2021 MAY 21 AM 10: 28

SOAH DOCKET NO. 473-21-0538
PUC DOCKET NO. 51415

APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES	§ § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

TEXAS INDUSTRIAL ENERGY CONSUMERS' ERRATA TO THE DIRECT TESTIMONY AND EXHIBITS OF MICHAEL P. GORMAN

Texas Industrial Energy Consumers ("TIEC") submits the following errata to the Direct Testimony and Exhibits of Michael P. Gorman:

Page 57, Line 6:	Replace "4-19" with "4-9"; and
Page 58, n.41:	Replace "1" with "2"; and
Page 70, Line 3:	Replace "A" with "Baa"; and
Page 72, Line 22:	Replace "465" with "456"; and
Page 120, Line 13, Reference Column:	Replace "3" with "4"; and
Page 122, Sources:	Replace "4-19" with "4-9".

Clean and redline errata pages are attached.

Respectfully submitted,

THOMPSON & KNIGHT LLP

/s/ James Z. Zhu
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ATTORNEYS FOR TEXAS INDUSTRIAL ENERGY CONSUMERS

579

CERTIFICATE OF SERVICE

I, James Zhu, Attorney for TIEC, hereby certify that a copy of the foregoing document was served on all parties of record in this proceeding on this 21st day of May, 2021 by facsimile, electronic mail and/or First Class, U.S. Mail, Postage Prepaid.

/s/ James Z. Zhu
James Zhu

Q DID YOU INCLUDE ANY OFF BALANCE SHEET DEBT ("OBS") DEBT EQUIVALENTS?

A Yes, I did. I included the debt equivalents ($264.8 million) calculated by S&P Capital IQ for the most recently available period. In addition, I included the most recent 13-month average amount of short-term debt of $90.1 million as provided by the Company in response to the 4th RFI, TIEC 4-9 and shown on my Exhibit MPG-18. I would also point out that I applied a Texas rate base allocation factor of approximately 37.6% as disclosed by the Company in its Schedule A-1.

Q PLEASE DESCRIBE THE RESULTS OF THIS CREDIT METRIC ANALYSIS AS IT RELATES TO SWEPCO'S REGULATED OPERATIONS.

A The S&P financial metric calculations for SWEPCO at a 9.15% return are developed on Exhibit MPG-18, page 1. The credit metrics produced below, with SWEPCO's financial risk profile from S&P of "Significant" and business risk profile of "Excellent," will be used to assess the strength of the credit metrics based on SWEPCO's retail operations in the state of Texas.

The adjusted debt ratio for credit metric purposes at my proposed capital structure is 53.1%, which is slightly higher but comparable to the debt ratio for the A-rated utilities of approximately 52.3%.

Based on an equity return of 9.15% and the Company's proposed common equity ratio of 49.37%, SWEPCO will be provided an opportunity to produce a Debt to Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") ratio of 3.8x. This is within S&P's "Significant" guideline range of 3.5x to 4.5x,[40] which supports SWEPCO's credit rating.

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[40] *Standard & Poor's RatingsDirect®*: "Criteria. Corporate Methodology," November 19, 2013.

SWEPCO's retail utility operations FFO to total debt coverage at a 9.15% equity return and 49.37% equity ratio is 19%, which is within S&P's "Significant" metric guideline range of 13% to 23%. Again, this FFO/total debt ratio will support a ratio consistent with SWEPCO's "Excellent" business profile from S&P.

Q DOES THIS FINANCIAL INTEGRITY ASSESSMENT SUPPORT YOUR RECOMMENDED OVERALL RATE OF RETURN FOR SWEPCO?

A Yes. As noted above, I believe my return on equity represents fair compensation in today's very low capital market costs, and as outlined above, my overall rate of return will provide SWEPCO an opportunity to earn credit metrics that will support its bond rating.

III. RESPONSE TO SWEPCO WITNESS MR. DYLAN D'ASCENDIS

Q WHAT RETURN ON COMMON EQUITY IS SWEPCO PROPOSING FOR THIS PROCEEDING?

A Mr. D'Ascendis estimates a market return on equity in the range of 9.85% to 10.96% using three market models – DCF, risk premium, and CAPM, applied to a utility proxy group and a non-price regulated proxy group. He then includes two ROE adders to his estimated market return on equity for SWEPCO: (1) a size adjustment of 20 basis points; and (2) a credit risk adjustment of 27 basis points. With these adders to his market return on equity, Mr. D'Ascendis recommends a return on equity within the range of 10.32% to11.43% with a point estimate return of 10.35%.[41]

[41]D'Ascendis Direct Testimony at 6 and Schedule DWD-1, Page 2.

Q CAN MR. D'ASCENDIS' RISK PREMIUM MODELS BE USED TO ESTIMATE A FAIR RETURN FOR SWEPCO?

A Only generally. Reflecting an updated observable Baa-rated utility bond yields of 3.21% (Exhibit MPG-15) and my equity risk premium estimate of 5.77% (Exhibit MPG-13) would imply a return on equity for SWEPCO of 8.98%, rounded to 9.00%.

III.E. D'Ascendis CAPM

Q HOW DID MR. D'ASCENDIS DERIVE HIS CAPM RETURN ESTIMATE FOR SWEPCO?

A Mr. D'Ascendis developed his CAPM return estimate on his Schedule DWD-5. As shown on that schedule, he relied on a proxy group beta of 0.95 which was the average of the mean and median beta published by Bloomberg and *Value Line* for his proxy companies, a market risk premium of 10.92%, and a risk-free rate of 2.09% to produce a CAPM return of 12.37%.

