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	)	DOCKET NO. 08-103-U
RATES AND TARIFFS	)	

Direct Testimony

of

Donald R. Rowlett

on behalf of

Oklahoma Gas and Electric Company

August 29, 2008

Q. **Please state your name, by whom you are employed and business address.**

A. My name is Donald R. Rowlett. I am employed by Oklahoma Gas and Electric Company (OG&E or Company) and my business address is 321 N. Harvey, P. O. Box 321, Oklahoma City, Oklahoma 73101.

Q. **What position do you hold with OG&E?**

A. I hold the position of Director of Regulatory Policy and Compliance.

Q. **Please state your educational qualifications and employment history with OG&E.**

A. I earned a Bachelor of Science degree in Business with an accounting emphasis (1980) and a Masters in Business Administration (1992), from Oklahoma City University. In 1983, I became a Certified Public Accountant, licensed to practice in Oklahoma. Prior to joining OG&E, I was employed by Arthur Andersen & Co. as a financial consultant and audit manager. During my employment, I performed audits of financial statements in a variety of industries. Additionally, I participated in the preparation of filings with the Securities and Exchange Commission (SEC) and provided clients with guidance on the financial reporting requirements of the SEC and Generally Accepted Accounting Principles (GAAP).

Q. **What are your responsibilities as Director of Regulatory Policy and Compliance for OG&E?**

A. I am responsible for the analysis, development and communication of regulatory policy for OG&E. This includes establishing policies to be followed by the Company in the Oklahoma, Arkansas and Federal Energy Regulatory Commission ("FERC") jurisdictions and monitoring compliance with those policies throughout the Company.

Q. Please describe the system of accounting utilized in maintaining the Company's books and records.

A. OG&E maintains its financial and accounting records in conformance with the "Uniform System of Accounts for Public Utilities and Licensees", CFR Title 18, Part 101, required by the FERC and adopted by the Commission. Financial statements are prepared in accordance with generally accepted accounting principles and audited annually by an independent public accounting firm to assure these principles are applied on a consistent basis and in keeping with the prescribed system of accounts. In addition, the Commission, OCC, FERC, the Internal Revenue Service and other governmental and regulatory agencies perform periodic audits to assure compliance with their respective requirements.

Q. Please state your role in this proceeding and identify OG&E's other witnesses.

A. I serve as the overall policy witness in this proceeding, particularly with respect to the Company's need for a rate increase. In addition, several other witnesses are sponsoring testimony in support of the Company's Application. OG&E's witnesses, along with their respective roles in this proceeding, are summarized in Chart 1 on the following page.

Chart 1

WITNESS	PURPOSE OF TESTIMONY
Donald R. Rowlett	Case Policy Witness and Accounting *Pro Forma* Adjustments
Donald A. Murry, Ph.D.	Return on Equity and Capital Structure
Jesse B. Langston	Redbud Acquisition – Used and Useful Justification Customer Benefits
Bryan J. Scott	Rate Design and Revenue *Pro Forma* Adjustments
Greg A. Veitch	Cost of Service

Q. **What is the purpose of your testimony in Docket No. 08-103-U?**

A. The purpose of my testimony is to summarize the calculation of the $26,391,288 requested general rate change and explain why the increase is necessary. I will also generally discuss OG&E's acquisition of the Redbud generating facility. Finally, I sponsor the Company's financial statements and schedules included in Volume I, Sections A, B, C, D, E, and F of the Company's Application and the majority of the Company's *pro forma* adjustments.

Q. **Why is the rate increase necessary?**

A. OG&E has invested over $700 million in electric infrastructure since 2006, the update period used in the Company's most recent Arkansas rate case. Additionally, OG&E has entered into an agreement to purchase 51 percent of a 1230 MW combined cycle generating plant known as the Redbud plant for approximately $441 million during the *pro forma* test year. Lastly, like other businesses, OG&E is faced with rising costs including labor, medical costs, gasoline and diesel and other operating costs.

Q. Has the Company taken steps to hold down costs?

A. Throughout its history, and especially for the past 20 years, OG&E has worked hard to streamline its operations. Like many corporations, it has learned to do more with less. By implementing new technology and improving our processes, the Company has been able to reduce its workforce to approximately half its 1987 size. OG&E has eliminated facilities across its service territory without affecting service quality. These efficiencies have allowed the Company to maintain reliable, low cost service to our customers more economically. While the average OG&E customers' usage has increased by more than 27% in this 20-year period, the average non-fuel cost of a residential kilowatt hour in 2008 is less than it was in 1987.

Q. What has created this surge in OG&E's capital investment?

A. Customer demand for electricity continues to grow requiring new investment in utility plant. Additionally, OG&E's infrastructure continues to age. Much of the existing transmission and distribution infrastructure is at, or exceeds its design life and has to be replaced. The combination of growing demand and replacement of old facilities has resulted in greater capital investment in recent years.

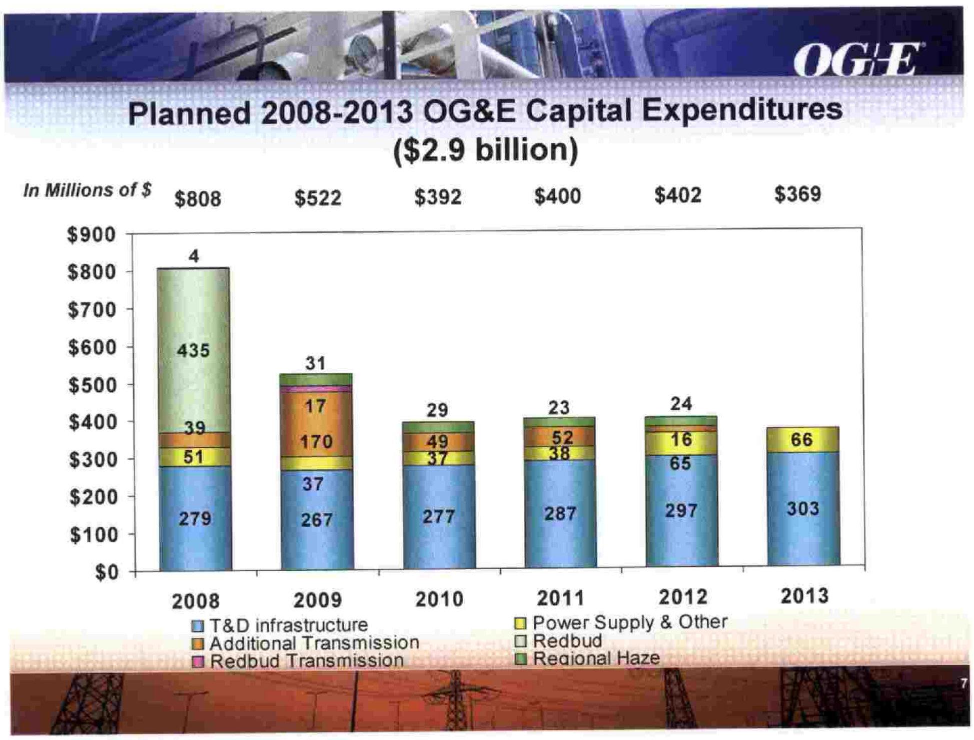
Q. Why is it important to address this infrastructure challenge now?

