp.)	2004
South Carolina	2004-178-E	South Carolina E&G (SCANA Corp.)	2004
Nevada	04-6030	Nevada Power (Sierra Pacific Resources)	2004
Connecticut	01-10-10	United Illuminating (UIL Holdings)	2001
Missouri	ER 99-247; ER-99-573	St. Joseph Light & Power	1999
Kansas	97-WSRE-676-MER	Western Resources	1997
Missouri	EM-97-515		
Virginia	PUE960296	Virginia Power (Dominion Resources)	1997