BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF	)	
OKLAHOMA GAS AND ELECTRIC COMPANY	)	
FOR AN ORDER OF THE COMMISSION	)	**CASE NO. PUD 2023-000087**
AUTHORIZING APPLICANT TO MODIFY ITS	)	
RATES, CHARGES, AND TARIFFS FOR RETAIL	)	
ELECTRIC SERVICE IN OKLAHOMA	)	

RESPONSIVE TESTIMONY AND EXHIBITS

OF

MARK E. GARRETT

REVENUE REQUIREMENT ISSUES

ON BEHALF OF

OKLAHOMA INDUSTRIAL ENERGY CONSUMERS ("OIEC")

April 26, 2024

TABLE OF CONTENTS

I. WITNESS IDENTIFICATION AND PURPOSE OF TESTIMONY

Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A: My name is Mark E. Garrett. My business address is 4028 Oakdale Farm Circle, Edmond, Oklahoma 73013.

Q: WHAT IS YOUR PRESENT OCCUPATION?

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

Q: PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND YOUR PROFESSIONAL EXPERIENCE RELATED TO UTILITY REGULATION.

A: I received my bachelor's degree from The University of Oklahoma and completed post graduate hours at Stephen F. Austin State University and the University of Texas at Arlington and Pan American. I received my juris doctorate degree from Oklahoma City University Law School and was admitted to the Oklahoma Bar in 1997. I am a Certified Public Accountant licensed in the States of Texas and Oklahoma with a background in public accounting, private industry, and utility regulation. In public accounting, as a staff auditor for a firm in Dallas, I primarily audited financial institutions in the State of Texas. In private industry, as controller for a mid-sized corporation in Dallas, I managed the company's accounting function, including general ledger, accounts payable, financial reporting, audits, tax returns, budgets, projections, and supervision of accounting personnel. In utility regulation, I served as an auditor in the Public Utility Division of the

Oklahoma Corporation Commission ("Commission") from 1991 to 1995. In that position, I managed the audits of major gas and electric utility companies in Oklahoma.

Since leaving the Commission, I have worked on numerous rate cases and other regulatory proceedings on behalf of various consumers, consumer groups, public utility commission staffs and attorney general's offices. I have provided testimony before the public utility commissions in the states of Alaska, Arizona, Arkansas, Colorado, Florida, Indiana, Massachusetts, Montana, Nevada, New Mexico, Oklahoma, Texas, Utah and Washington. My qualifications were accepted in each of those states. My clients primarily include industrial customers, hospitals and hospital groups, universities, municipalities, and large commercial customers. I have also testified on behalf of the commission staff in Utah and the offices of attorneys general in Indiana, Montana, Oklahoma, Washington, Nevada and Florida. I have also served as a presenter at the NARUC subcommittee on Accounting and Finance on the issue of incentive compensation, and as a regular instructor at the New Mexico State University's Center for Public Utilities course on basic utility regulation.

Q: HAVE YOUR QUALIFICATIONS BEEN ACCEPTED BY THIS COMMISSION IN PROCEEDINGS DEALING WITH REVENUE REQUIREMENT ISSUES?

A: Yes, they have. A description of my qualifications and a list of the proceedings in which I have been involved are attached to this testimony as *Exhibit MG-1*.

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

A: I am appearing on behalf of Oklahoma Industrial Energy Consumers ("OIEC").

Q: WHAT IS OIEC?

A: OIEC is an unincorporated association, consisting of a diverse group of large consumers of energy in Oklahoma, which is involved in Oklahoma regulatory and legislative matters primarily involving the supply of natural gas and electric power to large consumers of energy.

Q: WHAT IS OIEC'S INTEREST IN THIS PROCEEDING?

A: OIEC members purchase substantial quantities of electric power which are necessary to their operations. Electric power can constitute a significant percentage of industrial and other large consumers' operating costs. Electric power supplies are generally purchased from utilities pursuant to standard tariffs filed at the Commission. Industries and other large consumers served by OG&E often operate in highly competitive business environments. Thus, OIEC seeks an outcome in this proceeding that determines electric rates for OG&E that result in the delivery of reliable power at the lowest and most reasonable cost possible under the circumstances.

Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A: The purpose of my testimony is to address various revenue requirement issues identified in Oklahoma Gas & Electric Company's ("OG&E" or "Company") rate case application and to provide the Commission with recommendations for the resolution of these issues.

I also sponsor *Exhibit MG-2* included with this testimony, in which the overall impact of OIEC's revenue requirement recommendations is set forth. In total, OIEC recommends adjustments of $286.1 million which reduce the Company's requested rate increase from $332.5 million to an adjusted rate increase of $46.4 million, as outlined in the testimony below.

Q: PLEASE SUMMARIZE OG&E'S REQUEST IN THIS FILING.

A: The Company is seeking a $332.5 million rate increase, which results in an average total bill increase for customers of 12.1% over existing rates.[1] According to OG&E witness, Mr. Kimber L. Shoop, the primary reason for the requested rate increase filed for in this case is to recover the costs of capital investment in the utility system.[2] Much of the Company's requested increase in this case, however, relates to positions taken by the Company in its filing that are inconsistent with prior Commission orders. For example, OG&E requests: (1) Return on Equity ("ROE") of 10.5%, well above the levels currently authorized, which results in an increase of $63.5 million;[3] (2) recovery of 100% of Incentive Compensation, contrary to the Commission's longstanding treatment, for an increase of $17.4 million;[4] and (3) changes to its Depreciation rates, in which the Company seeks to implement new, more expensive depreciation rates, for an increase of about $79.4

---

[1] OG&E Errata filed Jan. 11, 2024, p. 2.

[2] Direct Testimony of Kimber L. Shoop, p. 4, lines 21 - 26.

[3] *Id.*, p. 15.

[4] *See* Exhibit MG-2.

million.[5] The evidence shows that a substantial reduction to the Company's requested revenue requirement is necessary to establish just and reasonable rates. Based on OIEC's recommendations the total rate increase should be limited to $46.4 million, as set forth in the table below and in *Exhibit MG-2*.

II. SUMMARY OF RECOMMENDATIONS

OG&E's Proposed Rate Increase	**$ 332,537,342**
Rate Base Adjustments	
Adjust Rate Base Account Balances to 6-Month Levels	2,812,738
Coal Inventory	(6,720,666)
Net Decrease from Rate Base Adjustments	$ **(3,907,928)**
Cost of Capital Adjustments	
Apply OIEC Capital Structure	(56,162,389)
Apply OIEC Return on Equity	(63,512,225)
Net Decrease from Cost of Capital Adjustments	**$ (119,674,614)**
Revenue and Expense Adjustments	
To update OG&E Oklahoma revenue	(17,645,966)
To update OG&E Expenses	(6,939,524)
To remove 50% of Annual Incentive Plan	(7,323,245)
To remove Long-Term Incentive Plan	(8,589,659)
To adjust Ad Valorem Tax Expense	(8,075,661)
To adjust Pension Tracker Amortization	(6,812,859)
To adjust Severance Pay	(528,414)
To remove 50% of Directors' and Officers' Liability Insurance	(619,566)
To remove 50% of Directors' and Officers' Compensation	(1,464,412)
To remove 50% of Investor Relations Expense	(370,427)
To remove 50% of Dues and Memberships Expense	(640,414)
To adjust Vegetation Management Expense	(24,030,835)
To adjust Depreciation Expense	(79,476,478)
Net Decrease from Revenue, Expense and Tax Adjustments	**$ (162,517,460)**
Total OIEC Recommended Adjustments	**$ (286,100,003)**
OIEC's Proposed Rate Increase	**$ 46,437,339**

[5] Direct Testimony of Kimber L. Shoop, p. 15.

III. RATE BASE UPDATE TO 6-MONTH POST TEST YEAR BALANCES

Q: ARE YOU PROPOSING AN ADJUSTMENT TO THE COMPANY'S PRO FORMA RATE BASE?

A: Yes. In Oklahoma, the Commission is required by law (Title 17 § 284) to give effect to known and measurable changes that occur within six months of test year end. In this application, the test year end is September 30, 2023, and the 6-month cut-off for post-test year adjustments is March 31, 2024. My adjustments update Plant, Accumulated Depreciation, Accumulated Deferred Income Taxes, Fuel Inventory Levels, Regulatory Assets, Regulatory Liabilities, Prepayments, Materials and Supplies, Customer Deposits, and the Net Pension Asset through the 6-month cutoff date.

Q: HOW ARE YOUR ADJUSTMENTS CALCULATED TO REFLECT ACTUAL INVESTMENT LEVELS AS OF MARCH 31, 2024?

A: The adjustments are calculated by comparing the Company's requested levels in plant, accumulated depreciation and all other rate base accounts to their actual balances as of March 31, 2024. As a result of this calculation, all of the Company's net investment in plant that is actually in service within six months of test year end is included in rate base along with all other investment levels, including inventories and regulatory asset balances. Also, all offsetting decreases in the investment levels, such as accumulated depreciation, accumulated deferred income taxes, customer deposits and regulatory liabilities are recognized as well.

Q: HAS THE COMMISSION PREVIOUSLY ACCEPTED THIS APPROACH?

A: Yes. To my knowledge, the Commission has used this approach in virtually every litigated natural gas and electric company rate case since Cause No. PUD 200400610, ONG's 2005 rate case, which was the first major rate case heard after passage of the 6-month rule in Title 17 § 284.

Q: WHY IS AN ADJUSTMENT TO THE COMPANY'S REQUESTED LEVEL REQUIRED?

A: The actual updated balances for the 6-month cut off were not available when the Company filed its Application. As a result, the amounts the Company used in its Application include *estimated* projected balances as of the 6-month cutoff date. In response to data requests, the Company has provided the actual account balances.[6] These adjustments are required to reflect actual account balances, rather than the Company's estimated balances as of the 6-month cutoff date.

Q: IS YOUR PROPOSED TREATMENT CONSISTENT WITH PRIOR COMMISSION DECISIONS, OKLAHOMA LAW AND SOUND RATEMAKING PRINCIPLES?

A: Yes. The proposed treatment satisfies the statutory requirement to give effect to known and measurable changes occurring within six months of test year end. The adjustments to reflect the March 31, 2024 balances are set forth below. The detailed calculations are

[6] See OG&E's response to Staff data request PUD 10-7.

1 shown at *Exhibit MG-2.1* attached to this testimony.