A. The number of facilities exceeding their operating life will increase unless more capital is invested in the infrastructure. In order for OG&E to maintain dependable and reliable service, large investments must be made so that electric service is available when needed by customers.

Q. What is OG&E doing to address this issue?

A. As is shown in the chart below, OG&E plans to invest approximately $2.9 billion in utility plant to serve customers and meet increasing environmental quality requirements through the year 2013.

Chart 2



Q. Is OG&E alone in facing the aging infrastructure challenge?

A. No. The age of OG&E's equipment is comparable to the national average. The industry as a whole is working to understand the drivers of the economic lives of each piece of equipment and predicting failure rates. OG&E is gathering quantitative data to assist in making decisions that will minimize the cost of maintaining a reliable electric system over the long-term. The Company is proactively working to reduce the failure rate of its aging equipment and is focusing on how best to economically invest resources to meet this issue going forward. However, in spite of OG&E's best efforts, addressing the aging infrastructure issue will require investments higher than historic levels for several years to come.

Q. **Please describe the increased operating costs that contribute to the need for a rate increase.**

A. The Company has experienced substantial increases in operations and maintenance ("O&M") expenses due to the national trend of higher medical costs, labor costs and the overall higher operating costs levels driven by increasing commodity price. The operating costs included in the Company's rates provide the funds necessary to operate and maintain its generation, transmission and distribution facilities. The Company cannot absorb continued rising operating costs without adequate compensation and maintain the quality and reliability of electric service.

Q. **How is the remainder of your testimony organized?**

A. The following testimony is organized into six sections.

SECTION I: Commission Procedures

SECTION II: General Rate Change

SECTION III: Redbud Plant Acquisition

SECTION IV: Rate Base *Pro Forma* Adjustments

SECTION V: Operating Income *Pro Forma* Adjustments

SECTION VI: Conclusion

SECTION I: COMMISSION PROCEDURES

Q. **Please state the relief sought from the Commission through this Application.**

A. OG&E is requesting a general rate change pursuant to the Commission Rules of Practice and Procedure, Section 9 and Appendices I and IA. The accounting exhibits, schedules, testimony and evidence that support the general rate change are included with the Application filed in this docket.

Q. **Did OG&E provide the Commission advance notice of the Company's Application?**

A. Yes. Pursuant to Ark. Code Ann. § 23-4-401 (1987), a utility is required to provide notice to the Commission of its intent to file an application for a general rate change. On June 2, 2008, OG&E filed its *Notice of Application for a General Change or Modification in Rates, Charges and Tariffs* for its Arkansas jurisdiction customers. Accordingly, the Company was required to file its Application no sooner than sixty (60) days and no later than ninety (90) days from the filing of such notice.

Q. **What is the amount of the requested general rate change?**

A. The Company is requesting the Commission to approve a $26,391,288 general rate change.

Q. **What test year was utilized in developing the Application?**

A. The Company's exhibits were based on the financial results of the test year ending December 31, 2007 and the *pro forma* year ending December 31, 2008. The Company has proposed twenty (20) *pro forma* adjustments to rate base and forty-one (41) *pro forma* adjustments to operating income. I will sponsor the rate base *pro forma* adjustments and *pro forma* adjustments 9 through 27 and 29 through 41 to operating income.

Q. Why are *pro forma* adjustments to a test year necessary?

A. In any rate review, the regulatory objective is to design rates to reflect revenue, expense and investment levels the utility is expected to experience prospectively. In some regulatory jurisdictions, a "future" test year is utilized to achieve this goal. As allowed by this Commission's rules, the Company has utilized a historical test year with *pro forma* adjustments, which reflect reasonably known and measurable changes within the subsequent twelve month period. In that process, test year results require restatement for (i) actual occurrences not expected to recur and (ii) events that were expected to occur but did not transpire, in whole or in part, during the test year. There may also be recurring costs that are not the customer's responsibility. In this specific proceeding, *pro forma* adjustments result in a *pro forma* test year that recognizes the revenue, expense and investment levels the Company will experience after new rates are implemented sometime in calendar year 2009.

Q. What is the importance of the *pro forma* adjustments in this proceeding?

A. The Company's proposed *pro forma* adjustments are critical to establish prospective rates in 2009. The adjustments proposed by the Company will provide (i) a fair return on the December 31, 2008 Company investment and (ii) the O&M expense level necessary to cover daily operating costs and sufficiently attract, train and retain a workforce capable of operating an electric system in a safe and reliable manner.

Q. Please explain the general categories of *pro forma* adjustments proposed by the Company.

A. *Pro forma* adjustments fall into one of the following three categories:

(1) *Normalization adjustments* are usually made to revenues and expenses to offset unusual levels of operations recorded during the test year. For example, extreme weather conditions can create abnormal levels of revenues and expenses. Additionally, abnormal levels of operations may occur due to delayed or accelerated projects during a test year. Whether the revenues and expenses are above or below a normal level, a *pro forma* adjustment is required to project a normal level of operations for the establishment of prospective rates.

(2) *Annualization adjustments* recognize that some action occurred during the test year that will be ongoing and must be captured on a prospective basis. One common annualization adjustment is for payroll or salary increases that occur during the test year. Future payroll costs are usually higher than the amount recorded in the historical financials. The *pro forma* adjustment is necessary to increase payroll costs to a level as if the payroll or salary increase had occurred at the beginning of the test year. In developing a payroll adjustment, the change in the number of employees should also be considered.

