

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

COURT CLERK'S OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF)
OKLAHOMA GAS AND ELECTRIC COMPANY)
FOR AN ORDER OF THE COMMISSION) CAUSE NO. PUD 201700496
AUTHORIZING APPLICANT TO MODIFY ITS)
RATES, CHARGES, AND TARIFFS FOR RETAIL)
ELECTRIC SERVICE IN OKLAHOMA)

**Summary of the Responsive Testimony of Edwin C. Farrar
Regarding Revenue Requirement Issues
On Behalf of Mike Hunter, Oklahoma Attorney General**

Mr. Edwin C. Farrar submitted pre-filed responsive testimony on behalf of Mike Hunter, the Attorney General of Oklahoma, on May 2, 2018. He testified as to his educational and professional background as a Certified Public Accountant. He also testified concerning his previous testimony before the Oklahoma Corporation Commission ("Commission"). Mr. Farrar recommended certain adjustments to rate base and to the operating income statement of Oklahoma Gas and Electric Company ("OGE" or "Company").

Six-Month Update Adjustments

Mr. Farrar recommended that rate base be updated for known and measurable changes known to occur six months after the end of the test year, or the period from September 30, 2017, to March 31, 2018, as required by statute. These adjustments include changes to plant in service, accumulated depreciation, accumulated deferred income taxes, regulatory assets, regulatory liabilities, and the net pension benefit asset. Mr. Farrar recommended a net reduction to rate base of \$27,607,518 for those adjustments on a total Company basis, or \$25,690,432 for the Oklahoma jurisdictional portion.

Mr. Farrar also recommended adjustments to update operating revenue and expenses for known and measurable changes occurring during the six months after the end of the test year. Mr. Farrar testified that the updated revenue level resulted in an adjustment to reduce the pro forma

level of revenue by \$6,729,429. Mr. Farrar recommended that payroll expenses and payroll taxes be reduced by \$1,042,902, below the jurisdictional levels requested by the Company. Mr. Farrar also recommended that the jurisdictional Southwest Power Pool expenses and bad debt expenses be increased by \$37,956 and \$18,537, respectively. Mr. Farrar recommended that OGE's retirement plan costs be reduced by \$583,351 based on the 2018 expense levels, and that the amortization of the pension regulatory liability be reduced by \$329,573. Mr. Farrar recommended an adjustment to update rate case expenses for the actual level of expenses incurred through March 31, 2018. The expenses incurred after that date will be deferred to OGE's next rate case, subject to Commission approval. Mr. Farrar recommended that ad valorem taxes be reduced by \$58,886, based on the accrual rates for 2018. Finally, Mr. Farrar recommended that the deduction for the amortization of the net unfunded deferred income taxes be increased based on the updated amounts from OGE. The amortization is a component of OGE's income tax expense calculation, and the adjustment reduces the jurisdictional revenue requirement by \$7,662,419.

Compensation Adjustments

Mr. Farrar sponsored other adjustments to OGE's expenses, including adjustments to OGE's annual incentive plan expenses and OGE's non-qualified pension plan expenses.

Mr. Farrar testified that OGE has an annual incentive plan for its employees, which includes financial and operational goals. OG&E had included a four-year average amount of this expense in the revenue requirement. Mr. Farrar noted that the financial component of the expense, consisting of Company earnings incentives and a share of the operating expense incentives, still represented a significant part of the incentive payments. Mr. Farrar recommended that the Commission continue its recent position that the annual incentive plan costs be shared equally

between shareholders and ratepayers. The adjustment to share the annual incentive plan expenses reduces the jurisdictional revenue requirement by \$6,250,933.

Mr. Farrar recommended the exclusion of OGE's non-qualified pension plan costs. A non-qualified pension plan covers the portion of the executives' retirement costs for salaries above the Internal Revenue Service limits, which are currently \$275,000 per year. This means that fund contributions are not tax deductible on a current basis, and as a result, companies rarely fund these plans. Mr. Farrar testified that this type of indirect compensation for highly paid executives is unnecessary and expensive because of its added cost to consumers. The adjustment to exclude the cost of the non-qualified pension plan reduces the Oklahoma retail revenue requirement by \$1,028,420.

Depreciation Adjustments

Mr. Farrar testified that the Attorney General's expert witness William W. Dunkel proposed changes to the depreciation rates requested by OGE, and that Mr. Farrar applied those rates to the depreciable plant balances updated to March 31, 2018. The combination of the Attorney General's recommended depreciation rates, along with the update to the depreciable plant balances resulted in an adjustment to reduce depreciation expense by \$49,058,487 on a total Company basis, net of OGE's supplemental adjustment to reduce depreciation expense by \$1,477,772. The adjustment is approximately \$44,745,676 for the Oklahoma retail jurisdiction using a composite allocation factor. The update to depreciation expense for the updated plant balances, as well as Mr. Dunkel's recommendations, should also be applied to the depreciation expense recovered from load serving entities. The Oklahoma jurisdictional amount of the adjustment for depreciation recovered from load serving entities reduces the revenue requirement by \$133,331.

Refund of Tax Savings

Mr. Farrar testified that the Commission, in Order No. 671,982, in Cause No. PUD 201700569, ordered OGE to establish a regulatory liability “to reflect the reduced federal corporate tax rate to 21 percent and the associated savings in excess ADIT and any other tax implications of the Act on an interim basis, subject to refund until utility rates are adjusted to reflect the federal tax savings and a final order is issued in OG&E’s pending general rate case in Cause No. PUD 201700496, or as otherwise ordered by the Commission.” The Commission further ordered that “the amounts of any refunds determined to be owed to customers shall accrue interest at a rate equivalent to OG&E’s cost of capital as recognized in Order No. 662059 issued in Cause No. PUD 201500273 until issuance of a final order in its pending rate case in Cause No. PUD 201700496.”

Mr. Farrar explained the calculation of the refund liability. Mr. Farrar explained that the accrual of the excess tax expense is based on the return of equity and rate base investment from OGE’s last rate case, Cause No. PUD 201500273. The equity return is then multiplied by the differences in the old income tax gross up factor and the new tax gross up factor to find the annual amount of excess income taxes being collected until an order is adopted in this Cause.

The next component of the refund is the 2018 amortization that is found in OGE’s response to discovery request AG-OGE-12-3, Attachment 4. That amount is then allocated to the Oklahoma retail jurisdiction. The excess tax expense and the excess ADIT amortization are added together to provide the total annual refund liability for 2018. This amount is then divided by twelve (12) to produce the monthly amount, and then interest is calculated on those monthly balances based on the pretax rate of return from the Cause No. PUD 201500273.

The monthly amounts of the excess tax expense, the excess ADIT amortization, and interest are accumulated to produce the Company’s total refund liability due to OGE’s customers. Mr.

Farrar calculated an Oklahoma jurisdictional refund liability of \$59,554,522, if new rates become effective on October 1, 2018.

CERTIFICATE OF SERVICE

On this 7th day of May, 2018, a true and correct copy of the above and foregoing *Summary of the Responsive Testimony of Edwin C. Farrar, on Behalf of Mike Hunter, Oklahoma Attorney General*, was sent via electronic mail to the following interested parties:

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