

BEFORE THE
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION)
OF OKLAHOMA GAS AND ELECTRIC COMPANY)
FOR APPROVAL OF A GENERAL CHANGE IN)
RATES, CHARGES AND TARIFFS)

DOCKET NO. 16-052-U

DIRECT TESTIMONY

OF

CLAUDE ROBERTSON
PUBLIC UTILITY AUDITOR
AUDITS SECTION

ON BEHALF OF THE GENERAL STAFF
OF THE ARKANSAS PUBLIC SERVICE COMMISSION

JANUARY 31, 2017

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INTRODUCTION

Q. What is your name and business address?

A. My name is Claude Robertson. My business address is Arkansas Public Service Commission (Commission), 1000 Center Street, Little Rock, Arkansas 72201.

Q. By whom are you employed and in what capacity?

A. I am employed by the General Staff (Staff) of the Commission as a Public Utility Auditor in the Audits Section. In that capacity, I analyze utility company filings, conduct field audits, identify and evaluate accounting issues, develop positions on those issues, and present those positions in written and oral testimony before the Commission, and perform other duties as assigned.

Q. Would you please describe your educational background and experience?

A. I hold bachelor degrees in Accounting and Business Administration from Northwestern State University in Louisiana. Before joining Staff in July 2012, I served as Finance Manager for a non-profit corporation in the medical industry overseeing the accounting department and performing financial analysis for management. I have eighteen years of experience in the accounting environment which includes corporate and regulatory accounting. Since joining Staff, I have attended "The Basics, Practical Regulatory Training" sponsored by New Mexico State University Center for Public Utilities. I have previously filed testimony and appeared before this Commission on matters concerning utility company rate cases and Act 310 filings.

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PURPOSE OF TESTIMONY

Q. What is the purpose of your Direct Testimony in this Docket?

A. I address certain expense adjustments made by Oklahoma Gas and Electric Company (OG&E or Company) in its Application for Approval of Changes in Rates for Retail Electric Service (Application) filed on August 25, 2016, and revised on September 2, 2016. In its Application, the Company used a projected test year ending June 30, 2016. I will discuss Staff's adjustments to Payroll Expense and related taxes, Pension Expense, Short-Term Incentive Compensation (Teamshare or STIC) and Long-Term Incentive Compensation (LTIC), Severance Expense, Contract Labor, and Relocation Expense. In my testimony, I will address the Direct Testimony of Company witness Jason Thenmadathil. I sponsor the adjustments shown in Tables 1 and 2 below. Any corresponding Company adjustment is shown for comparative purposes. I list the adjustments in Table 1 where the Company and I are in agreement, with any differences in the amount being solely due to my use of actual test year data instead of partially-projected test year data used by the Company. My testimony will address the adjustments listed in Table 2, where the Company and I differ in methodology, or where additional explanation is required. In my discussion, I contrast my adjustments with the Company's Application adjustment amounts reflected in Table 2.

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Table 1
Summary of Uncontested Adjustments

Staff Adj. No.	Co. Adj. No.	Description	Staff Adj. Amount*	Co. Adj. Amount*	Difference
IS-20	IS-20	Amortization of 2015 Pension Settlement Cost	\$175,494	\$175,494	\$0
IS-27	IS-27	Amortization of 2013 Pension Settlement Cost	\$1,746,210	\$1,746,210	\$0

*The Company and Staff Adjustment amounts are shown before income taxes

Table 2
Summary of Contested Adjustments

Staff Adj. No.	Co. Adj. No.	Description	Staff Adj. Amount*	Co. Adj. Amount*	Difference
IS-12	IS-12	Adjust Fringe Benefits: Pension Costs Post-Retirement Benefits Active Medical Costs Total Adjustment	\$1,458,754 (\$1,235,989) <u>(\$228,881)</u> <u>(\$6,116)</u>	(\$3,957,518) (\$1,552,278) <u>(\$345,671)</u> <u>(5,855,467)</u>	\$5,416,272 \$316,289 <u>\$116,790</u> <u>\$5,849,351</u>
IS-16	IS-16	Adjust Payroll to reflect increase costs	\$5,613,925	\$5,890,241	(\$276,316)
IS-17	IS-17	Adjust Payroll Tax related to increase in payroll costs	\$413,746	\$441,179	(\$27,433)
IS-37	IS-37	Adjust Teamshare: Incentive Compensation Payroll Taxes Total Adjustment	(\$1,968,854) <u>(\$145,104)</u> <u>(\$2,113,958)</u>	\$5,383,280 <u>\$403,208</u> <u>\$5,786,488</u>	(\$7,352,134) <u>(\$548,312)</u> <u>(\$7,900,446)</u>
IS-38	IS-38	Adjust LT Incentive Adjust LT Payroll Taxes Total Adjustment	(\$4,914,167) <u>(\$362,174)</u> <u>(\$5,276,341)</u>	\$533,254 <u>\$39,941</u> <u>\$573,195</u>	(\$5,447,421) <u>(\$402,115)</u> <u>(\$5,849,536)</u>
N/A	IS-42	Adjust Expense for Contract Labor Security	\$1,984,369	\$0	\$1,984,369
N/A	IS-43	Adjust Relocation Expense	(\$9,815)	\$0	(\$9,815)
N/A	IS-44	Adjust Severance Expense	(\$296,112)	\$0	(\$296,112)

*The Company and Staff Adjustment amounts are shown before income taxes

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PAYROLL EXPENSE

Q. What are the differences in Staff's Adjustment IS-16 Payroll Expense and the related IS-17 Payroll Taxes compared to the Company's?