(3) *Pro forma adjustments outside the test year* consider reasonably known and measurable changes that occur within twelve (12) months of the test year ending December 31, 2007. In this proceeding, two good examples are *Pro Forma* Adjustment B-2.1c to rate base and *Pro Forma* Adjustment C-2.2-25 to operating income. *Pro Forma* Adjustment B-2.1c recognizes construction expenditures for

projects that will be serving customers by December 31, 2008, which is within twelve (12) months of the test year. *Pro Forma* Adjustment C-2.2-25 recognizes additional employees that have been or will be hired as well as attrition during the period January 1 through December 31, 2008. These *pro forma* adjustments outside the test year are critical in establishing fair and reasonable rates that will be implemented sometime in calendar year 2009.

SECTION II: GENERAL RATE CHANGE

Q. How is OG&E's requested general rate change determined?

A. The calculation of the Company's requested $26,455,252 general rate change is summarized in Chart 3.

Chart 3

Line No.	Reference Schedule	General Rate Change Calculation[1]	
1	G-1	Total Rate Base	$ 386,528,827
2	D-1	Required Rate of Return	7.38%
3		Required Operating Income	28,525,827
4	G-1	Adjusted Operating Income	(12,423,761)
5		Operating Income Deficiency	16,102,067
6		Federal and State Income Tax	10,289,221
7	A-1	Revenue Deficiency **(Rate Increase)**	**$ 26,391,288**

Q. Please identify and explain the components that are used to determine the $386,425,674 rate base value in Chart 3, line 1.

A. Schedule B-1 displays the total company per book rate base and the total amount of *pro forma* adjustments. Schedule B-1 shows that the Company has invested over $4.2 billion

[1] Application, Volume I, Schedule A-1.

to serve its customers. The resulting Arkansas jurisdiction rate base is shown in Schedule G-1[2].

The components of the $4,205,379,776, of which the Arkansas jurisdictional portion is $386,528,827, are identified under the "Description" column of Schedule B-1. The supporting schedules, identified at the bottom of the schedule, provide the location of detailed schedules that support the total company investment for each component in Column 3. The second column reflects accumulated pro forma adjustments to rate base. Schedule B-2 itemizes each *pro forma* adjustment by component. The total company *pro forma* values are then allocated to determine the Arkansas jurisdiction rate base of $386,528,827. OG&E witness Greg Veitch, sponsors the Arkansas jurisdiction allocation factors shown on Schedule G-4[3].

Q. **What adjustments are proposed to the total company per book rate base?**

A. Schedules B-2.1, B-2.3, B-2.6, B-4, B-6 and B-10 identify the twenty (20) *pro forma* adjustments required to establish the appropriate rate base value for ratemaking purposes. These schedules also contain descriptions and amounts for these *pro forma* adjustments and identify supporting schedules.

Q. **What is OG&E's requested rate of return in this docket?**

A. OG&E is requesting a 7.38% rate of return as depicted on line 2 of Chart 3. The overall cost of capital is identified in Schedule D-1 and sponsored by Dr. Don Murry.

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[2] Application, Volume II, Schedule G-1.

Q. **Briefly explain the components of the 7.38% rate of return.**

A. As illustrated in Schedule D-1, the capital ratio is long-term debt of 33.38%, common equity of 41.96% and other debt components of 24.66%. Considering the cost of each component the resulting rate of return is 7.38%.

Q. **Please explain the relationship between lines 3 and 4 in Chart 3 above.**

A. When the 7.38% rate of return is applied to the Company's jurisdictional investment to provide electric service, the result is a return requirement of $28,525,827 (line 3). OG&E's *pro forma* operating income is $12,423,761 (line 4). The $16,102,067 difference (line 5) is the Company's return deficiency. When federal and state income taxes are added to the return deficiency, the result is a $26,391,288 rate increase (line 7).

Q. **Please identify the sections of the Application that are used to establish the $12,423,761 *pro forma* operating income found on Line 4 of Chart 3.**

A. Section G supports the $12,423,761 Arkansas jurisdiction *pro forma* operating income. Schedule C-1 displays the total company per book revenue and expenses and *pro forma* adjustments. The resulting Arkansas jurisdiction operating income can be found in Schedule G-1[4].

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[3] Application, Volume II, Schedule G-4.

[4] Application, Volume II, Schedule G-1.

Q. **Please explain Schedule C-1.**

A. The revenue, operating expenses and income tax categories are identified under the "Description" column. Column 1 displays the total company financial results for the test year ended December 31, 2007. Column 2 reflects accumulated *pro forma* adjustments to the operating income statement. Schedule C-2.1 itemizes each *pro forma* adjustment by category. The total company *pro forma* values are then directly assigned or allocated to the Arkansas jurisdiction. OG&E witness Veitch sponsors the Arkansas jurisdiction allocation factors shown on Schedule G-4[5].

Q. **What adjustments are proposed to the total company operating income?**

A. Schedule C-2.1 identifies the forty-one (41) *pro forma* adjustments required to establish a forward looking or *pro forma* income statement to measure prospective earnings under new rates. Schedule C-2.1 also contains the description and amount for each *pro forma* adjustment as well as supporting schedules.

Q. **What is the Arkansas jurisdiction total revenue requirement based on the *pro forma* test year results?**

A. A summary of the total revenue requirement is found on Schedule A-1. OG&E's Arkansas jurisdiction total revenue requirement is $94,942,999 as reflected on line 11. The Company's proposed terms and conditions of services will produce $675,049 of Other Operating Revenue (line 12). The remaining revenue requirement of $94,267,950 (line 13) will be recovered through OG&E's non-fuel base rates.

[5] Application, Volume II, Schedule G-4.

SECTION III: REDBUD PLANT ACQUISTION

Q. Please briefly describe OG&E's proposed acquisition of the Redbud Plant?

A. In January of this year, OG&E entered into a Purchase and Sale Agreement ("PSA"), an Asset Purchase Agreement ("APA") and a Redbud Generating Facility Ownership and Operating Agreement ("O&O"). Through these agreements, OG&E, Oklahoma Municipal Power Authority ("OMPA") and Grand River Dam Authority ("GRDA") agreed to jointly acquire 100% of the assets of Redbud Energy LP (Redbud") from Redbud Energy I, LLC, Redbud Energy II, LLC and Redbud Energy III, LLC.

