BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF OKLAHOMA GAS AND ELECTRIC COMPANY FOR COMMISSION AUTHORIZATION OF A PLAN TO COMPLY WITH THE FEDERAL CLEAN AIR ACT AND COST RECOVERY; AND FOR APPROVAL OF THE MUSTANG MODERNIZATION AND COST RECOVERY	)))))))	CAUSE NO. PUD 201400229

Rebuttal Testimony

of

John J. Spanos

on behalf of

Oklahoma Gas and Electric Company

January 26, 2015

INTRODUCTION

Q. **Please state your name and address.**

A. My name is John J. Spanos. My business address is 207 Senate Avenue, Camp Hill, Pennsylvania 17011.

Q. **Have your previously submitted testimony in this proceeding?**

A. Yes. I submitted my direct testimony in August 2014.

Q. **What is the purpose of your rebuttal testimony?**

A. I will rebut the pre-filed responsive testimony of Mark E. Garrett, witness for the Oklahoma Industrial Energy Consumers (OIEC) on the subject of depreciation.

Q. **What are the specific subjects of depreciation you will address?**

A. There are two related concerns raised by Mr. Garrett that I will address in this testimony. I will discuss the appropriateness of conducting a depreciation study for the Mustang units in this filing and then the most appropriate life spans for each of those units. To better understand why Mr. Garrett's concerns in these areas are misplaced, it would be helpful to briefly revisit the purpose of a depreciation study in determining the appropriate recovery of capital costs.

PURPOSE OF A DEPRECIATION STUDY

Q. **What is the primary reason for conducting a depreciation study?**

A. The concept of depreciation can be explained as follows:

Depreciation, in public utility regulation, is the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of utility plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among causes to be given consideration are wear and tear, deterioration,

action of the elements, inadequacy, obsolescence, changes in the art, changes in demand, and the requirements of public authorities.

Depreciation, as used in accounting, is a method of distributing fixed capital costs, less net salvage, over a period of time by allocating annual amounts to expense. Each annual amount of such depreciation expense is part of that year's total cost of providing electric utility service. Normally, the period of time over which the fixed capital cost is allocated to the cost of service is equal to the period of time over which an item renders service, that is, the item's service life. The most prevalent method of allocation is to distribute an equal amount of cost to each year of service life. This method is known as the straight-line method of depreciation.

With this general understanding of depreciation, then a depreciation study should be conducted regularly, every five years is the most common period, or when the major depreciation parameters of assets have changed. The major depreciation parameters are service life, net salvage percent, plant in service and depreciation methodology.

Q. **Have some of the depreciation parameters changed for the Mustang units?**

A. Yes. The two primary components that have changed recently are the anticipated retirement date of the Mustang Units and the overall costs to remove the units once retired.

Q. **What is the underlying reasoning for including the Mustang unit Depreciation Study?**

A. Contrary to Mr. Garrett's opinion, the decision to retire all of the Mustang steam units by end of 2017 establishes better utilization of capital dollars. The Mustang units are old and require high levels of capital improvements, not only to run efficiently but also to meet current operating requirements. Therefore, installing millions of dollars at these units just to retire the units between 2015 and 2020 does not make sense. Building new CT units which can be fully operational in a short period of time and designed to be utilized to meet peak demands is the needed

capacity rather than less efficient units that take hours to get to full capacity. Therefore, the decision to build new CTs and a combined cycle facility by 2020 makes more sense than added capital dollars to old units which will be retired a few years later.

Q. **How does the Depreciation Study related to Mustang produce more appropriate depreciation rates?**

A. As shown in the study, page VI-5, there is $29.6 million in rate base still to recover for the Mustang Units as of December 31, 2013. If no additional plant is added, then full recovery, including terminal net salvage costs, will be approximately $9.4 million for an average 3.2 years will be collected. If we follow Mr. Garrett's logic and wait for the results of the next rate case and need to recover the $29.6 million by year-end 2017, then we will have approximately $7.6 million annual expense for the next two years and then $14.4 million to be recovered over 1.2 years to achieve full recovery by end of 2017. Therefore, conducting the depreciation study in this filing systematically and rationally recovers the remaining rate base over the remaining years instead of pushing the burden of recovery to customers over the last 1.2 years of operation.