A. Company witness Jason Thenmadathil, in his Direct Testimony, annualizes the March 2016 payroll, applies an average annual pay increase, and adjusts this amount for any partnership amounts related to the Redbud and McClain Plants to develop his payroll amount. I used a similar methodology, but used a more recent payroll period dated December 9, 2016, then annualized the payroll, and adjusted it for the partnership interest related to McClain and Redbud and then applied the cost of living adjustment. This cost was then compared to the test year payroll expense to arrive at my payroll adjustment. The Company's Application adjustment is an increase of \$5,890,241 as compared to my adjustment increase of \$5,613,925; my reduction reduces cost by \$276,316 compared to the Company. I will update my payroll costs as new payroll information becomes available.

The Company's Adjustment IS-17 for payroll taxes uses the adjustment mentioned above and applies the tax to wage ratio of 7.49% supplied in the Company's Application to arrive at an increase of \$441,179. My adjustment for payroll taxes uses the tax to wage ratio of 7.37% as provided in the Company's update to actuals to arrive at an increase of \$413,746. The difference between the Company's adjustment and mine is a reduction of \$27,433.

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PENSION EXPENSE

Q. Have you reviewed Adjustment IS-12 Pension, Medical and Other Employment costs made by the Company?

A. Yes. The Company has projected costs of \$9,653,313 for Pensions, and \$1,223,365 for post-retirement benefits using the Fidelity Actuarial Report dated May 6, 2016. The Company then compared these actuarially-determined amounts to the projected test year which resulted in its reduction of \$3,957,518 for pension costs and reduction of \$1,552,278 for Post-Retirement Benefits. My adjustment compared actual test year costs with the actuarial report mentioned above to arrive at an increase of \$1,458,754 for Pension Expense and reduction of \$1,235,989 for Post-Retirement Benefits. The difference between my adjustment IS-12 and the Company's is an increase of \$5,416,272 for pensions and an increase of \$316,289 for post-retirement benefits. This difference is primarily due to the Company's use of a projected test year in its Application compared to my use of the actual test year.

Adjustment IS-12 also includes an adjustment for Active Medical Costs. The Company used the 2016 Budget to project active medical costs of \$12,465,119. I have used the 2016 Budget similar to the Company's approach, but made a reduction of \$112,923 related to the June 2016 lay-off of security personnel. This reduction in costs resulted in a *pro forma* level of cost for active employee medical expense of \$12,352,195. The Company's reduction for Active

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1 Medical of \$345,671 is greater than my reduction of \$228,881 by \$116,790 due
2 to the Company's use of a projected test year and my use of an actual test year
3 and the adjustment I previously mentioned related to the medical costs for
4 security personnel.

5 **INCENTIVE COMPENSATION**

6 **Q. What is OG&E's request regarding the appropriate level of incentive**
7 **compensation in this proceeding?**

8 A. In its Application, the Company is seeking full recovery of its incentive
9 compensation expense including its Teamshare and LTIC programs.

10 **Q. What are the requirements necessary for an expense, including incentive**
11 **compensation, to be recovered through rates?**

12 A. The expense must be prudently incurred, known and measurable, necessary for
13 the provision of utility service in Arkansas, and the level of expense must be
14 reasonable. I examined OG&E's incentive compensation programs using these
15 criteria to determine whether it is appropriate to recover 100% of those costs in
16 rates as the Company requests. Staff witnesses have addressed the appropriate
17 treatment of incentive compensation program costs in recent utility cases. In the
18 most recent Entergy Rate Case, Docket No. 15-015-U, Staff witness Kim O.
19 Davis supported the inclusion of 100% of STIC;¹ and Staff witness Bill Taylor
20 supported inclusion of both LTIC and STIC in Entergy's previous rate case,

¹ In Docket No. 15-015-U, Entergy did not request recovery of its LTIC costs.

