



## Filing Receipt

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**SOAH DOCKET NO. 473-22-2695**  
**PUC DOCKET NO. 53601**

**APPLICATION OF ONCOR  
ELECTRIC DELIVERY COMPANY  
FOR AUTHORITY TO CHANGE  
RATES**

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§

**BEFORE THE STATE OFFICE  
OF  
ADMINISTRATIVE HEARINGS**

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

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

Page 7, line 14: Change "9.35%" to "9.33%"; and

Page 10, line 16: Change "20.61x" to "20.29x"; and

Page 10, line 17: Change "17.26x" to "17.25x"; and

Page 10, line 21: Change "9.13x" to "9.11x"; and

Page 10, line 22: Change "7.55x" to "7.54x"; and

Page 11, lines 3-4: Change "2.00x" to "1.99x"; and

Page 22, fn. 7: Change "December 9" to "December 2"; and

Page 45, line 2: Change "3.32%" to "3.36%"; and

Page 45, line 3: Change "4.25%" to "4.30%"; and

Page 45, line 12: Change "4.05%" to "4.08%"; and

Page 62, line 16: Change "June" to "July".

Redlined and clean versions of the errata are attached.

Respectfully submitted,

O'MELVENY & MYERS LLP

/s/ Michael A. McMillin

Phillip G. Oldham

State Bar No. 00794392

Katherine L. Coleman

State Bar No. 24059596

Michael A. McMillin

State Bar No. 24088034

John R. Hubbard

State Bar No. 24120909

303 Colorado St., Suite 2750

Austin, TX 78701

(737) 204-4720

poldham@omm.com

kcoleman@omm.com

mmcmillin@omm.com

jhubbard@omm.com

OMMeservice@omm.com

**ATTORNEYS FOR TEXAS INDUSTRIAL  
ENERGY CONSUMERS**

**CERTIFICATE OF SERVICE**

I, John R. Hubbard, Attorney for TIEC, hereby certify that a copy of this document was served on all parties of record in this proceeding on this 21<sup>st</sup> day of September, 2022 by electronic mail, facsimile, and/or First Class, U.S. Mail, Postage Prepaid.

/s/ John R. Hubbard

John R. Hubbard

**II. RATE OF RETURN**

**II.A. Utility Industry Authorized Returns on Equity,  
Access to Capital, and Credit Strength**

**Q PLEASE DESCRIBE THE OBSERVABLE EVIDENCE ON TRENDS IN  
AUTHORIZED RETURNS ON EQUITY FOR REGULATED UTILITIES.**

**A** Authorized returns on equity are an important aspect available to utilities to produce revenues and cash flows adequate to support their credit standing and maintain their financial integrity, which supports their access to capital under reasonable terms and prices. Observing data on industry authorized returns on equity, trends and outlooks on credit standing, and ability to attract capital to fund large investments, provides clear evidence that industry authorized returns on equity have been judged by market participants to be fair and reasonable. With this as a backdrop, it is significant to observe that the industry authorized returns on equity for electric and gas utilities have ranged between 9.335% to 9.78% for the period 2014-2022 to date and, since 2020, the average industry authorized returns on equity have averaged below 9.5%. These returns are summarized in Figure 1 below.

1 commissions also must be careful to maintain reasonable prices and tariff terms and  
2 conditions to protect customers' need for reliable utility service at competitive prices.

3 **Q IS THERE EVIDENCE OF ROBUST VALUATIONS OF REGULATED UTILITY**  
4 **EQUITY SECURITIES?**

5 **A** Yes. As shown on my Exhibit MPG-2, utility valuation metrics show robust valuation of  
6 utility securities more recently compared to the historical period extending back to  
7 2002. Specifically, *The Value Line Investment Survey* ("*Value Line*") tracks and  
8 projects various valuation metrics related to regulated utility securities, as well as non-  
9 regulated companies followed by *Value Line*. These valuation metrics are considered  
10 by market participants in assessing the investment risk characteristics of individual  
11 company stocks and industries, and are used by market participants to derive their  
12 required rates of return for making investments. All of these valuation metrics for  
13 electric utility stocks indicate robust valuations of utility stocks, which in turn means that  
14 utilities' cost of capital is currently low, as it is inversely related to utility valuations.

