

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 201500273

REBUTTAL TESTIMONY
OF
MARK E. GARRETT

ON BEHALF
OF

OKLAHOMA INDUSTRIAL ENERGY CONSUMERS ("OIEC")
AND OKLAHOMA ENERGY RESULTS, LLC ("OER")

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I. WITNESS IDENTIFICATION AND PURPOSE OF TESTIMONY

1 **Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A: My name is Mark E. Garrett. My business address is 50 Penn Place, 1900 N.W.
3 Expressway, Suite 410, Oklahoma City, Oklahoma 73118.

4

5 **Q: WHAT IS YOUR PRESENT OCCUPATION?**

6 A: I am the President of Garrett Group, LLC, a firm specializing in public utility regulation,
7 litigation and consulting services.

8

9 **Q: DID YOU SUBMIT REVENUE REQUIREMENT TESTIMONY ON MARCH 21,**
10 **2016 IN THIS PROCEEDING AND RATE DESIGN TESTIMONY ON MARCH**
11 **31, 2016?**

12 A: Yes, I did.

13

14 **Q: WERE YOUR EDUCATIONAL BACKGROUND AND YOUR PROFESSIONAL**
15 **EXPERIENCE RELATED TO UTILITY REGULATION PROVIDED IN THAT**
16 **TESTIMONY?**

17 A: Yes, they were.

18

19 **Q: HAVE YOUR QUALIFICATIONS BEEN ACCEPTED BY THIS COMMISSION**
20 **IN PROCEEDINGS DEALING WITH REVENUE REQUIREMENT, COST OF**
21 **SERVICE AND RATE DESIGN ISSUES?**

1 A: Yes, they have. A more complete description of my qualifications and a list of the
2 proceedings in which I have been involved are attached to my Revenue Requirement
3 Testimony filed March 21, 2016.

4
5 **Q: ON WHOSE BEHALF ARE YOU APPEARING IN THESE PROCEEDINGS?**

6 A: I am appearing on behalf of Oklahoma Industrial Energy Consumers (“OIEC”) and
7 Oklahoma Energy Results, LLC (“OER”).

8
9 **Q: WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

10 A: The purpose of my Rebuttal Testimony is to address the following witnesses and
11 recommendation:

12 1. Staff witness R. Thompson’s recommendation to include 100% of short-
13 term and 25% of long-term incentive compensation costs in rates.

14 2. Staff witness R. Thompson’s failure to update revenues to the statutory 6-
15 month cutoff date for known and measurable changes.

16 3. Staff witness D. Garrett’s recommendations to adjust depreciation rates
17 for distribution assets.

18 4. Staff witness J. Schwartz’ recommendation to not move the customer rate
19 classes to cost-of-service.

20 5. Hospital witnesses J. Athas and K. Kelly’s recommendation to establish
21 privileged rate treatment for the hospitals at the expense of other customers.

II. REBUTTAL TO REVENUE REQUIREMENT TESTIMONY

A. Staff's Recommendations Regarding Incentive Compensation

1 **Q: WHAT IS STAFF RECOMMENDING WITH RESPECT TO INCENTIVE**
2 **COMPENSATION?**

3 A: In his revenue requirement testimony, Staff witness R. Thompson recommends including
4 100% of short-term incentive expense in rates and 25% of long-term expense. This is a
5 significant departure from the Commission's long-standing policy of excluding 50% of
6 short-term incentive costs and 100% of long-term incentive costs. Staff provided
7 virtually no rationale to support this significant departure from prior commission orders.
8 In my opinion, such a significant departure from a well-established Commission policy
9 requires sufficient explanation and support.

10

11 **Q: WHAT RATIONALE DID STAFF PROVIDE?**

12 A: Staff provided no rationale whatsoever for including 25% of the long-term, stock-based
13 incentives for upper management. With respect to the rationale for including 100% of
14 the short-term incentives in rates, Staff provided just five short lines of testimony at page
15 27, lines 9-13, of Mr. Thompson's Responsive Testimony as follows:

16 The Company's short-term incentive plan is not driven by profits of the
17 company but is driven by other goals set for individual employees and
18 should be included. The Company's risk and reward related to the
19 customers and the Company is shared. As the employees meet incentive
20 targets, that benefit is provided to customers in the next rate case proceeding.