Table 1: Rate Base Adjustments for Six Month Update[7]

Description	Actual Balance March 31, 2022	OG&E's Requested Amount	OIEC Adjustment Increase (Decrease)	Oklahoma Jurisdictional Amount
Plant in Service	$ 15,333,506,950	$15,417,660,662	$ (84,153,712)	$ (75,981,066)
Accumulated Depr.	(5,617,977,602)	(5,622,718,608)	4,741,006	4,288,506
Future Use Plant	2,256,157	2,099,537	156,620	151,245
Fuel Inventories	126,114,901	98,020,977	28,093,924	25,674,419
ADIT	(1,219,407,521)	(1,215,890,316)	(3,517,205)	(3,177,543)
Gas in Storage	8,785,076	16,840,880	(8,055,804)	(7,362,022)
Regulatory Assets	280,089,477	220,796,384	59,293,093	52,508,416
Regulatory Liabilities	(869,571,910)	(884,705,536)	15,133,626	13,662,105
Customer Deposits	(105,589,718)	(99,885,522)	(5,704,196)	(5,131,684)
Prepayments	12,105,692	10,400,353	1,705,339	1,560,091
Materials and Supplies	231,838,575	200,241,292	31,597,283	29,076,692
Net Pension Asset	(31,423,711)	(24,364,274)	(7,059,437)	(6,200,917)
Totals	**$ 8,009,321,339**	**$7,977,090,802**	**$ 32,230,537**	**$ 29,068,242**
Total Oklahoma Revenue Requirement Impact of Six-Month Updates				**$2,812,738**

[7] See OG&E's response to Staff data request PUD 10-7_Att 2 Supp - Rate Base.

IV. OPERATING INCOME ADJUSTMENTS

IV. A. ADJUST REVENUES – UPDATE TO MARCH 31, 2024

Q: WHAT IS THE RESULT OF OG&E's UPDATED REVENUE ADJUSTMENT?

A: The adjustment to update the revenue calculation increased OG&E's jurisdictional revenue by $17,645,966.[8] This adjustment is shown on *Exhibit MG-2.2*.

IV. B. ADJUST EXPENSES – UPDATE TO MARCH 31, 2022

Q: PLEASE DESCRIBE YOUR SECOND OPERATING INCOME ADJUSTMENT.

A: A second operating income adjustment is needed to reflect operating expenses for known and measurable changes occurring by March 31, 2024, as calculated by OG&E. Table 2 below summarizes these adjustments, which are also set forth on *Exhibit MG-2.2.*

[8] See OG&E's response to Staff data request PUD 10-7-Supp1_Att 4_Supp-WP H-2 Revenues.

Description	OG&E's Requested Amounts	Updated Amounts March 31, 2024	OIEC Adjustment Increase (Decrease)	Oklahoma Jurisdictional Amount
Ad Valorem Taxes	$95,066,383	$95,154,022	$(87,639)	$(79,413)
Pension and Post-Retirement Benefits	15,525,181	16,151,695	(626,514)	(550,829)
Updated Payroll	160,869,717	156,777,642	4,092,075	3,597,739
Payroll Taxes	358,288	27,215	331,073	290,810
Incentives and Other Compensation	18,006,155	19,520,222	(1,514,067)	(1,331,163)
Bad Debt Expense	2,111,415	2,086,662	24,753	24,753
Depreciation Expense	549,237,454	556,289,611	(7,052,157)	(6,410,587)
SPP Expenses	5,511,752	5,461,446	50,306	44,229
Pension Regulatory Asset Amortization	10,219,288	8,688,579	1,530,709	1,530,709
Long-Term Incentives	9,769,894	9,836,782	(66,889)	(58,808)
Other Amortization	354,630	352,362	2,268	2,062
Rate Case Expense	315,434	478,987	(163,553)	(163,553)
Vegetation Management Distribution	50,947,826	52,592,180	(1,644,354)	(1,644,354)
Vegetation Management Transmission	7,276,936	9,769,118	(2,492,182)	(2,191,119)
Total Expense Update				**$6,939,524**
Total Oklahoma Revenue Requirement Impact of Six-Month Updates				**$6,939,524**

Table 2: Expense Adjustments for Six Month Update[9]

[9] See OG&E's response to PUD 10-7-Supp1_Att 3_Supp - Expenses.

IV. C. ANNUAL INCENTIVE COMPENSATION EXPENSE

Q: PLEASE PROVIDE A BRIEF DESCRIPTION OF OG&E'S ANNUAL INCENTIVE COMPENSATION PLAN.

A: The Company provides annual incentive compensation plans for the employees of OG&E and for the employees of the holding company, OGE Energy Corp. In total, the Company seeks to include a total of $15,412,020 in rates for its updated annual incentive compensation expense, which is comprised of $10,422,220 for the utility and $4,989,799 for the holding company.[10] OG&E included one hundred percent of its short-term and long-term incentive plan expenses in the revenue requirement based on a four-year average of those costs.[11] OG&E argued that as an alternative it should recover a minimum of seventy percent of its short-term incentives since thirty percent of the metrics are based on Company earnings and that at least 35% of the long-term incentives should be allowed since that is the level of guaranteed annual payout.[12] The Company argues that it must provide market based compensation that includes incentives. However, the Company did not present a market compensation study and did not provide a witness supporting the results of those studies.

Q: DO YOU AGREE THAT ONLY THIRTY PERCENT OF THE STI AWARDS ARE RELATED TO COMPANY EARNINGS?

---

[10] See OG&E W/P H-2-23u.

[11] See Direct Testimony of Jason J. Thenmadathil, p. 9, lines 5-7 and p. 14, lines 11-13.

[12] See Direct Testimony of Kimber L. Shoop, p. 13, lines 21-29.

A: No. The actual test year awards based on company earnings was 50% of the total STI awards.[13]

Q: WHAT ADJUSTMENT ARE YOU PROPOSING WITH RESPECT TO THE COMPANY'S ANNUAL INCENTIVE PLAN?

A: I propose to exclude 50% of the annual incentive plan expense. This is consistent with the longstanding treatment of annual incentive compensation plans by this Commission. The recommended sharing of costs between the Company and its customers reflects the fact that OG&E's incentive compensation plan metrics are designed in part to enhance the financial performance of the Company. As a general rule, regulatory commissions typically exclude a portion of utilities' incentive compensation expense because incentive compensation plans typically benefit shareholders as well as ratepayers. This is particularly true for incentive compensation plans associated with financial performance.[14]

---

[13] See OIEC 02-02_Att1.xlsx, attached hereto as Exhibit MG-3, which shows STI expense. The pro forma STI-EPS totals $8,233,330 or 49.96&% of the total pro forma STI of $16,479,091. ($5,117,684 + $3,115,646) / ($11,060,017 + $5,419,074) = 0.4996.

[14] The following list of cases shows that incentives are disallowed in many states as a matter of policy. See, *U.S. West Communications, Inc. v. Public Service Comm'n*, 901 P.2d 270, 276-77 (Utah 1995); *Central Illinois Public Service Company Proposed General Increase In Natural Gas Rates*, Docket No. 02-0798 (Cons.), 2003 Ill. PUC LEXIS 824, p. 115 (Illinois Commerce Comm'n 2003); *Application of Wisconsin Power and Light Company as an Electric, Natural Gas and Water Utility for Authority to Change Electric, Natural Gas, and Water Rates*, Docket No. 6680-UR-113, 2003 Wisc. PUC LEXIS 822, pp. 40-41 (Wisconsin Public Service Comm'n 2003); *Petition of Northern States Power Company's Gas Utility for Authority to Change its Schedule of Gas Rates for Retail Customers Within the State of Minnesota*, 146 P.U.R.4th 1, pp. 40-43 (Minnesota Public Util. Comm'n 1993); *Application of Minnegasco, a Division of NorAm Energy Corp., for Authority to Increase its Natural Gas Rates in Minnesota*, 170 P.U.R.4th 193, pp. 69-77 (Minnesota Public Util. Comm'n 1996).

Q: WHAT IS THE GENERAL RATIONALE FOR EXCLUDING INCENTIVE COMPENSATION TIED TO FINANCIAL PERFORMANCE?

A: In most jurisdictions, the cost of incentive plans which are tied to financial performance measures are excluded for ratemaking purposes. When the costs associated with these plans are excluded, the rationale used by the regulators is generally based on one or more of the following reasons:

(1) **Payment is uncertain.** Incentive compensation payout is in the discretion of utility company management. Often, payment of incentive compensation is conditioned upon meeting some predetermined financial goal such as achieving a certain increase in earnings, reaching a targeted stock price or meeting budget objectives. If the predetermined goals are not met, the incentive payment is not made, or payment is made at some lesser amount. Because incentive compensation is discretionary, one cannot know from year to year what the level of the payment may be or whether the payment will be made at all. It is generally considered inappropriate to set rates to recover a tentative level of expense.[15]

(2) **Many of the factors that significantly impact earnings are outside the control of most company employees and have limited value to customers.** For example, an unusually hot summer can easily trigger an incentive payment based on company earnings for an electric utility, as a cold winter can for a gas utility. Obviously, weather conditions are outside the control of utility employees and customers receive no benefit from the higher utility bills that result from an unusually hot or cold weather. Similarly, company earnings may increase, thus triggering incentive payments, as a result of customer growth, which commonly occurs without significant influence from company personnel. In fairness, since shareholders enjoy the benefits of customer growth between rate cases, shareholders should also bear the cost of any incentive payments such growth may trigger. Finally, utility earnings may increase substantially if the utility is able to successfully argue for a higher ROE in a rate case

[15] PSO's experience with its 2008 rate case proceeding before the OCC, Cause No. PUD 08-144, is a good example of this problem. In 2009, AEP's below target EPS reduced the funding available for incentive compensation payments by 76.9%. Although in the Company's 2008 rate case, the Commission had included more than $4 million in rates for incentives, the Company chose not to use all of that money to pay incentives but instead retained some of those funds for its shareholders to help bolster the Company's lower earnings that year.

proceeding. Utility efforts to maximize ROE in a rate proceeding, however, have little to do with improving overall employee performance across the company. If utility employees gear their efforts toward securing an *unreasonably* high ROE in a rate proceeding, the incentive mechanism actually would work to the detriment of the utility customers.

(3) **Earnings-based incentive plans can discourage conservation.** When incentive payments are based on earnings, employees may not support conservation programs designed to reduce usage if they perceive these programs could adversely impact incentive payment levels. To the extent that earnings-based incentive plans discourage conservation and demand-side management programs, these plans do not serve the public interest. The growing focus on energy efficiency at both the national and state level renders this point especially important.

(4) **The utility and its stockholders assume none of the financial risks associated with incentive payments.** Ratepayers assume the risk that the utility will instead retain the amounts collected through rates for incentive payments whenever targeted increases are not reached. Employees assume the risk that the incentive payments will not be made in a given year. The utility and its stockholders, however, assume no risk associated with these payments. Instead, the company's only responsibility is to decide who gets the money, the stockholders or the employees.[16]

(5) **Incentive payments based on financial performance measures should be made out of increased earnings.** Whatever the targets or goals may be that trigger an incentive payment, when the plan is based in whole or in part on financial performance measures the company always obtains a financial benefit from achieving these objectives. This financial benefit should provide ample funds from which to make the payment. If not, the incentive plan was poorly conceived in the first place. As such, employees should be compensated out of the increased earnings, and not through rates.

(6) **Incentive payments embedded in rates shelter the utility against the risk of earnings erosion through attrition.** When utilities are allowed to embed amounts for incentive payments in rates, that money is available to the utility not only to pay the incentive payment when financial performance goals are met but also to supplement earnings in those years when the company does not perform well. In those years when financial performance measures are met, the increased earnings of the company provide ample additional funds from which to make the incentive payments

[16] *See e.g., In re Public Service Co. of Okla.*, Cause No. PUD 200800144, (Okla. Corp. Comm'n).