Redbud consists of a 1230 MW gas-fired, combined-cycle power generation facility ("Facility") located in Luther, Oklahoma. After closing the purchase OG&E, OMPA and GRDA will own the Facility as tenants in common at the percentage of fifty-one percent (51%), thirteen percent (13%) and thirty-six percent (36%) respectively, thus leaving OG&E with an approximate 627 MW interest in the Facility.

Q. What is the purchase price of the Facility?

A. The base purchase price to be paid by OG&E for the Facility is $852,000,000. The base purchase price, at closing, will be increased or decreased pursuant to the provisions of the PSA for changes to adjusted net working capital, certain ordinary and recurring items and changes to the value of Redbud's un-depreciated inventory. After closing of the PSA, OG&E will receive 36% and 13% of the total purchase price from GRDA and OMPA, respectively. OG&E's investment to be included in rate base upon closing is estimated to be approximately $441 million including the actual transaction costs, including but not limited to legal fees, engineering fees and filing fees.

Q. Why did OG&E enter into an agreement to purchase Redbud?

A. OG&E's Integrated Resource Plan identified a need for new generation. The demand for electricity on the OG&E system is estimated to grow at a rate of about 2.1% annually over the next decade. OG&E witness Jesse Langston's testimony describes how Redbud will improve reliability and meet the Company's capacity needs, at the lowest reasonable cost with no construction cost risk. Mr. Langston's testimony also discusses how Redbud provides protection against the risk of tightening SPP market conditions, new carbon regulations and increasing natural gas prices.

Q. How did OG&E determine the appropriate purchase price?

A. OG&E witness Langston will demonstrate that the acquisition of and purchase price for the Redbud facility was prudently determined and negotiated. Specifically, Mr. Langston will clearly explain that:

1) OG&E's resource planning analyses support a decision to acquire a 51% interest in the Redbud facility because it is part of the lowest reasonable cost portfolio when taking into account reliability of supply, capacity market risks and construction cost risk;

2) OG&E's business rationale and decision-making process employed during the bid and negotiation process was thorough and comprehensive and conducted at arm's-length;

3) OG&E's customers will enjoy significant benefits from the Company acquiring a controlling interest in Redbud; and,

4) The purchase price paid for Redbud is reasonable based on: (a) a Discounted Cash Flow analysis; (b) a current construction cost analysis; and, (c) a comparable transaction analysis.

Q. What amount of the $26.5 million rate request relates to Redbud?

A. The Arkansas jurisdictional revenue requirement includes approximately $8.0 million for Redbud.

Q. What relief is OG&E requesting for Redbud in this case?

A. OG&E is requesting that the Commission find Redbud to be used and useful and that the Company's investment of $441 million, plus actual transaction costs, is appropriately included in its rate base.

SECTION IV: RATE BASE *PRO FORMA* ADJUSTMENTS

Q. Please identify the *Pro Forma* Adjustments to rate base that you sponsor.

A. I am sponsoring *Pro Forma* Adjustments B-2.1a through B-2.1f, B-2.3a through B-2.3d, B-2.6a, B-4, B-6, and B-10 which are supported by the referenced schedules. The majority of these adjustments are self-explanatory based on the description in the summary of adjustments as shown on Schedules B-2.1, B-2.3 and B-2.6. The following *Pro Forma* Adjustments require some additional explanation:

B-2.1a – Holding Company Asset Allocation

B-4 – Working Capital Assets

B-2.1c – Plant in Service for the Period January-December 2008

Holding Company Asset Allocation

Q. Please explain *Pro Forma* Adjustment B-2.1a, Holding Company Asset Allocation.

A. Schedule B-2.1a includes the holding company assets in the total company per book "utility plant" value on line 1. Line 11 allocates $20,805,519 to non-utility activity. The allocation on line 11 is composed of $18,911,678 utility plant-in-service and $1,893,841 construction work in progress. After deducting $14,634,664 of non-utility plant accumulated depreciation, the net adjustment is a reduction to rate base of $6,170,855. The Company allocated 22.37% of the holding company assets to non-utility activity based on the allocation methodology that is consistent with the methodology agreed to in the joint stipulation settling Docket No. 06-070-U and supported by Schedule C-2.2-15b. The cost centers identified on this schedule utilize one of four allocation methods, (i) Distrigas, (ii) headcount, (iii) utilization percentage or (iv) direct assignment.

Q. **What services are performed by the Holding Company?**

A. Holding Company costs generally reflect shared, corporate overhead costs that must be charged or allocated to the subsidiaries. Most services of the Holding Company fall within one of two main types, both of which are included in Administrative and General (A&G) expenses:

(1) Corporate Services

(2) Shared Services

<u>Corporate Services</u> includes services of a more general nature benefiting the entire corporate organization such as corporate accounting and planning, legal, and executive services. The costs of these services are allocated to subsidiaries based on the Distrigas method. This group also includes Human Resources and employee benefits, which are allocated based on headcount.

Shared Services includes services such as facilities, computers, PC network, Enterprise system, telephone system, fleet maintenance, purchasing and material warehousing services. These services are generally charged based on specific orders, direct charge, usage or headcount where the benefit of such services is more easily tracked.

Working Capital Assets

Q. **Please explain *Pro Forma* Adjustment B-4, Working Capital Assets.**

A. A component of OG&E's rate base is working capital assets. In order to arrive at a reasonable level for working capital assets, the Company analyzed each asset account and its related year end balance. Based on this information, the Company first determined the relevance of the account to providing utility service. This analysis resulted in the exclusion of some account balances. The Company next determined the expected level of investment for the remaining accounts. If the year end balance was appropriate it was retained. In other instances, some adjustments were made either up or down to reflect balances that are more indicative of expected investment levels. After reflecting these adjustments, the Company believes the inclusion of $592,879,751 for working capital assets in the calculation of rate base for this proceeding is appropriate.