21 The first sentence -- stating that the short-term plan is not driven by company profits -- is
22 not accurate. An analysis of the Company's short-term plan was provided by the

1 Company's in its response to AG 3-5. This analysis shows that the Teamshare incentive
2 payments are associated with the following four categories:

- 3 ● Consolidated Earnings per Share
- 4 ● Utility Earnings per Share (EPS)
- 5 ● Operating and Maintenance Expenses
- 6 ● Customer Satisfaction

7 More importantly, a breakdown of the short-term incentive expense between these
8 categories was provided in the Company's response to AG 3-5 Supplement. This
9 breakdown shows that 38.38% of the payout is related to customer satisfaction measures
10 and 61.62% is directly related to company profits. I provided a summary of the
11 response to AG 3-5 Supplement in *Exhibit MG2.5* attached to my Responsive
12 Testimony.

13 The second sentence – stating that the Company's risk and reward related to the
14 customers and the Company is shared – actually provides a basis for sharing the costs, as
15 the Commission has always done in the past. The third sentence – stating that, as
16 employees meet incentive targets, these benefits are provided to customers in the next
17 rate case proceeding – might or might not be accurate. Certainly, EPS targets are not
18 passed on to ratepayers. Even in those instances, when the statement might be accurate –
19 in effect, when cost control measures are actually sustained and passed on to ratepayers
20 in the next rate case in the form of lower cost levels – this does not negate the fact that
21 shareholders retain all of the cost savings between rate cases. The statement also does
22 not take into account the fact that management has a legal duty to control costs and
23 preserve company assets. In other words, it is part of the job they are already well-paid
24 to do. If shareholders want to provide employees with extra compensation to help

1 achieve savings between rate cases that the shareholders can retain, they are free to do
2 so.

3
4 **Q: HOW HAS THE COMMISSION TREATED THESE COSTS IN THE PAST?**

5 A: In numerous litigated rate cases over the past 25-year period involving major utilities
6 with operations in Oklahoma (such as OG&E), the Commission has excluded all of the
7 long-term incentives and at least half of the short-term incentives. These cases included
8 PUD 91-1190, PUD 200400610, PUD 200500151, PUD 200600285, and PUD
9 200800144. I provided the language from each of these orders that addresses the
10 incentive compensation issues in my Responsive Testimony.

11
12 **Q: WHAT DO YOU RECOMMEND?**

13 A: I recommend that the Commission reject Staff's proposed departure from the
14 Commission's long-standing policy on this issue.

B. Staff Witness R. Thompson's Failure to Update Revenues to 6-Month Levels

15 **Q: WHAT DID STAFF RECOMMEND WITH RESPECT TO REVENUE LEVELS?**

16 A: Staff made no adjustment to recognize known and measurable changes in OG&E's
17 revenue levels during the 6-month period after test year-end, even though the Company
18 experienced a material increase in load during this period. In my opinion, this is an
19 important omission that must be corrected. In my Responsive Testimony, I explained
20 that a 6-month revenue update is necessary to fully comply with the requirements of
21 Title 17 § 284 to recognize known and measurable changes that occur within six months

1 of test year end. There are three major components of the revenue requirement: (1)
 2 investment levels, (2) revenue levels, and (3) expense levels. In my revenue requirement
 3 responsive testimony, I updated the investment levels to the 6-month cutoff with all of
 4 the rate base adjustments to plant, accumulated depreciation, accumulated deferred
 5 income tax, accumulated retirement obligations, customer deposits, prepayments and
 6 inventory levels. I also updated expense levels to the 6-month cutoff with adjustments to
 7 major expense categories such as payroll expense, property tax expense and depreciation
 8 expense. When investment levels (rate base) and expense levels are adjusted for known
 9 and measurable changes, revenue levels must also be adjusted to correctly synchronize
 10 the three major components for the revenue requirement formula. In other words, to
 11 fully comply with the requirements of Title 17 § 284, known and measurable changes in
 12 the revenue levels must be recognized. Practically speaking, only those accounts with
 13 known and measurable changes of a material amount need to be updated. In this case,
 14 the known and measurable change in load growth through the 6-month update period is a
 15 material amount that should be recognized. The incremental growth after test year-end
 16 through December 31, 2015 was \$5,375,062 as shown below:

| OIEC/OER Adjustment for Load Growth through December 31, 2015 | |
|--|-----------------------|
| Description | Okla Juris Amt |
| OG&E's Load Growth Adjustment through December 31, 2015 | \$17,886,497 |
| OG&E's Load Growth Adjustment through June 30, 2015 | \$12,511,435 |
| OIEC/OER Adjustment for Growth through December 31, 2015 | \$ (5,375,062) |

17 In my opinion, Staff should include this adjustment in its revenue requirement

1 calculations.

2
3 **Q: WHAT IS THE IMPACT OF THE TWO CORRECTIONS DISCUSSED ABOVE**
4 **TO STAFF'S OVERALL REVENUE REQUIREMENT RECOMMENDATION?**

5 A: The corrections to short-term and long-term incentives to follow Commission precedent
6 on these issues and the correction to recognize load growth calculated by OG&E through
7 December 31, 2015 are set forth in the table below:

| <u>Impacts of OIEC/OER Corrections to Staff's Revenue Requirement</u> | |
|--|------------------------------|
| <u>Descriptions</u> | <u>Okla Juris Amt</u> |
| Adjustment to Exclude 50% of Short-term Incentives | \$(7,104,554) |
| Adjustment for Payroll Taxes on 50% of Short-term Incentives | \$(498,740) |
| Adjustment to Exclude Remaining 25% of Long-term Incentives | \$(1,376,413) |
| Adjustment to Recognize Load Growth through 6-month Cutoff | \$(5,375,062) |
| Total Adjustments for Incentives and Growth | \$(14,354,769) |
| Staff's Filed Rate Increase (J. Schwartz Rate Design Testimony) | \$6,108,242 |
| Staff's Corrected Revenue Requirement (Rate Decrease) | \$(8,246,527) |

C. Staff Witness D. Garrett's Distribution Depreciation Rates

8 **Q: WHAT IS THE ISSUE REGARDING STAFF'S DEPRECIATION**
9 **RECOMMENDATIONS FOR DISTRIBUTION ASSETS?**

10 A. OIEC and OER's depreciation expert, Mr. Jack Pous, only addressed the depreciation
11 rates for transmission, generation and general assets. He did not address the depreciation
12 rates for OG&E's distribution assets, because OIEC and OER members do not take
13 distribution service. As a result, the Commission needs to add Staff's distribution
14 depreciation rate impacts to OIEC's revenue requirement recommendations to obtain a

1 complete picture of the overall rate decrease that should be ordered in this case. Staff
 2 witness D. Garrett provides a comprehensive analysis of OG&E's plant balances
 3 including distribution asset plant balances in his responsive testimony. Staff's
 4 distribution depreciation rate adjustments should be added to OIEC/OER's revenue
 5 requirement recommendations. These adjustments add another **\$15,183,126**¹ to
 6 OIEC/OER's recommended rate decrease as set forth in the table below:

| <u>Impacts of OIEC/OER Corrections to Staff's Revenue Requirement</u> | |
|--|------------------------------|
| <u>Descriptions</u> | <u>Okla Juris Amt</u> |
| Rate Decrease Recommended by OIEC/OER in Direct Testimony | <u>\$(32,674,789)</u> |
| Staff's Distribution Depreciation Recommendations | <u>\$(15,183,337)</u> |
| Rate Decrease Recommended by OIEC/OER in Rebuttal Testimony | <u>\$(47,858,126)</u> |

III. REBUTTAL TO RATE DESIGN TESTIMONY

A. Staff and AG's Recommendations Regarding Movement Toward Cost of Service

7 **Q: WHAT IS THE ISSUE REGARDING MOVEMENT TOWARD COST OF**
 8 **SERVICE?**

9 A. OG&E's cost of service study shows (and the parties' testimony appears to agree) that
 10 the Large Power and Light ("LPL") class and the Oil and Gas Production ("OGP") class
 11 are heavily subsidizing the other customer classes.² Thus, the primary rate design issue
 12 that needs to be addressed is the elimination of the inter-class subsidies. Yet, Staff and

¹ See attached PUD response to OIEC-PUD 1-1.