> to employees, and the incentive payment amount embedded in rates is not needed. In those years when financial performance measures are not met and the incentive payments are not made, the amount embedded in rates for incentive payments acts as a financial hedge to shelter the poor financial performance of the company.

Q: IN YOUR EXPERIENCE, WHEN REGULATORS EXCLUDE THE PORTION OF A UTILITY'S INCENTIVE PLAN TIED TO FINANCIAL PERFORMANCE MEASURES, DOES THE UTILITY STOP OFFERING INCENTIVE COMPENSATION TO HELP ACHIEVE ITS FINANCIAL GOALS?

No. Even though regulators generally disallow incentive compensation tied to financial performance for ratemaking purposes, utilities continue to include financial performance as a key component of their plans. In my opinion, utilities continue to tie incentive payments to financial performance because by doing so they achieve the primary objective of the incentive plans: to increase corporate earnings and, thereby, earnings per share (EPS). However, since the utility retains the increased earnings these plans help achieve, payments for these plans should be made from a portion of these increased earnings and should not be subsidized by ratepayers.

Q: WHY IS THE DISTINCTION BETWEEN FINANCIAL PERFORMANCE MEASURES AND OPERATIONAL MEASURES IMPORTANT FOR INCENTIVE COMPENSATION ANALYSIS?

A: When incentive compensation payments are based on financial performance measures, the compensation agreement between shareholders and employees could be loosely stated in this manner: "if you will help increase shareholder earnings, we will pay you a bonus."

The intended beneficiaries to this agreement are the shareholders and the employees. Ratepayers have no stake in this agreement; therefore, they should bear none of the costs that result from such an agreement. If, instead, the agreement was stated in this manner: "if you will help increase reliability and quality of service to the customers, we will pay you a bonus," then, ratepayers would have a stake in the agreement and could share in a portion of the costs. However, so long as some portion of the incentive plan is designed to increase earnings, a portion of the plan should be funded out of the increased earnings the plan helps produce.

Q: HOW HAS THIS COMMISSION ADDRESSED RECOVERY OF INCENTIVE COMPENSATION IN PAST ORDERS?

A: The Oklahoma Commission has consistently disallowed financially based incentive pay for more than 25 years. In OG&E's 2005 litigated rate case, PUD 200500151, the Commission's final order **disallowed 60%** of OG&E's TeamShare expense.

> **Incentive Compensation.** OG&E presents $9,308,619 in expense for incentive compensation under the "TeamShare" plan. The Referee does not accept the full amount as proposed by the company but reduces the expense by $5,582,192.[17]

In OG&E's 2015 litigated rate case, PUD 201500151, OG&E's requested short term incentive compensation costs were reduced by 50%.[18]

---

[17] *In re Oklahoma Gas and Electric Co.,* Cause No. PUD 200500151, (Okla. Corp. Comm'n). Order No. 516261, p. 99 (Dec. 12, 2005).

[18] *In re Oklahoma Gas and Electric Co.,* Cause No. PUD 201500273, (Okla. Corp. Comm'n) Order No. 662059, pp. 6-7 (Mar. 20, 2017).

Q: HOW HAS THE COMMISSION ADDRESSED RECOVERY OF INCENTIVE COMPENSATION RELATED TO OTHER OKLAHOMA UTILITIES?

A: The Commission has consistently disallowed recovery of a portion of incentive compensation costs where utilities' incentive compensation plans are tied in part to the attainment of financial goals. In its order in PUD 91-1190, at page 145, the Commission addressed ONG's Gainshare Plan and the Executive Stock Performance Plan and disallowed the entire cost of both plans, finding that the incentive plans were designed to increase corporate earnings. In PUD 04-610, the ALJ recommended, and the Commission ordered, the disallowance of the entire cost of ONG's incentive compensation payments. The ALJ made the following recommendation:

> The ALJ finds that incentive compensation should be disallowed from inclusion in the rates paid by Oklahoma Natural's ratepayers. Incentive compensation is typically tied to the attainment of certain financial goals, efficiencies in operations or similar criteria, which create additional income to the company, cost savings or other financial benefit. The ALJ concurs with the argument of the Staff and AG that a well-designed incentive compensation plan will generate resources from which to pay the incentives to the employees. Therefore, the ALJ recommends adoption of the Staff's recommended disallowance in the amount of $2,671,985.

Subsequently, in PSO's 2006 rate case, PUD 200600285, the Commission disallowed 50% of AEP/PSO's annual incentive expense.

> The Commission finds that 50% of PSO's incentive costs should be excluded for ratemaking purposes, as recommended by OIEC. The amount of those incentive costs is $3,454,217 as referenced in HE-17 at page 16 of 24, OIEC Adjustment No. H-4.[19]

[19] *In re Pub. Serv. Co. of Okla.*, Cause No. PUD 200600285, (Okla. Corp. Comm'n) Final Order No. 545168, p. 145 (Oct. 9, 2007).

In PSO's 2008 rate case, PUD 200800144, the Commission again disallowed 50% of AEP/PSO's annual incentive plan.

> The Commission finds that although there is no evidence to conclude PSO's and AEPSC's overall salary levels are excessive, that the recommendation of the AG and Staff to disallow 50% of PSO's and AEPSC's incentive compensation should be adopted. Incentive compensation benefits both shareholders and ratepayers equally, by encouraging the attainment of goals that provide good customer service and increase the earnings of the shareholders. [20]

In PSO's 2015 rate case, Cause No. PUD 201500208, the Commission's final order states the following with respect to incentive compensation:

> The ALJ adopts Staff and AG's recommendation that an adjustment be made to remove the portion of the Annual Incentive Program costs related to financial performance measures. In many jurisdictions, including Oklahoma, the cost of incentive plans tied to financial performance measures generally are excluded for ratemaking purposes for several reasons. *(See* Garrett Responsive Testimony, pp. *23-33).* The evidence in this case established that the Company's incentive compensation is funded primarily based on the Company's financial performance *(*75% earnings per share)
> The result of the above disallowances reduces the recoverable expenses of PSO by . . . $4,369,947 for short term incentive expense, which is 50% of the $8,739,895 requested by *PSO.*[21]

Finally, in PSO's 2017 rate case, the Commission again disallowed 50% of PSO's short-term incentive plan. At page 24 of the final order, the Commission states:

> 82. THE COMMISSION FURTHER FINDS that the annual incentive plan expenses be reduced by $4,863,954 to exclude 50 percent of the target level of this expense from the revenue requirement.[22]

[20] *In re Pub. Serv. Co. of Okla.*, Cause No. PUD 200800144, (Okla. Corp. Comm'n). Final Order No. 564437, p. 21 (Jan. 14, 2009).

[21] *In re Pub. Serv. Co. of Okla.*, Cause No. PUD 201500208, (Okla. Corp. Comm'n). Final Order No. 657877, pp. 161-62 (Nov. 10, 2016).

[22] *In re Pub. Serv. Co. of Okla.*, Cause No. PUD 201700151, (Okla. Corp. Comm'n). Order No. 672864, p. 24 (Jan. 31, 2018).

Q: DOES OG&E DISAGREE WITH THE COMMISSION'S LONGSTANDING TREATMENT OF DISALLOWING 50% OF ITS SHORT-TERM INCENTIVE COMPENSATION FROM RATES?

A: Yes. OG&E's witness, Kimber L. Shoop, states that the Company does not agree with the Commission's rationale for disallowing any portion of incentive compensation from rates.[23] He also claims that the Commission's historical disallowance of 50% of the short-term incentive compensation is not consistent with the proportional amount of financial metrics in the Company's plans. He states:

> Even if the Commission were to exclude financial metrics from the calculation of short-term incentives included in rates, which would mean that OG&E should be entitled to reflect 70 percent (not 50 percent) of short-term incentive costs in rates. The target breakdown for most OG&E members between operational and financial metrics is approximately 70 percent and 30 percent, respectively. That 70 percent of the short-term incentive metrics can be broken down into the following categories: O&M, customer satisfaction, safety, and environmental operations.[24]

In other words, Mr. Shoop contends that the financial metrics in OG&E's incentive compensation plans comprise less than 50% of its plans for most of OG&E's employees.

> OG&E believes that this Commission should at a minimum allow OG&E to include 70 percent short-term incentive compensation in rates because that percentage of short-term incentive compensation is based on operational metrics like O&M, customer satisfaction, safety and environmental operations.[25]

---

[23] *See* Direct Testimony of Kimber L. Shoop, p. 11, lines 1-15.

[24] *Id.*, p.12, ln. 27—p. 13, ln. 2.

[25] *Id.*, p.13, lines 22-26.

Q: DO YOU AGREE WITH MR. SHOOP'S CONCLUSION THAT OG&E's INCENTIVE PLANS INCLUDE 70% NON-FINANCIAL PERFORMANCE METRICS?

A: No. The Company's incentive compensation plans continue to heavily emphasize financial performance goals more than they emphasize customer service, safety and other operational goals. This fact is demonstrated in the Company's response to Data Request OIEC 02-02.[26] OG&E's short-term incentive compensation payments consists of five metrics which OG&E identified as: (1) *Earnings per Share*, (2) *Operation and Maintenance Expense,* (3) *Safety,* (4) *Customer Satisfaction,* and (5) *Environmental.* For the test year, the payout associated with the *Earnings per Share and Operation and Maintenance Expenses* far outweighs the payout associated with the other measures as shown below:

Test Year Results[27]

• Earnings per Share	50.0%
• Operation and Maintenance Expenses	11.5%
• Safety	6.8%
• Customer Satisfaction	17.6%
• Environmental	14.1%

OG&E's discovery response shows that in the test-year, of the $16.0 million total payout for the year, $9.8 million is related to financial measures, while $6.1 million is related to customer, safety, and environmental goals. It is noteworthy, too, that of the total payout for the year, only 17.6% relates to *Customer Satisfaction* measures.

[26] *See* OG&E response to data request AG-1-15.

[27] *See* OIEC 02-02 Attachment 1, attached hereto as Exhibit MG-3.

Based upon this evidence, as shown in the table above the Commission would be justified in disallowing ***more than*** 50% of the Company's short-term incentive compensation plan costs. If the Commission were to strictly follow the financial performance rule, it could disallow 61.5% of OG&E's plan costs based on the relative weight OG&E's plans place upon financial performance metrics.28 Mr. Shoop's claim that 70% of the Company's plan is based on operational metrics is flawed because he characterizes '*O&M Expense*' as a non-financial metric. While it is true that some financial metrics, such as cost control, may benefit both shareholders and ratepayers to some extent, these metrics clearly benefit shareholders more because shareholders retain the savings that these measures produce between rate cases. The Commission has long followed a 50/50 sharing approach in recognition that both shareholders and customers derive benefits from the various components of the Company's plans. Therefore, it is appropriate that plan costs should be shared equally between shareholders and customers.