Plant in Service for the Period January-December 2008

Q. **Please explain *Pro Forma* Adjustment B-2.1c, Plant in Service 2008.**

A. As discussed earlier in my testimony, Staff's historical position accepts out-of-period adjustments that are reasonably known and measurable within twelve months of the test year. The Company analyzed the (i) $367 million capital expenditure budget for 2008 and

(ii) construction work in progress at December 31, 2007. A determination was then made as to which projects will be completed and serving customers by December 31, 2008. *Pro Forma* Adjustment B-2.1c increases total company rate base by $264,258,018 to recognize these completed and "in-service" construction projects as well as estimated 2008 retirements. Additionally, as reflected in Schedule B-2.1e, $441 million was included in Plant in Service for the Redbud Plant acquisition.

SECTION V: OPERATING INCOME *PRO FORMA* ADJUSTMENTS

Q. **Please identify the *pro forma* adjustments to operating income that you sponsor.**

A. I am sponsoring *Pro Forma* Adjustments C-2.2-9 through C-2.2-27, C-2.2-29 through C-2.2-38, C-9, C-11 and C-12. Many of these adjustments are self-explanatory based on the description in Schedule C-2.1. The following *Pro Forma* Adjustments require some additional explanation:

C-2.2-10 – Redbud Variable O&M

C-2.2-11 – Ad Valorem Taxes

C-2.2-12 – Pension, Post-Retirement Other Than Pension and Medical Costs

C-2.2-13 – Advertising

C-2.2-14 – Insurance expense

C-2.2-15 – Holding Company O&M Reclassification

C-2.2-16 / C-2.2-17– Payroll & Related Taxes at December 31, 2007

C-2.2-18 – Regulatory Expense

C-2.2-19 – Bad Debt Expense

C-2.2-20 – Pension Settlement Cost

C-2.2-21 – Payroll Expense 2008

C-2.2-22 – Southwest Power Pool Assessment

C-2.2-23 – Vegetation Management

C-2.2-24 – Redbud Plant Pension and Benefit

C-2.2-25a / C-2.2-25b – Payroll & Related Taxes for New Employees January-June 2008

C-2.2-26 – Depreciation Expense

C-2.2-27 – Payroll Tax Expense 2008

C-2.2-29 – Insurance Expenses

C-2.2-30 – Removal Regulatory Asset Amortization - McClain

C-2.2-32 / C-2.2-33 – Redbud Plant O&M and Payroll

C-2.2-36 – Red Rock Project Expenses

C-2-2-37 – FLAR Correction

Redbud Operating Expenses

Q. **Please explain the *Pro Forma* Adjustments C-2.2-10, C-2.2-24, C-2.2-32 and C-2.2-33, Redbud Operating Expenses.**

A. Earlier in my testimony, I discussed the Company's proposed addition of a 51% interest in the Redbud facility. Because of that addition, the cost of service for OG&E for the test year must include a full year's level for 51% of Redbud's: (a) variable operations and maintenance expense; (b) pensions, postretirement expense other than pension expense, and medical expense; (c) fixed operations and maintenance expenses; and, (d) payroll and payroll related tax expense. The calculations for each of these four adjustments are determined and presented separately in *Pro Forma* Adjustments C-2.2-10, C-2.2-24, C-

2.2-32 and C-2.2-33, and those adjustments increase expenses by $3,001,289, $290,617, $3,237,276 and $1,479,866, respectively.

In addition to these expenses, the cost of service for OG&E for the test year includes a normalized level of Ad valorem tax expense for the 51% ownership of Redbud which is included in Adjustment C-2.2-11.

Ad Valorem Taxes

Q. **Please explain *Pro Forma* Adjustment C-2.2-11, Ad Valorem Taxes.**

A. This adjustment increases property taxes by $6,723,631. The adjustment recognizes an increase in property taxes based on historic levels of increases in valuations and millages and the expected tax liability for the Redbud Plant.

Pensions, Post-Retirement Other Than Pension, and Medical Costs

Q. **Please explain *Pro Forma* Adjustment C-2.2-12, Pension, Post-Retirement Other Than Pension, and Medical Costs.**

A. Based on actuarial valuation reports, the Company's pension, post-retirement other than pension and medical costs (employee benefits) will be $3,711,222 below the test year expenditures. *Pro Forma* Adjustment C-2.2-12 adjusts employee benefit costs to recognize the decrease. The actuarial valuation report is for employee benefit costs in calendar year 2008. The employee benefit costs identified in that report are being recorded on the Company's books for 2008.

Q. **Has the Company made any changes in the way Pension or Post-Retirement Benefits Other Than Pension are calculated?**

A. No. Pension and Post-Retirement Benefits Other Than Pension continue to be calculated in accordance with generally accepted accounting principles which are consistent with the way these costs were determined in the joint stipulation settling OG&E's last Arkansas rate case, Docket 06-070-U.

Q. **Is a portion of employee benefit expenses capitalized?**

A. Yes. A portion of pension, retiree medical, retiree life and medical as well as payroll expenses are normally capitalized as a part of construction projects.

Q. **How did you determine the amount that should be capitalized?**

A. The ratio of amounts capitalized or expensed as O&M varies slightly each year. In calculating our *pro forma* adjustments a four year average of the capitalization ratio was used to normalize these annual variations. This four year average capitalization rate was utilized in *Pro Forma* Adjustments C-2.2-12, C-2.2-16, C-2.2-21 and C-2.2-25.

Advertising

Q. **Please explain *Pro Forma* Adjustment C-2.2-13, Advertising.**

A. This *Pro Forma* Adjustment reflects the removal of any direct or indirect expenditure for promotional or political advertising as required by Ark. Code Ann. § 23-1-101 (1987).

Insurance Expense

Q. **Please explain the *Pro Forma* Adjustments C-2.2-14 and C-2.2-29, Insurance Expense.**

A. *Pro Forma* Adjustments C-2.2-14 and C-2.2-29 adjust test year insurance expense by $(477,140) and $13,868, respectively. Specifically, *Pro Forma* Adjustment C-2.2-14 has the effect of *decreasing* actual test year insurance expense to reflect a 2008 estimate for insurance expense based on current insurance premium levels. Similarly, *Pro Forma* Adjustment C-2.2-29 has the effect of *increasing* the 2008 estimate for insurance expense to reflect the expected insurance premiums in place at the end of 2008.