Q. **How have the retirement dates changed in this study?**

A. There are four steam units at the Mustang generating facility. Unit 1 was built in 1950, Unit 2 built in 1951, Unit 3 built in 1955 and Unit 4 placed into service in 1960. The table below sets forth the initial year of service, the current retirement date and the new retirement dates.

Unit	Initial Year of Service	Current Retirement Date[1]	New Retirement Date
1	1950	2016	2015
2	1951	2016	2017
3	1955	2017	2017
4	1960	2020	2017

[1] Current Retirement Date reflects approved life span dates from the last depreciation study from Cause No. PUD 201100087.

Q. **How has the net salvage percentages changed in this study?**

A. The current net salvage percentages were determined at the account level based on historical indications and applied to the entire plant balance of the account by location. In this study, a more precise calculation is performed to properly assess the interim net salvage percent at the account level for the assets which will be retired on an interim basis and a calculation of terminal net salvage is performed for the assets on a unit basis which will be retired at end of life. This combined calculation produces a weighted net salvage percent to be recovered over the remaining life of each unit.

Q. **Does the changed life span and net salvage percentages of the Mustang Units dictate the reasoning for the Depreciation Study for these assets as part of this filing?**

A. Yes. In order to properly recover the remaining investment at Mustang by the time the facilities are retired without creating a short-term rate spike, it was important to propose the change for Mustang as soon as possible. The overall remaining recovery period is considerably shorter with the new life span dates.

Q. **Have other utilities across the United States made similar decisions with their older steam facilities?**

A. Yes. There are many steam units which were built prior to 1970 that are being retired in the next few years if they have not been retired already. One primary reason for the retirements is the technological obsolescence of units and the required permitting to continue operating these facilities. Utilities have a difficult time justifying spending millions of dollars to upgrade 60-year old units which will only be able to operate efficiently for a few extra years. Thus, new combustion turbines and combined cycle facilities are being built to replace the lost capacity similar to the plans of Oklahoma Gas and Electric.

LIFE SPANS OF THE MUSTANG UNITS

Q. **Have the life spans for each Mustang Unit changed in the Depreciation Study?**

A. As shown in the table on page 5 of this testimony the life spans have changed from what is currently being utilized for depreciation purposes. The rates in this Depreciation Study reflect the one-year shorter life span for Unit 1, the one-year longer life span for Unit 2, no change for Unit 3 and the three-year shorter life span for Unit 4. Therefore, the only significant change relates to Unit 4.

Q. **Are there benefits to shutting down Unit 4 at the same time as Units 2 and 3?**

A. Absolutely. The operational costs to shut down two units while attempting to run one unit are higher and less efficient than to shut down all three at once.

Q. **Would the overall life span of Mustang 4 still be reasonable?**

A. Yes. The most common life span for natural gas units in steam production plant is 55 to 65 years, therefore, very few units built in the 1950s and early 1960s are expected to stay in service beyond 2020. With the proposed estimates in the Depreciation Study, the life spans for the four Mustang Units would range from 57 to 65 years.

Q. **Mr. Garrett makes a claim in his testimony that it is not appropriate to shorten lives for the Mustang Units independently from other assets. Do you agree?**

A. No. Mr. Garrett's entire premise assumes depreciation is a results oriented calculation, instead of the more appropriate purpose of recovery based on the matching principle. In other words, Mr. Garrett proposes his changes based on the level of depreciation he wants to present, not the level of depreciation which is consistent with full recovery while the assets are still in service. Depreciation should match the capital recovery of the assets with the asset's useful life.

Q. **Mr. Garrett also discusses in his testimony a proposed amortization change for recovery of Coal Handling and Ash Removal equipment. Do you agree with his proposal?**

A. No. Mr. Garrett proposes to change a 6-year amortization of Coal Handling and Ash Removal equipment to a 24-year recovery period based on unrelated assets. By definition, the recovery of the full service value of all assets should be recovered over the life of the asset. Mr. Garrett's proposal defers the remaining costs of the Coal Handling and Ash Removal equipment over a 24-year period in the future based on a life of an unrelated asset class. Not only does this improperly recover the full service value of an asset after the asset is no longer used and useful, but it requires future rate payers to incur costs of an asset they did not receive any benefit. The new gas units which replace the coal units at Muskogee 4 and 5 should not include the costs of the coal related assets.

Q. **Does this conclude your rebuttal testimony?**

A. Yes.