Q: PLEASE ADDRESS OG&E'S ASSERTION THAT THE COST OF INCENTIVE PLANS SHOULD BE INCLUDED IN RATES BECAUSE THEY ARE PART OF A TOTAL COMPENSATION PACKAGE THAT IS COMPARABLE WITH THE COMPENSATION PAID BY OTHER UTILITIES AND ARE NEEDED TO ATTRACT AND RETAIN QUALIFIED PERSONNEL.

[28] Earnings per share 50% and O&M 11.5%.

A: OG&E's rationale for including incentive pay in rates is not new: incentive pay should be included in rates because it is needed to attract and retain qualified personnel.[29] In my experience, this is the argument typically raised by OG&E and other utilities seeking to justify inclusion of incentive pay in rates. However, the argument is problematic. First, it misses the point. The question for regulators is not about what the <u>company</u> should pay; the question for regulators is what <u>ratepayers</u> should pay. The utility is free to offer whatever compensation package it wants to offer, but most commissions find that ratepayers should not pay the costs of plans designed to increase corporate earnings. Also, as stated above, because incentive pay related to financial performance is generally disallowed, most of the utilities that OG&E competes with for talent generally do not recover all of their incentive compensation in rates. Therefore, OG&E is not put at a competitive disadvantage when its incentive pay is similarly adjusted.

The other common problem with the Company's "total compensation package" argument is that when an incentive payment is based on achieving financial performance goals there is a financial benefit to the company that comes from achieving these goals. This financial benefit should provide ample additional funds from which to make the incentive payments. If not, the plan was poorly conceived. Thus, a utility is not placed at a competitive disadvantage when incentive payments tied to financial performance are not collected through rates, because the funding for these payments should come out of the additional earnings the incentive plans help achieve.

---

[29] *See* Direct Testimony of Kimber L. Shoop, p. 11, lines 11-15.

Q: DOES OG&E PROVIDE OTHER RATIONALE IN SUPPORT OF ITS REQUEST FOR FULL RECOVERY OF INCENTIVE COMPENSATION COSTS?

A: Yes. Mr. Shoop asserts that "OG&E must provide market-based compensation, which includes attractive incentive compensation similar to other electric companies."[30] This assertion overlooks the fact that in many instances electricity is provided by municipal electric providers, cooperatives, and state-run electric systems without the use of short-term incentives. So, it is inaccurate to say that incentives are *necessary* for the provision of electric service. Incentive compensation may help utilities obtain greater increases in shareholder wealth each year, but these costs are not necessary for the provision of safe and reliable electric service. Virtually all utilities have the same need to attract qualified employees, but these other utilities are <u>not</u> recovering incentive pay in rates, when that incentive pay is tied to the financial performance of the utility. The Company has raised nothing new in this case that should cause the Commission to change its long-standing precedent on this issue.

Q: ARE YOU RECOMMENDING THAT THE COMPANY ELIMINATE ITS SHORT-TERM INCENTIVES?

A: No. The question for ratemaking purposes is not whether the utility should offer short-term incentives to its employees; the question is, who should pay for them. The consensus is that financially based incentives benefit the shareholders more than they do the ratepayers, and, as a result, should be paid for by the shareholders.

---

[30] See Direct Testimony of Kimber L. Shoop, p. 11, lines 14-15.

Q: HOW DO PUBLIC UTILITY COMMISSIONS IN OTHER JURISDICTIONS TREAT INCENTIVE COMPENSATION?

A: The results of an Incentive Compensation Survey of the 24 Western States taken by the Garrett Group in 2007, and updated in 2009, 2011, 2015 and 2018, shows that a clear majority of public utility commissions in the states surveyed follow the financial-performance rule, in which incentive payments associated with financial performance are excluded from rates. While some commissions disallow incentive pay using other criteria, none of the jurisdictions surveyed allow full recovery of incentive compensation through rates as a general rule. The table below provides a summary of the survey results:

Table 3
Garrett Group, LLC 24 Western State Incentive Survey Results

Incentives Not Allowed in Rates	Financial Performance Rule Followed	Other Sharing Approach	Incentives Not at Issue
Hawaii			
	Arizona		
	Arkansas		
	California		
	Idaho		
	Kansas		
	Louisiana		
	Minnesota		
	Missouri		
	Nebraska		
	Nevada		
	New Mexico		
	North Dakota		
	Oklahoma		
	Oregon		
	South Dakota		
	Texas		
	Utah		
	Washington		
	Wyoming		
		Alaska[31]	
		Colorado[32]	
			Iowa
			Montana

1 **Q: PLEASE DISCUSS COMMISSIONS IN THE STATES SURVEYED THAT USE A**
2 **SHARING APPROACH FOR ANNUAL INCENTIVE PLANS SIMILAR TO THE**
3 **50/50 APPROACH YOU SUGGEST?**

[31] Incentive compensation has not been an issue in the past, partly because most utilities in Alaska are municipalities and COOPs. In one recent case, however, the Commission approved incentives in rates, which may turn out to be an anomaly.

[32] Colorado followed the financial performance rule in the past. In one recent case, however, the Commission approved another approach, which may turn out to be an anomaly.

A: As shown in the table above, many of the commissions in the western states surveyed use a sharing approach to allocate the benefits derived from incentives plans between shareholders and ratepayers when incentive plans contain both financial and operational measures. These jurisdictions include:

Arizona: The Arizona commission on numerous occasions has determined that the cost of annual incentive plans should be shared on a 50/50 split between shareholders and ratepayers.[33]

Arkansas: The Arkansas commission disallows 50% of Entergy's short-term plan. In Entergy's 2015 rate case, the parties settled the case, but the Arkansas Commission rejected the stipulation because it would have allowed more than 50% of the Company's incentive costs in rates.[34]

Kansas: The Kansas commission has disallowed recovery of 100% of plan costs based on financial measures and 50% for plans using a balance of financial and operational measures.[35]

Oregon: The Oregon commission has a history of disallowing 50% of operational plan costs and 75% of financial plan costs.[36]

---

[33] *See* for example, APS 2008 rate case, Decision 70360, Southwest Gas 2008 rate case, Decision 70665 and UNS Gas 2008 rate case, Decision 70011.

[34] Arkansas PSC Docket No. 13-028-U.

[35] *See e.g.,* 2012 KCPL rate case (12-KCPE-764-RTS) in which the Commission ordered a 50/50 split of the short-term plan.

[36] *See* Oregon Public Utility Commission Order Nos. 76-601, p. 13; 77-125, p.10; and 87-406, pp. 42-43.

Q: WHAT ARE YOU RECOMMENDING WITH RESPECT TO THE COMPANY'S ANNUAL INCENTIVE COMPENSATION EXPENSE?

A: Consistent with the Commission's longstanding treatment of Oklahoma's investor-owned electric utilities, I recommend a 50/50 sharing of these costs between shareholders and ratepayers. This recommendation is based on the recognition that more than 50% of the Company's incentive compensation plan goals are related to financial performance measures, while a smaller percentage relates to customer satisfaction and reliability. Because ratepayers receive at least some benefit from these customer-related goals, some portion of the plan costs can be included in rates.

Q: HOW IS YOUR ADJUSTMENT CALCULATED?

A: OIEC's adjustment is set forth below and can be seen at *Exhibit MG-2.3*.

Annual Incentive Plan Payment	$ 15,412,02
Incentive Compensation Sharing Percentage	50%
OIEC Adjustment to Annual Incentive Plans	$ 7,706,010
Payroll Tax Expense Percentage	8.09%
OIEC Adjustment Incentive Plan --Payroll Taxes	**$ 623,462**
Total STI Adjustment	**$ 8,329,472**
Oklahoma Jurisdictional STI Adjustment	**$ 7,323,245**

IV. D. LONG-TERM INCENTIVE COMPENSATION EXPENSE

Q: WHAT HAS OG&E PROPOSED WITH RESPECT TO THE RECOVERY OF LONG-TERM STOCK INCENTIVE PLAN COSTS FOR EXECUTIVES?

A: The Company is proposing to recover a four-year average level of $9,038,616 for its long-term incentive plan costs. This consists of $7,078,369 for the Holding Company and $1,960,247 for OG&E.

Q: WHAT DO YOU RECOMMEND FOR THESE COSTS?

A: I recommend, consistent with the Commission's longstanding treatment, that Long-Term Incentive Plan ("LTIP") compensation costs be excluded from rates.

Q: WHAT IS THE RATIONALE FOR EXCLUDING ALL FINANCIALLY-BASED LONG-TERM INCENTIVE COMPENSATION EXPENSE?

A: Incentive compensation payments to officers, executives and key employees of a utility are generally excluded for ratemaking purposes. Since officers of any corporation have fiduciary duties of loyalty and care to the corporation itself and not to the customers of the company, these individuals are required to put the interests of the company first. Undoubtedly, the interests of the company and the interests of the customer are not always the same, and at times, can be quite divergent. This natural divergence of interests creates a situation where not every cost associated with executive compensation is presumed to be a necessary cost of providing utility service. Most regulators exclude executive bonuses, long term incentive compensation and supplemental benefits from utility rates, understanding that these costs should be borne by the utility shareholders.

Further, long-term executive incentive plans are specifically designed to tie executive compensation to the financial performance of the company. This is done to further align the interests of the employee with those of the shareholder. Since the compensation of the employee is tied over a long period of time to the company's stock price, it motivates employees to make business decisions from the perspective of long-term shareholders. This intentional alignment of employee and shareholder interests means the costs of these plans should be borne solely by the shareholders. It would be inappropriate to require ratepayers to bear the costs of incentive plans designed to encourage employees to put the interests of the shareholders first. In fact, some utilities treat long-term executive incentive compensation costs as a below-the-line item even without a Commission order directing them to do so.

Q: WHAT IS THIS COMMISSION'S POLICY REGARDING THE RATEMAKING TREATMENT OF LONG-TERM INCENTIVE COMPENSATION?

A: The Oklahoma Commission has consistently held that financially-based long-term incentives are excluded from rates for ratemaking purposes.

Q: DID THE COMMISSION DISALLOW RECOVERY OF LONG-TERM INCENTIVES IN OG&E'S LAST FULLY LITIGATED RATE CASE?

A: Yes. In OG&E's 2015 rate case, the Oklahoma Commission found that OG&E's long-term stock-based incentives should be disallowed.[37] The Commission disallowed 100% of OG&E's long-term executive incentive plan costs. The Commission stated in its final order:

> The Commission declines to adopt the recommendation of the ALJ for recovery of twenty-five percent of long-term incentive compensation. In this cause, the Commission is not persuaded that such compensation provided benefit to ratepayers. Therefore, no recovery is given for long-term incentive compensation.[38]

Q: HAS THE COMMISSION ALSO DISALLOWED LONG-TERM INCENTIVE PLAN COSTS OF PSO?