The adjusted levels of insurance expense each include *pro forma* amounts for OG&E and OGE Energy. The amounts for OGE Energy are allocated to OG&E using the Distrigas allocation factor of 74.86%.

Holding Company Reclassification

Q. **Please explain *Pro Forma* Adjustment C-2.2-15, Holding Company Reclassification.**

A. This *Pro Forma* Adjustment relates to Holding Company expenses. Holding Company expenses charged to the utility are initially recorded as other operations and maintenance expenses on OG&E's books.

Pro Forma Adjustment C-2.2-15 appropriately reclassifies these other operations and maintenance expenses to depreciation, property taxes and payroll taxes. Total Holding Company expense allocated to OG&E for the test year ending December 31, 2007, in the amount of $8,554,766 consisted of depreciation expense, $5,971,615; property taxes,

$464,263 and payroll taxes, $2,118,888. Therefore, this adjustment reclassifies the $8,554,766 in expenses to those accounts for those amounts.

Detail for this reclassification adjustment is found in Schedules C-2.2-15a and C-2.2-15b. This adjustment reclassifies costs from O&M expense to the appropriate category and does not result in an increase or decrease to the Company's total revenue requirement. However, this adjustment is important in calculating the proper jurisdiction revenue requirement.

Annualized Payroll and Related Taxes

Q. **Please explain *Pro Forma* Adjustments C-2.2-16 and C-2.2-17, Payroll and Related Taxes.**

A. *Pro Forma* Adjustments C-2.2-16 and C-2.2-17 increase operating expenses in the amount of $5,544,807 and $400,245, respectively. These *pro forma* adjustments are based on changes to the 2007 test year cost of service related to employee compensation levels. They consist of two components, salaries and wages (C-2.2-16), and related payroll taxes (C-2.2-17).

To determine the test year annualized payroll and related payroll taxes, payroll amounts were annualized based on the number of employees and wage levels existing during the first pay period of 2008 (December 24, 2007 through January 6, 2008). Further, Holding Company payroll costs were allocated to OG&E using the relevant Distrigas allocation factor and OG&E's payroll cost was charged to operations and maintenance expense based on the current expense ratio of 76.01%.

Q. **Are there any other components to the payroll adjustment?**

A. Yes. An adjustment was made to the test year payroll expense by approximately $1.3 million to update the TeamShare award to the amount actually paid out in 2008 which is included in the $5.5 million payroll adjustment.

Q. **What is the TeamShare award?**

A. TeamShare is a company-wide incentive program designed to assist in the attraction and retention of quality employees which enlists the active support of all employees to work toward the same operational goals, provide competitive pay programs, and link individual goals with company goals. The program is based on a balanced scorecard methodology that measures organizational performance across four perspectives: serving customers, internal business processes, financial/shareholder and learning and growth. The use of performance targets assists in the communication and implementation of corporate strategy, fosters accountability and promotes teamwork throughout the Company.

Q. **Can you give some examples of performance targets?**

A. Yes. In an effort to improve reliability a target level is established in regard to the number of outages (SAIFI) and the average duration of such outages (CAIDI). As the actual level varies from the target, the amount of the award increases or decreases depending on the direction of the variance. If the actual performance varies too far from the target, there is no payout related to that component of the TeamShare payment. Other performance targets include, system availability, earnings per share and customer satisfaction.

Q. **Has this incentive compensation program been compared to the market to see if it is in line with compensations being paid by other firms?**

A. Yes. OG&E retained Mercer, a global management and human resource consulting firm with extensive energy industry experience. Mercer analyzed the competitive positioning of OG&E's annual compensation plans compared to similar companies in the utility industry and how OG&E's annual incentive and cash compensation compared to its peers.

Q. **What did the study reveal?**

A. The study found that all of the companies in OG&E's peer group had formalized annual incentive plans. The study also found that OG&E's total cash compensation is below its peer group which indicates that absent the annual cash incentive award, OG&E's total cash compensation is well below market.

Payroll Expense and Related Taxes for 2008

Q. **Please explain *Pro Forma* Adjustments C-2.2-21 and C-2.2-27, Payroll Expense and Related Taxes.**

A. *Pro Forma* Adjustments C-2.2-21 and C-2.2-27 increase operating expenses in the amount of $5,981,697 and $431,781, respectively. These *pro forma* adjustments are similar to the test year end 2007 annualized payroll adjustments discussed earlier in my testimony. That is, they consist of two components, salaries and wages (C-2.2-21), and related payroll taxes (C-2.2-27). These adjustments take into account the number of employees existing during the first pay period of 2008 and also take into account an out of period increase to wages and salaries during 2008 of an estimated 4.4%.

Further, Holding Company payroll costs were allocated to OG&E using the relevant Distrigas allocation factor and OG&E's payroll cost was charged to operations and maintenance expense based on the current expense ratio of 76.01%.

Payroll Expense and Related Taxes for New Positions Filled in 2008

Q. **Please explain *Pro Forma* Adjustments C-2.2-25(a) and C-2.2-25(b), Payroll Expense and Related Taxes for New Positions Filled in 2008.**

A. *Pro Forma* Adjustments C-2.2-25(a) and C-2.2-25(b) increase operating expenses in the amount of $1,195,384 and $86,287, respectively. These *pro forma* adjustments are similar to the annualized and out of period payroll adjustments discussed earlier in my testimony. That is, they consist of two components, salaries and wages (C-2.2-25(a)), and related payroll taxes (C-2.2-25(b)). However, these *pro forma* adjustments take into account an out of period increase to operating expenses to allow for positions to be filled during 2008. Further, Holding Company payroll costs were allocated to OG&E using the relevant Distrigas allocation factor and OG&E's payroll cost was charged to operations and maintenance expense based on the current expense ratio of 76.01%.

Regulatory Expense

Q. **Based on *Pro Forma* Adjustment C-2.2-18, what is the Company requesting for Regulatory Expense?**

A. The Company is requesting a level of $665,561 for the Arkansas jurisdiction. The amount has two components. The first component is the test year Arkansas jurisdiction expense of $407,811. The second component is an estimated rate case expense for this proceeding of $515,500 amortized over two years, which results in an additional $257,750 annual expense to arrive at $665,561.