15 For example, my Exhibit MPG-2 shows *Value Line* electric utility industry price-  
16 to-earnings ratio of 20.2964x, compared to a 21-year average price-to-earnings ratio of  
17 around 17.256x (Page 1). The current price-to-earnings ratio for gas utilities is 19.77x  
18 relative to the 17-year average price-to-earnings ratio of 18.45x (Page 11). This strong  
19 price-to-earnings performance indicates stock prices relative to earnings have been  
20 robust. Robust stock prices, or higher stock prices, indicate lower cost of capital.

21 The market price-to-cash flow for electric utilities is currently 9.131x, compared  
22 to the 21-year average of 7.545x (Page 2). The market price-to-cash flow for gas  
23 utilities is currently 9.88x, compared to the 17-year average of 9.61x (Page 11). Again,

1 high stock prices in relationship to utility cash flows indicates investors are willing to  
2 accept lower rates of return to invest in utility stocks.

3 Finally, the current market-to-book ratio for the electric utility industry is  
4 ~~2.00~~1.99x, compared to the 18-year average of 1.71x (Page 3). The current market-  
5 to-book ratio for the gas utility industry is 1.78x, which is comparable to the 17-year  
6 average of 1.82x (Page 11). Again, the market-to-book ratio indicates that utilities are  
7 experiencing robust stock prices and low cost of capital.

8  
9 **Q WHAT DOES IT MEAN FOR REGULATED UTILITIES' EQUITY SECURITIES TO**  
10 **HAVE ROBUST VALUATIONS?**

11 A Robust valuations are an indication that utilities can sell securities at high prices, which  
12 is a strong indication that they can access equity capital at relatively low cost and under  
13 reasonable terms and conditions.

14 **Q PLEASE DESCRIBE THE CREDIT STRENGTH AND FINANCIAL INTEGRITY OF**  
15 **THE REGULATED UTILITY INDUSTRY.**

16 A Credit ratings are reasonable assessments of the utility industry's financial integrity  
17 because they indicate the utility's credit strength, which in turn provides strong  
18 evidence of the utility's ability to attract sufficient capital to make necessary  
19 infrastructure investments under reasonable terms and prices. Trends in credit ratings  
20 are an indication of whether or not regulatory decisions have supported utilities' ability  
21 to generate adequate revenue to recover their costs, produce adequate cash flows,  
22 and maintain strong credit. The primary factors in these regulatory decisions are the  
23 approved returns on equity, regulatory capital structures, and depreciation rates.

1 restoration costs and recovery of deferred coronavirus expenses will  
2 compound the pressure on customer bills. Declining O&M costs due to  
3 cost control initiatives and the ongoing energy transition to lower cost  
4 renewables should provide some offset.

5 Fitch expects median FFO leverage for the sector to modestly improve  
6 to 4.5x in 2022 as utilities see a rebound in FFO from growth  
7 investments and recovery in retail sales. Parent holding companies will  
8 likely continue to look for asset monetization opportunities to  
9 supplement or replace equity needs to fund high capex. However, the  
10 improvement in leverage may not be enough to reverse the negative  
11 ratings trend for utility parent holding companies.

12 Fitch expects liquidity of regulated utilities and parent holding  
13 companies to remain strong. The companies maintain large credit lines  
14 and benefit from unfettered access to capital markets. For competitive  
15 generators, robust FCF generation supports liquidity.<sup>7</sup>

16 S&P currently has a negative outlook for the regulated utility industry, because utility  
17 companies are operating with minimum financial cushion from their downgrade  
18 thresholds and their exposure to environmental, social and governance risk.  
19 Specifically, S&P states the following:

20 **Key Takeaways**

21 - For the second consecutive year rating downgrades outpaced  
22 upgrades for the investor-owned North American regulated utility  
23 industry, causing the median rating on the industry to fall to the 'BBB'  
24 category.