A: Yes. The Commission has consistently disallowed 100% of PSO's long-term executive incentive plan costs. In PSO's 2006, 2008, and 2015 rate cases, the OCC found that AEP's long-term stock-based incentives should be disallowed.[39] In PSO's 2017 rate case, PUD 201700151, the OCC continued its regulatory treatment of disallowing 100% of the utility's long-term incentive costs:

> The long-term incentives are provided to highly compensated employees to align their interests and loyalty to shareholders. (Garrett Rev. Req. Resp. Test. at 40:15-41:3.) These costs are not essential to serve the ratepayer and should be excluded from rate recovery. The performance measures used in the long-term incentive program are based on achieving financial goals that benefit shareholders and thus should not be borne by ratepayers. It would be inappropriate to require ratepayers to bear the costs of incentive plans designed to encourage employees to put the interests of shareholders first. [40]

---

[37] See OCC Final Order in Cause No. PUD 201500273, p. 6.

[38] *Id.*

[39] See OCC Final Order in Cause No. PUD 200600285, at p. 145, and OCC Order No. 564437 in Cause No. PUD 200800144, at p. 21. See Final Order in Cause No. PUD 201500208.

[40] See Final Order in Cause No. PUD 201700151, at p. 24.

Q: SHOULD LONG-TERM INCENTIVE COMPENSATION BE RECOVERED IN RATES IF IT IS INCLUDED AS PART OF A "MARKET-COMPETITIVE TOTAL COMPENSATION" PLAN?

A: No. Utilities often argue that executive incentives are part of an overall compensation package that is the best practice to retain qualified personnel. They contend that their long-term incentive plans are based on benchmarking against the long-term incentive plans of peer utilities, and that since other utilities offer incentive plans to their executives, a company would run the risk of not being able to compete for key personnel if it did not offer a comparable plan.[41]

Q: DO YOU AGREE WITH THIS ARGUMENT?

A: No. When utilities, such as OG&E, compete with other utilities for qualified executives, and the executive incentive compensation plans of those other utilities are <u>not</u> being recovered through rates, OG&E is not placed in a competitive disadvantage when its executive incentive compensation is excluded as well. Since most states exclude executive incentive pay as a matter of course, OG&E would actually be given an unfair advantage if its executive plans were included in rates. The fact that other utilities offer executive incentive plans is not relevant; what is relevant is the fact that other utilities are *not recovering* the costs of these plans in rates. In an order disallowing Nevada Power's recovery of long-term incentive plan costs, the Nevada Commission articulated this

[41] See Direct Testimony of Kimer Shoop at p. 12.

important ratemaking concept as follows:

> Therefore, the Commission accepts BCP's and SNHG's recommendations to disallow recovery of expenses associated with LTIP. Both parties provide a valid argument that this type of incentive plan is mainly for the benefit of shareholders. Further, both BCP and SNHG provide examples of numerous other jurisdictions that do not allow the recovery of these costs and, <u>therefore, disallowance in this instance would not place NPC in a competitive disadvantage.</u>[42] (Emphasis added).

Q: HOW IS LONG-TERM INCENTIVE COMPENSATION COST RECOVERY TREATED BY PUBLIC UTILITY COMMISSIONS IN OTHER STATES?

A: The results of the Garrett Group Incentive Compensation Survey, discussed in the previous section of this testimony, show that most commissions in the western United States follow the general rule that incentive pay associated with financial performance is not allowed in rates. This means that the recovery of long-term, stock-based incentives in rates is <u>not allowed</u> in most states. According to the survey, public utility commissions in 20 of the 24 western states surveyed <u>exclude</u> all or virtually all long-term stock-based incentive pay, either through an outright ban on stock-based incentives or through applying the *financial performance* rule, which has the effect of excluding long-term earnings-based and stock-based awards. These states include Arizona, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Louisiana, Minnesota, Missouri, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Utah, Washington and Wyoming. In four of the states surveyed, Alaska, Iowa, Montana and Nebraska, the issue to my knowledge has not been addressed.

---

[42] *In re Nevada Power Company*, Docket No. 08-12002, (Nev. Pub. Util. Comm'n) Final Order, ¶ 549.

Q: ARE THERE OTHER REASONS WHY STOCK-BASED INCENTIVES SUCH AS OG&E'S LONG-TERM PLANS SHOULD NOT BE ALLOWED IN RATES?

A: Yes. There is no cash expense associated with stock-based incentive awards. So, if these awards are included in rates, the utility will collect cash from ratepayers to cover a cash expense that does not exist.

Q: WHY IS THERE NO CASH ASSOCIATED WITH STOCK AWARDS?

A: For stock awards, the accounting entries, both the debit and the credit, are effectively made to the same account, the capital account. Thus, when the utility awards stock-based incentives, there is no net impact on the financial position of the utility. The debit and the credit, each to the same account, effectively wash each other out. This is not true for any other recoverable expense for ratemaking purposes, where there is a cash outlay that reduces the financial position of the utility. When the restriction period expires, and the stock is actually awarded to the employee there is still no change in the financial position of the company. The only change is that the value of the stock held by the other stockholders is minutely diminished. In effect, the utility is trying to collect from ratepayers the diminution in value to its other stockholders caused by its stock awards to executives and management level employees of the Company. In other words, the utility is trying to collect cash from ratepayers for a cash expense that does not exist. This is certainly not a cost that ratepayers should pay.

Q: WHAT IS YOUR RECOMMENDATION TO ADJUST THE COMPANY'S LONG-TERM STOCK INCENTIVE PLAN COSTS?

A: As shown in *Exhibit MG-2.4,* my adjustment removes 100% of the long-term incentive plan costs in the updated operating expense, in the amount of $9,038,616, total Company.

Q: ARE THERE PAYROLL TAXES ASSOCIATED WITH OG&E'S LONG-TERM INCENTIVE PLAN?

A: Yes. The adjustment to exclude the long-term incentives reduces the payroll taxes by $731,278, total Company. The combined Oklahoma jurisdictional LTI expense adjustment, with the associated taxes is $8,589,659 as shown in *Exhibit MG-2.4.*

IV. E <u>PENSION AND POST EMPLOYMENT BENEFITS</u>

Q: WHAT IS THE COMPANY PROPOSING WITH RESPECT TO ITS RETIREMENT AND POST EMPLOYMENT BENEFIT EXPENSE?

A: OG&E is proposing to amortize the accumulated balance of $51,096,441 in the pension tracker account over a 5-year period. This results in an annual amortization of $10,219,288.

Q: DO YOU AGREE WITH THE COMPANY'S PROPOSED INCREASE IN THESE COSTS?

A: No. I recommend a 15-amortization of these costs. This is the amortization period agreed to in the settlement approved in the Company's last rate case.[43] There is no need to accelerate the amortization of deferred pension costs, especially in a case where the utility is seeking a $333M increase in rates. Moreover, since the pension tracker balance is included in rate base, the Company is financially indifferent to the recovery period. With this in mind, the Commission should be looking for every adjustment possible to reduce the Company's requested increase.

Q: WHAT DO YOU RECOMMEND?

A: I recommend that the Commission maintain its 15-year amortization of the pension tracker account. This adjustment decreases OG&E's pension tracker adjustment in the amount of $6,812,859, as set forth at Exhibit MG-2.6.

IV. F <u>SEVERANCE PAY</u>

Q. DID THE COMPANY INCLUDE SEVERANCE PAY IN ITS REVENUE REQUIREMENT?

A. Yes. The Company is seeking to recover a 4 year average severance pay level in the revenue requirement.[44] The total requested severance expense of $528,414[45] is comprised of $378,919[46] for the holding company and $149,495 for the utility. The main problem

---

[43] OG&E Rate Case No. 202100164.

[44] See Company response to AG 17-04.

[45] See WP H2.23u, line 6.

[46] See WP H2.23u, line 42.

with this request is that there was virtually no severance pay in the test year. There was no severance at the holding company level and only $23,959, at the utility level. This means the Company is seeking to recover $528,414 for a $23,959 expense. The other problem with the Company's adjustment is that severance pay is not necessary for the provision of utility service and therefore should not be a recovered expense for ratemaking purposes.

Q. WHAT IS THE PURPOSE OF SEVERANCE PAY?

A: Severance packages are typically provided as a means to ease the transition for both employer and employee. OG&E's standard practice for severance is to pay, in a lump sum, two weeks salary, per year of service, (minimum 2 weeks and maximum 26 weeks) upon return of signed separation agreement and release.[47]

Q: IS SEVERANCE PAY REQUIRED FOR THE PROVISION OF UTILITY SERVICE?

A: No. The parent company elects to provide severance pay to former employees whose employment has been terminated. As such, severance pay is not required to provide utility service to customers, either now or in the future. Moreover, severance payments are non-recurring items that should not be recovered from customers.

[47] See Company response to AG 17-01.

Q: WHAT ADJUSTMENT DO YOU PROPOSE?

A: For the reasons stated, I recommend that the Company's requested $528,414 in severance pay expense should not be included in rates. I propose an adjustment for this amount as set forth in Exhibit MG-2.7.

IV. G DIRECTORS' AND OFFICERS' LIABILITY INSURANCE

Q: WHAT AMOUNT IS THE COMPANY REQUESTING IN RATES FOR DIRECTORS AND OFFICERS (D&O) LIABILITY INSURANCE IN THIS PROCEEDING?

A: For the test year the Company was allocated $1,409,391 for Directors' and Officers' ("D&O") liability insurance.[48] The Company is seeking full recovery of its allocated share of these expenses.

Q: WHAT IS D&O LIABILITY INSURANCE?

A: D&O liability insurance generally protects the assets of a company's directors and officers from the financial impact of litigation that results from their actions and decisions taken on the corporation's behalf. D&O liability insurance also neutralizes the impact of the OG&E's board and senior leadership's decisions and actions on shareholders.[49]

[48] Company response to OIEC 02-16.

[49] Martin M. Boyer, *Directors' and Officers' Insurance and Shareholder Protection*, (Mar. 2005), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=886504.

Q: IF AN OFFICER OF OGE WAS FOUND NEGLIGENT IN THE INJURY OF ANOTHER PARTY, WOULD IT BE APPROPRIATE TO RECOVER THOSE COSTS FROM RATEPAYERS?

A: No. The costs of a director's or officer's negligent acts is not a necessary cost of providing utility service. Moreover, since directors and officers have a fiduciary duty to put the interests of shareholders first, some of the costs of their compensation and benefits should be paid by shareholders. This would include the cost of D&O liability insurance.

Q: PLEASE DISCUSS THE RATEMAKING POLICY REASONS FOR RECOMMENDING THE SHARING OF D&O LIABILITY INSURANCE COSTS.

A: The D&O liability insurance is in place to protect not only the directors and officers of the Company, but ultimately, the shareholders. Ratepayers should not be expected to bear the full amount of BOD compensation and expenses, including D&O liability insurance, because officers and directors have legal, fiduciary duties of loyalty and care to the corporation itself and not to its customers. The duty of care and duty of loyalty require that corporate officers put the interests of the Company first. Undoubtedly, the interests of the Company and the interests of customers are not always the same, and at times, can be quite divergent. This natural divergence of interests creates a situation where not every compensation cost is presumed to be a necessary cost of providing utility service. A 50/50 allocation between shareholders and ratepayers is appropriate because both groups benefit from the Company holding D&O liability insurance.