Bad Debt Expense

Q. **Please explain *Pro Forma* Adjustment C-2.12-19, Bad Debt Expense.**

A. The Arkansas jurisdiction estimated uncollectible rate is 0.40% of revenues. By applying this rate to the Arkansas jurisdictional operational revenues the expected bad debt expense level is $662,377. As illustrated in Schedule C-2.2-19, the total company test year "per book" amount of $6,000,311 must be reduced by $5,337,934 to reflect the Arkansas jurisdictional level.

Pension Settlement Cost

Q. **Please explain *Pro Forma* Adjustment C-2.2-20, Pension Settlement Cost.**

A. *Pro Forma* Adjustment C-2.2-20 increases operating expenses in the amount of $3,112,793. This adjustment allows the Company to recover amounts paid for pension settlement costs for each of 2006 and 2007 over a 10.627 year amortization period instead of charging and recovering them as incurred and expensed. The amortization period is based on the average expected future working lifetimes of Company employees. The adjustment is presented in Schedule C-2.2-20.

Q. **Why were these settlement costs charged to operating expense in 2006 and 2007?**

A. FAS 88 requires immediate recognition of certain previously unrecognized settlement costs when certain transactions or events occur. One such event is for certain pension obligation settlements. Absent the settlement provision, the previously delayed costs for the obligation would have been recognized over the average expected future working lifetimes of Company employees. Therefore, the Company proposes this adjustment to reverse the settlement charges recorded during 2006 and 2007 and instead recover these costs over the proposed amortization period. This alternative method allows the Company to recognize these costs over the same timeframe as if FAS 88 did not apply here.

Southwest Power Pool Assessment

Q. **Please explain *Pro Forma* Adjustment C-2.2-22, Southwest Power Pool Assessment.**

A. As a result of the Southwest Power Pool (SPP) assessment structure, OG&E is experiencing fee increases in excess of the expenditures during the 2007 test year. The *pro forma* adjustment of $2,637,438 increases OG&E's SPP operating costs from $8,621,977 to the 2008 estimate of $11,259,415. The calculation of the cost components for the SPP assessment and the adjustment are presented in Schedule C-2.2-22.

Q. **What are the components of the overall SPP fees?**

A. The SPP fees consist of seven components as itemized in Chart 4 on the following page.

Chart 4[6]

Line No.	Components	Amount
1	Annual Membership	$ 6,000
2	NERC Assessment	844,072
3	Administrative Fees	7,701,096
4	Schedule 9	980,302
5	Schedule 1	15,112
6	Schedule 2	12,320
7	Schedule 11	1,700,514
8	Total	11,259,415
9	SPP Fees paid in Test Year	(8,621,977)
10	*Pro Forma* Adjustment	$ 2,637,438

Q. **What is the basis for the increased costs?**

A. The FERC granted Regional Transmission Organization (RTO) status to the SPP in an October 1, 2004 order. The RTO is subject to FERC regulation and subject to annual assessment fees. Beginning in 2007, OG&E started receiving Schedule 11 Base Plan Assessments. In 2008, these Schedule 11 Assessments increased approximately $1.7 million. Additionally, Schedule 9 Network Integration Transmission Service charges increased approximately $800,000. The change in these two components constitutes the majority of the increase.

[6] Application, Volume I, Schedule C-2.2-22.

Vegetation Management

Q. Please explain *Pro Forma* Adjustment C-2.2-23, Vegetation Management.

A. *Pro Forma* Adjustment C-2.2-23 represents an annual increase of $5,272,176. This increase in Vegetation Management costs is necessary to maintain a 4-year trim cycle and meet new requirements set by NERC. OG&E has identified 1,600 miles of transmission lines out of 4,000 miles of transmission lines which are subject to the new NERC Vegetation Standard FAC-003-01. Failure to comply with the standard may result in significant fines. In addition, OG&E has studied the factors contributing to outages and has determined that aggressive vegetation management is the most cost effective means to reduce the number of outages and their duration.

Depreciation Expense

Q. Please summarize the *pro forma* adjustments to depreciation expense.

A. The utility "per book" depreciation expense for the test year was $138,781,790. The Company has proposed three adjustments as reflected in Chart 5 that increase the book depreciation expense to $177,969,226. The first adjustment is a $33,203,874 *pro forma* increase to "utility" depreciation expense based on the December 31, 2008 depreciable plant in service. The depreciation rates used to calculate adjusted depreciation expense, except for the Redbud facility and for certain security related assets, are the Company's current Arkansas jurisdiction depreciation rates approved in Docket No. 06-070-U. The second adjustment of $5,971,615 represents the adjustment to depreciation expense pursuant to the reclassification adjustment discussed in *Pro Forma* Adjustment C-2.2-15. The third adjustment is for amortization of an Acquisition adjustment on property purchased in December, 2007. In total, the *pro forma* increase to depreciation expense is $39,187,436 as identified in Chart 5.

Chart 5

DEPRECIATION EXPENSE *Pro Forma Adjustment Summary*		
Adjustment	**Description**	**Amount**
C-2.2-26	Plant Balances as of 12/31/08	$ 33,203,874
C-2.2-15	Holding Company O&M Reclassification	5,971,615
C-2.2-34	Acquisition Adjustment Amortization	11,947
	Total *Pro Forma* Adjustment	**$39,187,436**

Q. **In your previous answer you said the depreciation adjustment was based on the rates approved in your last case to the extent they were available. Are there assets for which no rate has been approved?**

A. Yes. Included in OG&E's December 31, 2008 depreciable plant in service is the Redbud plant and certain security related assets that are newly acquired assets and were therefore not included in the rates approved by the Commission.

Q. **What depreciable life does OG&E propose for the newly acquired Redbud plant?**

A. OG&E proposes to use a remaining life of 27 years over which to depreciate its investment in Redbud. This equates to a 32 year total life.

Q. **Is the Redbud plant similar to OG&E's McClain plant?**

A. Yes. Both plants are natural gas fired combined cycle gas turbines. However, there are some differences, primarily in the configuration of the turbines and the heat recovery steam generators (HRSG). Redbud has one HRSG for each combustion turbine. McClain has one HRSG for its two combustion turbines. Otherwise they are similar technology.