1 AG's recommendations merely reduce the subsidy but, do not eliminate it. The LPL and
2 OGP classes are the two classes least able in the current economic downturn to subsidize
3 other ratepayers. These classes include customers in industries that make up the state's
4 largest job producers. They also include many customers from industries that compete
5 on a global rather than local level. As I explained in my Rate Design Testimony, every
6 dollar that industrial companies pay for electricity above the actual cost of that electricity
7 is a dollar not available to provide jobs and economic growth in Oklahoma. For this
8 reason, the Commission should work to eliminate interclass price subsidies to the
9 greatest extent possible. In my opinion, Staff and AG's recommendations to marginally
10 reduce the subsidy does not go nearly far enough. Fortunately, this case should result in
11 a material rate decrease rather than an increase. That decrease, if large enough, should
12 be used to eliminate the interclass subsidies. If the decrease is not large enough to fully
13 eliminate the interclass subsidies without putting a substantial increase on the residential
14 class, the decrease that is ordered should go entirely to the classes that are currently
15 subsidizing the other classes.

B. OHA's Recommendations to Establish Special Rates for Hospitals

16 **Q: WHAT IS THE OKLAHOMA HOSPITAL ASSOCIATION (OHA)**
17 **RECOMMENDING IN THIS CASE?**

18 A. OHA is recommending a special rider to eliminate the subsidy that its members are
19 paying in rates. OHA provides little to no justification for this recommendation and no
20 explanation of exactly who will pick up the difference. OHA certainly does not explain

2 The Power and Light Time of Use ("PL-TOU") class is also heavily subsidizing the PL class.

1 why its members who compete on a local and regional level should receive rate relief
2 while the oil and gas producers and manufacturing industries that compete on a global
3 level should not. For the sake of economic development, job creation and job retention,
4 OHA members, oil and gas producers and the manufacturing industries on OG&E's
5 system all need to have the subsidies they provide to other customers eliminated. The
6 Commission should not favor one industry at the expense of others when all industries
7 need appropriate rate relief.

VI. CONCLUSION

8 **Q: DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

9 A: Yes, it does.

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IN THE MATTER OF THE APPLICATION OF)
OKLAHOMA GAS AND ELECTRIC COMPANY)
FOR AN ORDER OF THE COMMISSION)
AUTHORIZING APPLICANT TO MODIFY ITS) CAUSE NO. PUD 201500273
RATES, CHARGES, AND TARIFFS FOR RETAIL)
ELECTRIC SERVICE IN OKLAHOMA)

**PUBLIC UTILITY DIVISION RESPONSE TO
OKLAHOMA INDUSTRIAL ENERGY CONSUMERS'
FIRST SET OF DATA REQUESTS**

1. Regarding Mr. David Garrett's depreciation testimony, please provide a distribution of the total revenue requirement recommendation among the following functions: Production Plant, Transmission Plant, Distribution Plant, General Plant and Holding Company Assets. Please provide the information on a total company basis and reconcile the total of the amounts attributable to the separate functions with the total revenue requirement recommendation included in Staff's Accounting Exhibit.

PUD Response to OIEC 1: PUD's proposed depreciation expense on DG 2-2 (data point [9]) included \$1,178,479 of unrecovered reserve from the depreciation study, and it did not include \$2,195,082 of plant completed by December 2015 from Schedule I-1-1 (line 36). After accounting for these two items, PUD's updated proposed depreciation expense adjustment is (\$35,288,683). None of PUD's proposed depreciation rates have changed.

Response provided by: Fairo Mitchell
Response provided on: March 29, 2016
Contact & Phone No: David Garrett 405-521-4114

*By responding to these Data Requests, PUD is not indicating that the provided information is relevant or material and PUD is not waiving any objection as to relevance or materiality or confidentiality of the information or documents provided or the admissibility of such information or documents in this or in any other proceeding.