Q: IS THERE AN EXAMPLE OF A RECENT CASE THAT ADDRESSES WHETHER A SHARING OF D&O LIABILITY INSURANCE BETWEEN SHAREHOLDERS AND CUSTOMERS IS APPROPRIATE?

A: Yes. The Texas Railroad Commission recently excluded 50% of Texas Gas System's D&O liability insurance expense in Docket No. 9896 based on a finding that both shareholders and ratepayers benefit.

> It is reasonable to include 50 percent of TGS's requested amounts for … Directors' and Officers' Liability Insurance ... because both shareholders and ratepayers benefit.[50]

Q: ARE YOU AWARE OF REGULATORY COMMISSIONS IN OTHER JURISDICTIONS THAT REQUIRE SHARING OF D&O LIABILITY INSURANCE COSTS?

A: Yes. I am aware that regulatory commissions in Arkansas, California, Connecticut, Nevada, New Mexico, Florida, and New York have required the sharing of these costs, as discussed below:

Arkansas The Arkansas Public Service Commission ("APSC") has for many years required a 50/50 sharing of these costs between shareholders and ratepayers. In the 2004 rate case of CenterPoint Energy/Arkla, the APSC found that because shareholders receive

---

[50] In re Texas Gas Services, Tex. Railroad Commission, Docket No. 9896, Final Order, OS-22-00009896, (Jan. 19, 2023) ¶ 74.

the benefit of D&O liability insurance payouts, they should bear a portion of the cost of buying the insurance.[51] Similarly, in the 2006 Entergy rate case, the APSC stated:

> The Commission agrees that ratepayers, as well as shareholders, benefit from good utility management, which D&O Insurance helps secure. However, as found in prior dockets, the direct monetary benefits of D&O Insurance flow to shareholders as recipients of any payment made under these policies. That monetary protection is not enjoyed by ratepayers. The Commission therefore finds that, *because shareholders materially benefit from this insurance, the costs of D&O Insurance should be equally shared between shareholder and ratepayer*.[52]

California The California Public Utilities Commission ("CPUC") similarly ordered a 50/50 sharing of D&O liability insurance costs in a case involving Pacific Gas and Electric Company. The CPUC explained:

> We reduce PG&E's D&O insurance forecast by 50%, resulting in a $1.423 million reduction. Past Commission policy of equal sharing of cost responsibility for D&O insurance should continue for this GRC [base rate case]. In situations such as this, where a corporate service or product offers separate benefits both to ratepayers and shareholders, imposing cost sharing does not conflict with cost-of service ratemaking principles. By allowing 50% of such costs for ratepayer funding, we provide reimbursement for a reasonable level of costs attributable to D&O insurance to the extent that ratepayers benefit. It is not reasonable for ratepayers to bear all of the costs related to D&O insurance when a share of those insurance benefits flow to shareholders.[53]

---

[51] *See Application for a General Change or Modification in CenterPoint Energy Arkla, a Division of CenterPoint Energy Resources Corp. Rates, Charges and Tariffs,* Ark. Pub. Svc. Comm'n, Docket No. 04-121-U, Order No. 16, Sept. 19, 2005, pp. 39-40.

[52] *Application of Entergy Arkansas, Inc. for Approval of Changes in rates for Retail Electric Service*, Ark. Pub. Svc. Comm'n, Docket No. 06-101-U, Order No. 10, June 15, 2007, p. 70. (Emphasis added).

[53] *Application of Pacific Gas & Elec.*, Application 12-11-009, 2014 Cal. PUC LEXIS 395 (Cal. P.U.C. Aug. 14, 2014).

Connecticut In a 2014 Connecticut Light & Power rate case, the Connecticut Public Utilities Regulatory Authority ("CPURA") allowed recovery of only 25% of D&O liability insurance costs in rates. The CPURA stated:

> The OCC agreed that DOL protects the officers of the Company from lawsuits brought against them by shareholders that arise as a result of decisions that they make while performing their duties. Therefore, *the shareholders, who receive the payout, are the primary beneficiaries of this insurance. Ratepayers receive very little of the benefit and should not be responsible for all of the costs*. . . The OCC noted that the Company failed to recognize that many legitimate expenses (e.g., image building advertisements, lobbying expenses) are not recoverable. . . The Authority finds no convincing reason to deviate from its previous treatment of DOL insurance. *Consistent with the determinations in previous Decisions regarding BOD expense and DOL expense, the Authority will allow only 25% of DOL costs in rates*.[54]

Florida The Florida Public Service Commission excluded 50% of Gulf Power's D&O liability insurance expense in Docket No. 110138-EI based on a finding that customers and shareholders both benefit from D&O Liability Insurance.

> Based on the above, we find that both the shareholders and the customers receive benefits from D&O Liability Insurance and that the associated cost shall reflect this fact. As such, we find that D&O Liability Insurance expense shall be reduced by $58,133 ($59,384 system) to share the cost equally between the shareholders and the customers.[55]

Nevada The Nevada Public Utility Commission ("PUCN") has issued several orders requiring a 50/50 sharing of D&O liability insurance costs between shareholders and ratepayers. One such order was issued in a Southwest Gas rate case. The PUCN stated:

[54] *Application of the Connecticut Light and Power Co., to Amend its Rate Schedules*, Conn. Pub. Util. Reg. Authority, Docket No. 14-05-06, Order issued Dec. 17, 2014, pp. 76-77 (OCC stands for Connecticut Office of Consumer Counsel) (Emphasis added).

[55] *In re Gulf Power Co., Florida Pub. Serv. Comm'n*, Florida Pub. Serv. Comm'n, Docket No. 110138-EI, Order No. PSC-12-0179-FOF-EI, (Apr. 3, 2012) pp. 100-101.

> The Commission agrees with Staff that D&O insurance benefits both shareholders and ratepayers, and consequently, those costs should be shared. Based on the foregoing analysis, the Commission finds that a 50/50 apportionment of the cost of D&O Liability Insurance between ratepayers and SWG is just and reasonable.[56]

<u>New Mexico</u> The New Mexico Public Regulation Commission ("NMPRC") addressed the issue of D&O liability insurance cost sharing in a recent El Paso Electric rate case. The ALJ's Recommended Decision (RD) discussed why allocation of D&O liability insurance cost is consistent with balancing the interests of ratepayers and shareholders. The ALJ stated:

> What is unique about D&O insurance is that it is a cost specifically incurred for directors and officers, who have a fiduciary duty to put the interests of shareholders first. Therefore, the responsibility for the cost of D&O insurance goes to the heart of the Commission's obligation to balance the interests of shareholders and ratepayers.[57]

It is also my understanding that the regulatory commission in New York[58] has also allocated these expenses on a 50-50 basis on the determination that shareholders and customers both benefit from D&O liability insurance.

---

[56] See *Application of Southwest Gas Corporation for Authority to Increase Rates*, Pub. Util. Comm'n of Nev., Docket No. 18-05031, Modified Order, May 15, 2019, p. 152. The PUCN has followed this ruling in later cases involving SWG; *See also Application of Southwest Gas Corp. for Authority to Increase Its Retail Natural Gas Util. Serv. Rates et al.*, Docket No. 20-02023, 2020 WL 6119350, at *86 (Nev. P.U.C. Sept. 20, 2020).

[57] *Application of El Paso Electric Co. for Revision of its Retail Electric Rates,* New Mex. Pub. Reg. Comm'n, Case No. 20-00104-UT, Recommended Decision (RD) issued April 6, 2021, p. 167. The treatment of D&O liability insurance was not raised as an exception, and the NMPRC adopted, approved and accepted the ALJ's RD in its Order Adopting Recommended Decision with Modifications, issued June 23, 2021, pp. 33-34.

[58] Order Setting Electric Rates. State of New York Pub. Serv. Comm'n. Cases 08-E-0539 and 08-M-0618. (April 24, 2009), pp. 90-91.

Q: WHAT DO YOU RECOMMEND FOR THE RECOVERY OF D&O LIABILITY INSURANCE?

A: I recommend that the Commission allocate the cost of the Company's D&O liability insurance expense on a 50%-50% basis between its customers and shareholders. The adjustment to remove 50% of the D&O liability insurance expense reduces total operating expense by $704,696, with an Oklahoma jurisdictional adjustment of $619,566, as set forth in *Exhibit MG-2.8*.

IV. H <u>BOARD OF DIRECTORS' COMPENSATION AND EXPENSES</u>

Q: PLEASE DESCRIBE THE BOARD OF DIRECTORS' COMPENSATION THE COMPANY SEEKS TO RECOVER IN THIS CASE.

A: According to the Company's response to OIEC 2-17, OG&E included $1,091,250 in its revenue requirement for Board of Directors' cash compensation. OG&E also included an additional $1,120,000 for Board of Directors' equity compensation.

Q: WHAT IS THE ISSUE WITH RESPECT TO DIRECTORS' COMPENSATION AND EXPENSES?

A: Officers and directors of a corporation have a legal fiduciary duty of loyalty and a duty care to protect the interests of the corporation itself and not its customers. As such, these duties require corporate officers to put the interests of the Company first. Undoubtedly, the interests of the Company and the interests of customers are not always the same, and at times, can be quite divergent. This natural divergence of interests creates a situation where not every compensation paid to a utility's board of directors cost is presumed to be a necessary cost of providing utility service. Instead, a sharing of director compensation costs recognizes the fact that the costs of directors' fees provide a benefit to both shareholders and the ratepayers alike.

Q: DO YOU HAVE OTHER CONCERNS WITH OG&E'S BOARD OF DIRECTORS' COMPENSATION?

A: Yes. In addition to the concern that OG&E has requested that 100% of its board of directors' costs be recovered from ratepayers, I am also concerned that a portion of OG&E's directors' compensation is paid in the form of *stock awards*. As with executives and high-level managers, compensation in the form of stock awards provides undue incentives to increase shareholder earnings, rather than to balance the interests of shareholders and customers. For this reason, I recommend the BOD cash compensation and expenses be shared equally between shareholders and ratepayers, and the stock compensation be borne by the shareholders.

Q: HAVE YOU TESTIFIED IN OTHER CASES IN WHICH BOARD OF DIRECTORS' COMPENSATION COSTS HAVE BEEN ALLOCATED BETWEEN SHAREHOLDERS AND RATEPAYERS?

A: Yes. I have previously testified on the issue of board of directors' fees before the Public Utility Commission of Nevada ("PUCN") and the Washington Utilities and Transportation Commission ("WUTC"). First, in the Southwest Gas Corp. ("SWG") rate case, the

Nevada commission divided the cost of the BOD compensation equally between ratepayers and shareholders. The commission stated:

> 420. The Commission accepts Staffs proposal to disallow 50 percent of the BOD compensation costs in order to share the costs equally between ratepayers and shareholders. The Commission finds that the evidence on the record supports benefits to both ratepayers and shareholders. A competent BOD provides value to SWG through increased earning and market value, while ratepayers benefit from safe, reliable service. Accordingly, it is appropriate that the costs be shared between shareholders and ratepayers.[59]

Similarly, in the 2020 rate case of Cascade Natural Gas before the Washington commission, the customers' proposed adjustment to share board of directors' costs equally between shareholders and customers was uncontested and was accepted by the Washington commission.[60]

Q: HOW IS YOUR ADJUSTMENT CALCULATED?