Q DO YOU HAVE ANY ISSUES WITH MR. D'ASCENDIS' CAPM STUDY?

A I disagree with several aspects of his methodology. First, his market risk premium of 10.92% is excessive and unreliable due to unsustainable growth rates he used to develop a market return. Second, his projected risk-free rate of 2.09% is largely driven by Treasury bond yield projections out to 2031. Even though I disagree with Mr. D'Ascendis' reliance on projected yields 5-10 years in the future, I would not take issues with his risk free rate of 2.09% because it is comparable to the near-term projected yield as described in my CAPM study. Finally, his market risk premium estimates suffer from many of the same previously described flaws surrounding his equity risk premium estimates such as his significant reliance on the unproven PRPM™ methodology.

Q PLEASE EXPLAIN WHY MR. D'ASCENDIS' MARKET RISK PREMIUMS ARE OVERSTATED.

A Mr. D'Ascendis' *Value Line* 3-5 appreciation market risk premium, his *Value Line* market risk premium based on the S&P 500 and his Bloomberg-based DCF-derived market risk premiums are based on inflated market returns of 16.53%, 13.66% and 13.75%, respectively. These projected market returns are produced using growth rates of 14.02%, 11.82% and 11.93%, and market dividend yields of 2.51%, 1.83% and 1.82%, respectively.

As discussed above, the DCF model requires a long-term sustainable growth rate. Mr. D'Ascendis' sustainable market growth rates in the range of 11.82% to 14.02% are far too high to be a rational outlook for sustainable long-term market growth. These growth rates are around three times the consensus analysts' projected long-term growth of the U.S. GDP of 4.35%.

As a result of his inflated long-term market growth rate, Mr. D'Ascendis' projected market returns are likewise inflated and not reliable. Mr. D'Ascendis' Value Line risk premiums of 14.44% and 11.57% and his Bloomberg market risk premium of 11.66% should be given no weight in estimating a fair return for SWEPCO in this case.

Q DO HISTORICAL ACTUAL RETURNS ON THE MARKET SUPPORT MR. D'ASCENDIS' PROJECTED MARKET RETURNS?

A No. Mr. D'Ascendis relies on historical market returns data to develop one of his market risk premiums. The market risk premium he developed using historical data is 7.01%, or 456 to 743 basis points less than his unreasonable projected market return based Value Line and Bloomberg market returns. Historical data shows just how unreasonable Mr. D'Ascendis' projected returns on the market are going forward.

Southwestern Electric Power Company

Standard & Poor's Credit Metrics

Line	Description		TX Retail Cost of Service Amount (1)	S&P Benchmark (Medial Volatility) Intermediate (2)	Significant (3)	Aggressive (4)	Reference (5)
1	TX Rate Base	$	2,025,542,720				Schedule A-1
2	Weighted Common Return		4 52%				Page 2, Line 2, Col 4
3	Pre-Tax Rate of Return		8 00%				Page 2, Line 3, Col 5
4	Income to Common	$	91,505,242				Line 1 x Line 2
5	EBIT	$	162,086,043				Line 1 x Line 3
6	Depreciation & Amortization	$	105,928,834				Schedule A-1
7	Imputed Amortization	$	2,424,541				S&P Capital IQ, downloaded on March 16, 2021
8	Capitalized Interest*	$	(294,472)				Response to 4th RFI, TIEC 4-10
9	Deferred Income Taxes & ITC	$	(128,564)				Schedule A, Workpaper A
10	Funds from Operations (FFO)	$	199,435,580				Sum of Line 4 and Lines 6 through 9
11	Imputed Interest Expense	$	5,956,837				S&P Capital IQ, downloaded on March 16, 2021
12	EBITDA	$	276,396,255				Sum of Lines 5 through 7 and Line 11.
13	Adjusted Debt*	$	1,047,065,141				Page 3, Line 4, Col 1 x RB TX Allocator
14	Total Adjusted Debt Ratio		53 1%				Page 3, Line 4, Col 2
15	Debt to EBITDA		3 8x	2 5x - 3 5x	3 5x - 4 5x	4 5x - 5 5x	Line 13 / Line 12
16	FFO to Total Debt		19%	23% - 35%	13% - 23%	9% - 13%	Line 10 / Line 13
17	Indicative Credit Rating			**A**	**A-**	**BBB**	S&P Methodology, November 19, 2013

Sources
Standard & Poor's "Criteria Corporate Methodology," November 19, 2013
*The allocation factor was obtained from Schedule A-1

Note
Based on the January 2021 S&P report, SWEPCO has an "A-" credit rating, an "Excellent" business profile, a "Significant" financial profile, and falls under the 'Medial Volatility' matrix

S&P Business/Financial Risk Profile Matrix			
Business Risk Profile	**Financial Risk Profile** 3 (intermediate)	4 (significant)	5 (aggressive)
1 (excellent)	a+/a	a-	bbb
2 (strong)	a-/bbb+	bbb	bb+
3 (satisfactory)	bbb/bbb-	bbb-/bb+	bb

Southwestern Electric Power Company

Standard & Poor's Credit Metrics
(Off-Balance Sheet Debt)

Line	Description	Amount (1)	Weight (2)
1	Long-Term Debt	$ 2,521,046,613	48.07%
2	Short-Term Debt*	$ 90,103,357	1.72%
3	Off-Balance Sheet Debt**	$ 264,838,000	5.05%
4	**Total Debt**	**$ 2,785,884,613**	**53.12%**
5	Common Equity	$ 2,458,534,232	46.88%
6	**Total**	**$ 5,244,418,845**	**100.00%**

Sources:
Schedule K-1.
*Response to 4th RFI, TIEC 4-9
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