Q. **How does the proposed Redbud depreciable life compare to the previously approved depreciable life of McClain?**

A. The McClain depreciation rate approved by the Arkansas Commission was based upon a 30 year life. OG&E is proposing essentially the same rate for Redbud, adjusted for the fact that the Redbud plant had limited duty in its first two years. The Redbud plant was initially developed by an independent power producer in anticipation of competitive retail energy markets. Legislation deregulating retail electricity sales in Arkansas and Oklahoma was repealed prior to the opening of the market. The Redbud plant's commercial operation date was December 2003. As a result of the repeal of retail competition in Arkansas and Oklahoma, the Redbud plant output was limited to the wholesale market. The capacity factors for the plant in 2004 and 2005 were 5.1% and 16.7%, respectively. Due to this limited operation in its first two years, OG&E proposes to reduce the Redbud depreciation rate slightly from the approved McClain rate to adjust for the limited initial operation. The proposed Redbud depreciation rate equates to a 32 year total life with 27 years remaining at acquisition. OG&E's proposed depreciation rate of 3.7% was derived by dividing 1 by 27. This depreciation rate is consistent with the rate proposed in OG&E's Oklahoma application and is consistent with the rate to be used to record depreciation expense for financial accounting purposes.

Q. **You also mentioned security related assets. Can you please explain what these are?**

A. Yes. Subsequent to the September 11, terrorist attacks, OG&E completed a study that recommended increased physical security and mitigation measures to protect the infrastructure for the production and delivery of electricity to OG&E's customers. Implementation of these recommendations required OG&E to expend additional capital, and increase O&M expenses. OG&E filed an application seeking recovery and subsequently received an order from the OCC approving recovery of the cost of these expenditures. The depreciation expense adjustment proposed by OG&E in this cause is consistent with those approved by the Oklahoma Commission.

Q. **How was the proposed 20% rate developed for these newly acquired security assets?**

A. The security related assets consist primarily of closed circuit TV systems and access controls. The proposed life for these assets is five years. These assets were designated with the five-year life due to manufacturer recommendations that due to weather exposure, the systems could be expected to be replaced every five years. The proposed depreciation rate of 20% was derived by dividing 1 by 5.

Removal of Regulatory Asset Amortization – McClain

Q. Please explain *Pro Forma* Adjustment C-2.2-30, McClain Regulatory Asset Amortization.

A. *Pro Forma* Adjustment C-2.2-30 removes $944,187 of amortization expenses not already adjusted for in other *pro formas* from the test year cost of service for the McClain Regulatory Asset. The amortization expense for the asset is not recoverable through Arkansas jurisdictional rates.

Q. Please explain why these costs are not recoverable through Arkansas jurisdictional rates.

A. The McClain expenses were deferred in accordance with a rate case settlement agreement approved by the Oklahoma Commission. Therefore, the amortization of the deferred amounts is not applicable to Arkansas jurisdictional rates.

Red Rock Project Expenses

Q. Please explain *Pro Forma* Adjustment C-2.2-36, Red Rock Project Expenses.

A. *Pro Forma* Adjustment C-2.2-36 increases Arkansas jurisdictional operating expenses by $430,881 to include one year's amortization expense for Red Rock project costs. The full amount requested over a two-year amortization period is $861,761. Recovering $861,761 over two years allows the Company to recover approximately 5% of the total Company costs for Red Rock of $17,005,636. The full Arkansas jurisdictional portion of the costs are $1,723,521, thus the Company only requests to recover half of the Arkansas jurisdictional amount of Red Rock costs. On August 22, 2008, the Oklahoma

Commission in its Order No. 558445 authorized the Company to recover fifty percent of its Oklahoma jurisdiction portion of these costs.

Q. **Please explain what the $17,005,636 in Red Rock costs pertains to?**

A. The $17,005,636 consists primarily of engineering, design and other consulting cost incurred to ensure that the Red Rock plant development could proceed. OG&E had identified Red Rock as a least cost resource option and it was necessary to incur these costs to maintain the favorable economics of the project.

2008 FLAR Correction

Q. **Please explain *Pro Forma* Adjustment C-2.2-37, 2008 FLAR Correction.**

A. The Company's adjustment to increase test year operating expense by $11,136,974 corrects for expenses incorrectly capitalized for the 2007 test year. In March of 2008, OG&E determined that the application of fully loaded activity rates ("FLAR") had unintentionally resulted in the over-capitalization of amounts of certain payroll, benefits and other employee related costs and overhead costs in prior years. These expenses were incorrectly capitalized using the Company's FLAR in error for the years 2004 through 2007. The FLAR is a standard model adopted by OG&E in 2004 for use in calculating fully loaded activity rates for capitalization or deferral of certain project costs. To correct the cumulative error for 2004 through 2007, the Company recorded an adjustment to its account records increasing O&M and a corresponding adjustment decreasing utility plant in the quarter ended March 31, 2008. This *pro forma* adjustment only reflects the 2007 amount.

Storm Damage

Q. Has OG&E made any *pro forma* adjustments to the test year amounts presented for storm damages?

A. No. During 2007, OG&E incurred approximately $79.0 million in storm damage costs. Approximately $39.8 million of this amount was capitalized as replacement of plant in service. The remaining $39.2 million was charged to O&M. In accordance with Oklahoma Commission Order No. 516261, the Oklahoma jurisdiction amount in excess of $3.2 million, approximately $35.9 million, of the amount charged to O&M was then deferred as a regulatory asset for future recovery. Thus, approximately $3.4 million is included in total company O&M in this application.

SECTION VI: CONCLUSION

Q. What is the overall increase in electric rates proposed in the Company's application?

A. OG&E's requested rate relief would result in a 14.02% overall increase in electric rates. For the residential customers, this is the first general rate increase in 25 years. Under the proposal, an average residential customer's bill would increase by $12.35 per month. OG&E witness Bryan Scott explains the specific increase to each customer class based on the Company's rate proposal.

Q. How do OG&E's electric rates in Arkansas compare to the region and the nation?

A. Our customers' rates in Arkansas are 23% below the region and 36% lower than the national average.

Q. **Do you have a final comment?**

A. Yes. Electricity impacts every aspect of our customers' lives and drives the nation's economy. Our customers' needs and expectations have increased considerably due to the extent of technology utilized in the average home. OG&E's ability to ensure long-term reliability and meet customer expectation depends on adequate rate relief through this regulatory proceeding.

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

A. Yes.