A: My proposed adjustment allocates the $1,091,250 cash portion of OG&E's Board of Directors' compensation expense equally between ratepayers and shareholders, with the ratepayers share amounting to $545,625. My adjustment then removes the equity portion of OG&E Board of Directors' compensation in the amount of $1,120,000, for a total adjustment of $1,665,625 for the total Company, and $1,464,412 for the Oklahoma jurisdiction. This adjustment is set forth at *Exhibit MG-2.10*.

---

[59] *In re Southwest Gas Corp.*, Docket No. 18-05031, (Nev. Pub. Util. Comm'n) Modified Final Order, at p. 138, ¶ 420 (Feb. 15, 2019).

[60] *In re Cascade Natural Gas Corp.*, Docket No. UG-200568 (Wash. Util. and Transport. Comm'n), Order No. 5, pp. 9-10 (May 18, 2021).

IV. I INVESTOR RELATIONS EXPENSE

Q: HOW DOES OGE ENERGY CORP. DISTRIBUTE INFORMATION TO ITS SHAREHOLDERS?

A: As a publicly traded corporation, OGE Energy Corp. ("OGE") is responsive to the needs and expectations of thousands of shareholders. OGE maintains an investor relations unit to provide publicly available information in various formats to existing and potential shareholders. These practices promote transparency between OGE and the public and help the Company build and maintain a positive reputation that encourages public trust. For example, the OGE website[61] contains information which provides news releases, investor presentations, regulatory filings with state regulatory commissions as well as the U.S. Securities and Exchange Commission. An existing or potential shareholder can download documents related to OGE's corporate governance, and its Environmental, Social, and Governance ("ESG") reports. Finally, an individual may also access information of unique relevance to a shareholder, such as historical share prices, dividend history, earnings estimates and dividend dates.

Q: ARE THERE OTHER MEANS IN WHICH OGE COMMUNICATES WITH THE INVESTMENT COMMUNITY?

A: Yes. After OGE publishes its earnings results from the prior quarter, it hosts "Quarterly Earnings & Business Update" conference calls to provide a summary of the prior quarter's

[61] https://www.ogeenergy.com/

earnings results as well as to respond to questions regarding how specific actions or decisions may impact its market value.

Q: WHAT COSTS DID OGE ALLOCATE TO THE COMPANY FOR INVESTOR RELATIONS EXPENSES?

A: OGE allocated $842,648 to the Company during the test year to maintain these communication channels with its existing and potential shareholders.[62]

Q: HOW DO SHAREHOLDERS BENEFIT FROM INVESTOR RELATIONS EXPENSES?

A: When global capital markets have access to timely, relevant, and accurate financial and operational data, it allows the underlying value of OGE to be more closely reflected in its market capitalization. Existing and potential shareholders can then make better informed decisions regarding their OGE share ownership.

Q: IS INVESTOR RELATIONS EXPENSE A NECESSARY AND REASONABLE COST TO PROVIDE ELECTRIC UTILITY SERVICE?

A: No. The parent company, OGE, is the party responsible for communicating timely, relevant, and accurate financial and operational data regarding all of its subsidiaries to the global capital markets. As evidenced by the hundreds of local gas and electric utilities nationwide owned by cities, counties, and tribal nations which do not maintain an investor

[62] See Company response to OIEC 02-23_Att1, cell B-11.

relations function, these expenses are not a necessary and required cost for the provision of utility service.

Q: WHAT IS THE RECOMMENDED REGULATORY TREATMENT FOR THE COMPANY'S ALLOCATED INVESTOR RELATIONS EXPENSES?

A: For reasons listed previously, I recommend that the Commission disallow 50 percent of these investor relations expenses. These expenses should not be recovered exclusively from the Company's customers because the responsibility to communicate with the global capital markets ultimately falls upon the parent company, OGE, not the utility company or its customers. As shown in *Exhibit MG-2.9*, I am proposing a reduction in the amount of $370,427 for the Company's operating expenses to account for this disallowance for investor relations expenses.

IV. J <u>DUES AND MEMBERSHIPS EXPENSE</u>

Q. SHOULD THE COMPANY RECOVER 100% OF THE EXPENSES ASSOCIATED WITH ITS MEMBERSHIP DUES TO INDUSTRY ASSOCIATIONS?

A. No. Industry associations provide services to their members and typically provide advocacy for their members' private interests as well as advocacy related to the public interest. Because industry associations benefit both shareholders and ratepayers, I recommend sharing these expenses equally. Unless the Company can demonstrate that its request for recovery of industry associations' membership dues is adjusted to remove the specific amount membership costs allocable to its members' private interests, the Commission should allocate the costs 50% - 50% between shareholders and ratepayers.

As shown on *Exhibit MG-2.11*, this results in in a total adjustment of $728,408, and $640,414 to the Oklahoma jurisdiction during the test year.

Q: HAVE OTHER STATE PUBLIC UTILITY COMMISSIONS DISALLOWED INDUSTRY ASSOCIATION DUES ASSOCIATED WITH ADVOCACY ACTIVITIES?

A: Yes. Kentucky,[63] Minnesota,[64] and California[65] have disallowed all or part of a utility's trade or industry association dues expenses because the utility failed to demonstrate that such expenses were required or necessary for the provision of utility service. Although Michigan did allow for recovery for these expenses, that commission reiterated "the need to continually justify that [membership] fees are truly required and/or are in the interests of ratepayers," and "of its continuing obligation to identify, describe, and explain projected costs associated with membership fees in future rate cases."[66]

---

[63] Application of Kentucky Utilities Company for an Adjustment of Its Electric Rates, Case No. 2020-00349, Order at 28 (Ky. Pub. Serv. Comm'n June 30, 2021) (KYPSC KU Order); Application of Louisville Gas and Electric Company for an Adjustment of its Electric and Gas Rates, Case No. 2020-00350, Order at 30.

[64] In the Matter of the Application of Otter Tail Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota, Docket No. E-017/GR-20-719, Findings of Fact, Conclusions, and Order (Minn. Pub. Util. Comm'n Feb. 1, 2022).

[65] Application of Southern California Edison Company (U338E) for Authority to Increase its Authorized Revenues for Electric Service in 2021, among other things, and to Reflect that Increase in Rates, Application 19-08-013, Decision on Test Year 2021 General Rate Case for Southern California Edison Company, Decision 21-08-036 (Cal. Pub. Util. Comm'n Aug. 20, 2021).

[66] In the Matter of the Application of DTE Electric Company for Authority to Increase Its Rates, Amend Its Rate Schedules and Rules Governing the Distribution and Supply of Electric Energy, and for Miscellaneous Accounting Authority, Case No. U-20561, Order at 200 (Mich. Pub. Util. Comm'n May 8, 2020).

Q: HAS THERE BEEN STATE LEGISLATION ENACTED THAT PROHIBITS THE RECOVERY OF TRADE OR INDUSTRY ASSOCIATIONS' DUES?

A: Yes. Colorado,[67] Connecticut,[68] New York,[69] and Maine[70] have each enacted legislation that prohibits its jurisdictional utilities from recovering the expenses for trade or industry association dues from their retail customers.

Q: HOW HAS THIS COMMISSION RULED ON THIS ISSUE IN THE PAST?

A: In OG&E's last litigated rate case (PUD 201500273), the Commission accepted Staff's recommendation to reduce dues and donations expense by 50% so that the utility and customers would equally share this expense.[71]

Q: WHAT IS AN APPROPRIATE ALLOCATION OF INDUSTRY ASSOCIATION DUES?

A: A fair and reasonable ratemaking approach is to share these costs equally between shareholders and ratepayers, resulting in an adjustment of $640,414 as set forth in *Exhibit MG-2-11*.

---

[67] Colorado Revised Statutes 40-3-114(2)(g).

[68] Connecticut Statutes §16-243p(b)(3).

[69] New York Statutes § 334-114-a

[70] 35-A MRSA §302(2)(B).

[71] See Case No. PUD 201500273, Order No. 662059 issued on Mar. 20, 2017, at 52.

V. AD VALOREM TAXES

Q: PLEASE DISCUSS THE AD VALOREM TAX ADJUSTMENTS PROPOSED BY OG&E.

A: The Company adjusted its ad valorem taxes based on a ratio of its 2023 ad valorem taxes to its plant in service, materials and supplies inventories, fuel inventories, and construction work in progress. The Company then applied this ratio to pro forma balances of plant in service (excluding construction work in progress) and inventories. The Company's adjustment increased its total company ad valorem tax expense from $86,154,188 to $95,066,383, an increase of $8,912,195 in total and $8,075,661 to the Oklahoma jurisdiction.

Q: DO YOU AGREE WITH THE COMPANY'S AD VALOREM TAX ADJUSTMENT?

A: No. The Company included gross plant in service instead of the net plant investment in the annualization calculation. The plant in service amount should be reduced for accumulated depreciation because accumulated depreciation is an important component considered in the assessment of OG&E's property values. Also, the Company overestimated its Plant in Service at 3-31-24, the 6-month update. As a result, I recommend that the ad valorem tax expense should not be based on estimated gross plant expense as the Company has done, but instead should be based on actual net Plant in Service as of 3-31-24.

Q: WHAT ADJUSTMENT DO YOU RECOMMEND TO AD VALOREM TAXES?

A: I recommend that the jurisdictional ad valorem tax expense be reduced by $8,075,661. This adjustment is set forth in *Exhibit MG-2.5*.

VI. <u>OG&E'S CAPITAL STRUCTURE</u>

Q: WHAT IS THE ISSUE WITH RESPECT TO THE COMPANY'S CAPITAL STRUCTURE?

A: OG&E's equity to debt ratio is extremely high. The capital structure is currently comprised of 53.5% equity, which is substantially higher than the 44.8% level recommended by OIEC witness David Garrett.

Q: HAS THIS COMMISSION ADDRESSED THIS ISSUE BEFORE?

A: Yes. In OG&E's last litigated rate case, Cause No. PUD 201500273, the Commission admonished OG&E for maintaining a capital structure too rich in equity. The Commission stated:

> Despite accepting the recommendation of the ALJ, ***<u>the Commission is concerned with OG&E's current equity to debt ratio, which is not in line</u>*** with averages of other utilities. OG&E should further evaluate adjusting its equity to debt ratio to ***<u>maximize the benefits of lower cost debt</u>***, similar to that of other utilities, by its next base rate proceeding. The Commission will be closely reviewing OG&E's weighted average cost of capital in a future base rate proceeding and ***<u>is not opposed to considering utilizing a</u>***

> ***hypothetical capital structure for OG&E*** if sufficiently persuaded based upon the evidence presented in that case.[72]

OG&E's equity level in the 2015 rate case was 53.31, about the same as it is here.[73] In the years after the Commission's order in that case, OG&E did not made adjustments to address the Commission's concerns, nor did it bring its equity to debt ratio down to a more reasonable, market-based level. Because OG&E has failed to maximize the benefits of lower cost debt, the Commission should utilize a hypothetical capital structure for OG&E, based on the evidence presented in this case, to ensure fair and reasonable rates.