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1 Docket No. 13-028-U. In Docket No. 13-028-U, Staff witness Bill Taylor stated
2 that "it is appropriate to evaluate whether the overall level of payroll costs,
3 including incentive and stock-based compensation, is reasonable."² Also, in
4 Docket No. 15-015-U, Staff witness Kim O. Davis summarized the requirements
5 necessary for an expense, including incentive compensation program costs, to
6 be recovered from ratepayers, stating, "[T]he expense must be prudently
7 incurred, known and measurable, necessary for the provision of utility service in
8 Arkansas, and the level of expense must be reasonable."³ Mr. Davis concluded
9 by noting that the normal level of EAI's STIC met those requirements and should
10 be included in EAI's revenue requirement.⁴

11 **Q. Are you able to reach the same conclusions and make the same**
12 **recommendations regarding OG&E's incentive compensation costs in this**
13 **docket?**

14 A. No, I am not. In this case, OG&E has not provided sufficient evidence to
15 demonstrate that the structure and the level of its incentive compensation plans
16 are reasonable and that recovery of the full amount of those costs through rates
17 is appropriate. The Company has not provided adequate information to enable
18 me to recommend recovery of 100% of those costs in rates applying the criteria
19 set forth by Staff in its testimony in recent rate case dockets. Therefore, I

² Docket No. 13-028-U, Direct Testimony of Staff Witness Bill Taylor, p. 7.

³ Docket No. 15-015-U, Direct Testimony of Kim O. Davis, pp., p. 59, Ln 22, p.60, ln 1-2.

⁴ *Id.* at 59-60.

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1 recommend that these costs be treated consistently with recent Commission
2 orders in other cases where the Commission found that there was not sufficient
3 information to support inclusion in payroll of 100% of incentive compensation
4 program costs.

5 **Q. What is the difference between your Adjustment IS-37 for Teamshare and**
6 **the Company's?**

7 A. The Company in its Application projected a Teamshare increase of \$5,786,487
8 after applying the effects of the four-year average capitalization rate and related
9 payroll taxes. The Company did not make any reductions based upon specific
10 categories of payments as I will discuss below. My adjustment takes the actual
11 costs for Teamshare in the test year and adjusts this amount based upon specific
12 categories to allow the Company to recover in base rates, 50% for financial-
13 related incentives, 100% for customer-related incentives, and 100% for
14 Innovation and Learning incentives. I calculated my adjustment based upon five
15 years of payments as a percentage of total Teamshare payments. I applied this
16 percentage to the test year to arrive at the *pro forma* costs to the ratepayer. My
17 adjustment after the effects of the capitalization rate and related payroll taxes is a
18 reduction of \$2,113,958, which is a decrease of \$7,900,446 as compared to the
19 Company's adjustment.

20 **Q. What is the difference between your Adjustment IS-38 for LTIC and the**
21 **Company's?**

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1 A. The Company's response to Data Request APSC-1.20 attached hereto as
2 Exhibit CR-1, states that "OGE has a stock incentive plan that includes long term
3 incentive." The Company in its Application projected an increase of \$573,195
4 using a four-year average of LTIC compared to the projected test year. My
5 adjustment reduced all actual test year costs by \$5,276,341. My adjustment is
6 consistent with previous Commission orders. The Commission previously
7 disallowed 100% of Long Term Incentives that are tied to the stock price of the
8 parent company as is referenced in the Entergy Rate Case, Docket No. 06-101-
9 U⁵. The difference between the Company's adjustment and mine is a decrease of
10 \$5,849,536.

11 **OTHER ADJUSTMENTS**

12 **Q. What is the purpose of your Adjustment IS-42 for Contract Labor Security?**

13 A. I have added Adjustment IS-42 for Contract Labor Security as a result of the
14 increased costs due to the hiring of an outside contractor for security to replace
15 the security personnel who were laid off in June 2016. The allowance of contract
16 labor for security provides a vital component to the security of OG&E's power
17 plants and as such should be included in base rates. My Adjustment IS-16
18 Payroll Adjustment did not include security personnel and, as a result, I have
19 included the contract labor that has replaced these employees in this adjustment.

⁵ Docket No. 06-101-U, Order No. 10, pp 68-69, (T.692)

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1 The Company has provided detailed information relating to the costs of the
2 contract labor from June 2016 to December 2016. Based upon this data, I was
3 able to annualize these costs and make a known and measurable adjustment of
4 \$1,984,369.

5 **Q. What was the purpose of your Adjustment IS-43, Relocation Expense?**

6 A. The purpose for this adjustment is to normalize the costs of relocating
7 employees. In making this adjustment, I used an average of five years of
8 relocation expenses and compared that amount to the current test year to
9 calculate a reduction of \$9,815. The Company did not make a similar
10 adjustment.

11 **Q. What is your Adjustment IS-44 for Severance Expense?**

12 A. I normalized severance expense based upon a five-year historical average of
13 costs for OGE and OG&E, and compared this normalized cost to the test year to
14 arrive at my reduction of \$296,112. The Company did not make a similar
15 adjustment.

16 **Q. Does this conclude your Direct Testimony?**

17 A. Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been served on all parties of record by electronic mail via the Electronic Filing System on this 31st day of January, 2017.

/s/ Justin A. Hinton
Justin A. Hinton