25 - During 2021, credit quality was primarily pressured by weak financial  
26 measures and Environmental, Social, and Governance (ESG) credit  
27 risks. We expect that these risks will continue to pressure the credit  
28 quality of the industry in 2022.

29 - Our outlook on the investor-owned North American regulated utility  
30 industry remains negative. We believe that 2022 could be the third  
31 consecutive year that downgrades outpace upgrades.

32 - Recently, several new credit risks have emerged, including inflation,  
33 higher interest rates, and rising commodity prices. Persistent pressure  
34 from any of these risks would likely lead to a further weakening of the  
35 industry's credit quality in 2022.

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<sup>7</sup> *Fitch Ratings*: "Neutral Outlook for North American Utilities, Power & Gas in 2022,"  
December 29, 2021 at 1-2. (emphasis added).

1 Specifically, as shown on my Exhibit MPG-2 (pages 4 and 12), the 2022  
2 dividend yield of electric (3.362%) and gas (3.21%) utility stock was competitive with  
3 the yield on "A" rated utility bonds in 2022 (4.3025%). The current yield spread between  
4 stock and A-rated utility bond yields is reasonably comparable to that realized  
5 historically, and suggests that the stock yield component of the DCF model is robust  
6 and competitive with alternative income producing investments.

7 The growth component of the DCF return relates to earnings and stock growth  
8 over time. The growth outlook for utility stocks is not depressed generally, but rather  
9 provides a robust outlook for dividends and stock price growth. Including a growth rate  
10 component in the DCF analysis ensures that the DCF return is not understated.

11 Additionally, the annual growth in dividends over the last 17 years has been  
12 approximately 4.085% for electric utilities and 5.23% for gas utilities as shown on my  
13 Exhibit MPG-2 (pages 5 and 13). In my constant growth DCF study presented below,  
14 the current three- to five-year forward projected growth rate for electric utilities is  
15 approximately 5.04%, which is considerably higher than the historical growth rate for  
16 the industry. Furthermore, utility earnings growth is expected to be considerably more  
17 robust than U.S. GDP growth, which generally is regarded as a reasonable proxy for  
18 the maximum sustainable rate of growth for investor capital markets. Going forward,  
19 long-term sustainable growth for equity investments is around 4.45%, as described  
20 below. Based on these factors, the growth rate component of a regulated utility DCF  
21 return is quite robust and produces a highly competitive DCF return estimate.

22 For these reasons, both dividend yield and growth components of a utility DCF  
23 indicate an economically logical return estimate that is competitive with comparably  
24 risky alternative investments.



1 time and the achieved actual investment returns over long time periods would  
2 approximate investors' expected returns. Therefore, it is reasonable to assume that  
3 averages of annual achieved returns over long time periods will generally converge on  
4 the investors' expected returns.

5 My risk premium study is based on data that inherently relied on investor  
6 expectations, not actual investment returns, and, thus, need not encompass a very long  
7 historical time period.

8 **Q WHAT DOES CURRENT OBSERVABLE MARKET DATA SUGGEST ABOUT**  
9 **INVESTOR PERCEPTIONS OF UTILITY INVESTMENTS?**

10 **A** The equity risk premium should reflect the relative market perception of risk in the utility  
11 industry today. I have gauged current investor perceptions of utility risk in Exhibit  
12 MPG-14, where I show the yield spread between utility bonds and Treasury bonds over  
13 the last 43 years. As shown in this exhibit, the average utility bond yield spreads over  
14 Treasury bonds for "A" and "Baa" rated utility bonds for this historical period are 1.48%  
15 and 1.91%, respectively. The utility bond yield spreads over Treasury bonds for "A"  
16 and "Baa" rated utilities through July~~ne~~ 2022 were 1.52% and 1.83%, respectively.

17 The current 13-week average "A" rated utility bond yield of 4.79% when  
18 compared to the current Treasury bond yield of 3.13%, as shown in Exhibit MPG-15,  
19 implies a yield spread of 1.66%. This current utility bond yield spread is higher than  
20 the 43-year average spread for "A" rated utility bonds of 1.48%. The current spread for  
21 the "Baa" rated utility bond yield of 2.01% is also higher than the 43-year average  
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