Q: HAS THE COMMISSION PREVIOUSLY ISSUED ORDERS THAT REQUIRE A LOWER EQUITY LEVEL?

A: Yes. In OG&E's application to form a holding company, the Company committed to maintaining a balanced capital structure. The Holding Company order contained the following language:

> 6. OG&E agrees to abide by the principles outlined in Section II.10 of the Amended Application, especially in matters affecting payment of dividends to the Holding Company and maintaining a balanced capital structure.[74] (Emphasis added).

---

[72] *In re Oklahoma Gas & Electric Co.*, Cause No. PUD 201500273, (Okla. Corp. Comm'n), Final Order No. 662059 at pp. 5-6 (Feb. 2, 2017) (Emphasis added).

[73] *In re Oklahoma Gas & Electric Co.*, Cause No. PUD 201500273, (Okla. Corp. Comm'n), Report of the Administrative Law Judge on the Full Evidentiary Hearing, p.33 (Dec. 8, 2016).

[74] *In re Oklahoma Gas & Electric Co.*, Cause No. PUD 950000148, (Okla. Corp. Comm'n), Order No. 399818, at Exhibit A, p. 2 (Mar. 1, 1996).

Q: HAS OG&E MAINTAINED A BALANCED CAPITAL STRUCTURE AS PROMISED IN ITS HOLDING COMPANY APPLICATION?

A: No. The Company's capital structure now is heavily weighted with equity and is nowhere near the balanced structure promised in the Holding Company application.

Q: IS A BALANCED STRUCTURE NECESSARILY A 50/50 CAPITAL STRUCTURE?

A: No. A balanced structure would be one that reflects the market. In this case, a balanced structure would be 44.8% equity – as that is the equity level in the proxy group used by the cost of capital witnesses in this case. Since the Commission serves as the surrogate for competition, it should set the capital structure to the level that would be required in the competitive markets, which is 44.8% equity and 55.2% debt. OG&E's actual structure of 53.5% equity is not market based and should be rejected by the Commission.

Q: WOULD THE COMMISSION BE INTERFERING WITH MANAGEMENT DISCRETION IF IT REVISED THE CAPITAL STRUCTURE FOR RATEMAKING PURPOSES TO REFLECT MARKET CONDITIONS?

A: No. The Company is free to maintain any capital structure it wishes to maintain; however, prices (rates) should be set as if the utility functions within competitive markets.

Q: WHAT IS THE IMPACT ON RATEPAYERS FROM OG&E'S EQUITY-RICH CAPITAL STRUCTURE?

A: Adjusting OG&E's capital structure to reflect 44.8% equity, as recommended by David Garrett, would save ratepayers $56.2 million per year. Thus, OG&E's equity-rich capital structure results in significant amounts of money flowing out of the local economy each year, all for the purpose of enriching OGE's shareholders.

Q: IS THERE A RISK ASSOCIATED WITH MOVING TO A 44.8% EQUITY STRUCTURE?

A: No. The Company will likely claim that a lower level of equity could cause a downgrade in its credit ratings and higher debt costs as a result. It will also likely assert that it is saving ratepayers money by maintaining lower debt costs. However, these claims simply are not true. The increase in rates from higher debt costs would be much lower than the cost of maintaining an equity-rich capital structure, as quantified above. In other words, the difference, even if there were a downgrade, would be a net savings to ratepayers. The potential tick upwards in higher debt costs would not overtake the huge savings ratepayers will experience from a decrease in high-cost equity.

Q: IS THERE OTHER EVIDENCE THAT OG&E'S EQUITY LEVEL IS ARTIFICIALLY HIGH?

A: Yes. OG&E's parent, OGE Energy, has a consolidated capital structure with an equity level of 48.31%.[75] Also, Value Line shows a consolidated capital structure for OGE Energy at 48% equity for 2023. Value Line also projects an equity level in 2024 of 48%.

---

[75] See OG&E response to AG 19-01.

Since OGE Energy has no other business operations other than the utility operations at OG&E, the parent company's consolidated capital structure should not differ significantly from the capital structure of the utility. Accordingly, OGE Energy's equity of 48.31% should be the *ceiling* for the equity level of the utility used to set rates. As a result, the equity recommendation for OG&E should be established on a market-based level of 44.8%, but in no event should the equity for the utility be set higher than the actual equity level at the parent, since the parent has no operations other than OG&E.

Q: WHAT DO YOU RECOMMEND?

A: I recommend that the Commission implement an equity ratio of 44.8% as recommended by OIEC witness David Garrett. The Commission should require the Company to utilize more debt than equity to bring its capital structure in line with market competitive levels. In the alternative, the Commission could set the equity level at 48.31%, the level at OGE Energy Corp., in moving towards the correct market-based level.

VII. ADJUSTMENTS PROPOSED BY OTHER OIEC WITNESSES

Q: PLEASE PROVIDE A LIST OF THE ISSUES SPONSORED BY THE OTHER OIEC WITNESSES.

A: The recommendations of the other OIEC witnesses are set forth below:

- **Recommendations of OIEC witness David Garrett on Cost of Capital**

  Mr. David Garrett addresses cost of capital issues. Specifically, he recommends a Return on Equity ("ROE") of 9.0% and a capital structure of 44.8% equity and 55.2% debt. The impacts of his recommendations are set forth at *Exhibit MG-2*.

- **Recommendations of OIEC witness David Garrett on Depreciation**

  Mr. David Garrett addresses the Company's depreciation study and recommends numerous adjustments to the Company's proposed depreciation rates. The impacts of his depreciation recommendations are set forth at *Exhibit MG-2.*

- **Recommendations of OIEC witness Scott Norwood**

  Mr. Norwood addresses an adjustment to the Company's coal inventory levels. He also proposes an adjustment related to OG&E's proposed vegetation management increase. The impacts of his recommendations are set forth at *Exhibit MG-2*.

VIII. CONCLUSION

Q: DO YOU HAVE ANY FURTHER COMMENTS?

A: Yes. My testimony does not address every potential issue. The fact that I do not express an opinion on a particular issue is not to be interpreted as agreement with the Company's position on that issue.

Q: DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A: Yes, it does.

CERTIFICATE OF MAILING

This is to certify that on this 26th day of April, 2024, a true and correct copy of the above and foregoing was emailed, addressed to:

Mr. Mark Argenbright
Mr. Geoffrey Rush
Public Utility Division
Oklahoma Corporation Commission
Jim Thorpe Building
2101 North Lincoln Boulevard
Oklahoma City, Oklahoma 73105
Mark.Argenbright@occ.ok.gov
Geoffrey.Rush@occ.ok.gov

Mr. Michael L. Velez
Mr. Michael S. Ryan
Mr. Justin Cullen
Mr. Jonathon Herndon
Ms. Nathasha Scott
Oklahoma Corporation Commission
P.O. Box 52000
Oklahoma City, Oklahoma 73152
michael.velez@occ.ok.gov
michael.ryan@occ.ok.gov
justin.cullen@occ.ok.gov
jonathon.herndon@occ.ok.gov
natasha.scott@occ.ok.gov
pudenergy@occ.ok.gov
Attorneys for the Public Utility Division

Mr. A. Chase Snodgrass
Ms. K. Christine Chevis
Ms. Ashley Youngblood
Utility Regulation Unit
Oklahoma Attorney General
313 NE 21st St.
Oklahoma City, OK 73105
chase.snodgrass@oag.ok.gov
christine.chevis@oag.ok.gov
ashley.youngblood@oag.ok.gov
utilityregulation@oag.ok.gov
Office of The Attorney General of Oklahoma

Mr. William L. Humes
Oklahoma Gas and Electric Company
P.O. Box 321, MC 1208
Oklahoma City, Oklahoma 73101
Humeswl@oge.com
Reginfor@oge.com
Attorney for Oklahoma Gas and Electric Company

Ms. Deborah Thompson
Mr. Kenneth A. Tillotson
Thompson Tillotson PLLC
PO Box 54632
Oklahoma City, Oklahoma 73154
deborah@ttfirm.com
kenneth@ttfirm.com
Attorneys for Oklahoma Gas and Electric Company

Mr. Jack G. Clark, Jr.
Clark, Wood & Patten, P.C.
3545 Northwest 58th Street, Suite 400
Oklahoma City, Oklahoma 73112
cclark@cswp-law.com
Attorney for OG&E Shareholders Association

Mr. Ronald E. Stakem
Cheek & Falcone, PLLC
6301 Waterford Boulevard, Suite 320
Oklahoma City, Oklahoma 73118
rstakem@cheekfalcone.com
jhenry@cheekfalcone.com
Attorney for OG&E Shareholders Association

Mr. J. David Jacobson
Jacobson & Laasch
212 E. 2nd Street
Edmond, OK 73034
Jdj8788@aol.com
Attorney for The Petroleum Alliance of Oklahoma

Mr. Adam Singer
Derryberry & Naifeh, LLP
4800 North Lincoln Boulevard
Oklahoma City, OK 73105
asinger@derryberrylaw.com
Attorney for AARP

Mr. Jeremy E. Melton
Trimble Law Group, PLLC
5510 N. Francis Ave.
Oklahoma City, OK 73118
jmelton@trimblelawgroup.com
Attorney for CMC Steel Oklahoma

Ms. Kayla D. Dupler
Attorney-Advisor
Administrative and Civil Law Division
Office of the Staff Judge Advocate
Bldg. 463 (Rm. 201)
Fort Sill, OK 73503
kayla.d.dupler.civ@army.mil
Attorney for The United States Dept. of Defense and all other Federal Executive Agencies (DOD/FEA)

Mr. J. Eric Turner
Derryberry & Naifeh, LLP
4800 North Lincoln Boulevard
Oklahoma City, OK 73105
eturner@derryberrylaw.com
Attorneys for OAEC

Mr. Rick D. Chamberlain
P.O. Box 21866
Oklahoma City, OK 73156-1866
rick@chamberlainlawoffices.com
Attorney for Walmart Inc.

Maj. Leslie R. Newton
Ashley N. George
Thomas A. Jernigan
Ebony Payton
Rafael A. Franjul
USAF
139 Barnes Dr., Ste. 1
Tyndall AFB, FL 32403-5317
leslie.newton.1@us.af.mil
ashley.george.4@us.af.mil
thomas.jernigan.3@us.af.mil
ebony.payton.ctr@us.af.mil
rafael.franjul@us.af.mil
Attorneys for Federal Executive Agencies (FEA)

Mr. Adam J. Singer
Derryberry & Naifeh, LLP
4800 N. Lincoln Blvd.
Oklahoma City, OK 73105
asinger@derryberrylaw.com
hdavis@derryberrylaw.com
Attorney for AARP

Thomas P. Schroedter