

BEFORE THE
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF AN INTERIM RATE SCHEDULE)	
OF OKLAHOMA GAS AND ELECTRIC COMPANY)	
IMPOSING A SURCHARGE TO RECOVER ALL)	
INVESTMENTS AND EXPENSES INCURRED)	
THROUGH COMPLIANCE WITH LEGISLATIVE OR)	DOCKET 15-034-U
ADMINISTRATIVE RULES, REGULATIONS OR)	
REQUIREMENTS RELATING TO THE PUBLIC)	
HEALTH, SAFETY, OR THE ENVIRONMENT)	
UNDER THE FEDERAL CLEAN AIR ACT FOR)	
CERTAIN OF ITS EXISTING GENERATION FACILITIES)	

DIRECT TESTIMONY

OF

WILLIAM L. MATTHEWS
PUBLIC UTILITY AUDITOR

ON BEHALF OF THE STAFF OF THE
ARKANSAS PUBLIC SERVICE COMMISSION

AUGUST 10, 2015

1 **INTRODUCTION**

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

3 A. My name is William L. Matthews. My business address is Arkansas Public
4 Service Commission (APSC or Commission), 1000 Center Street, PO Box 400,
5 Little Rock, Arkansas 72203-0400.

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

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

12 **Q. Please describe your educational background and experience.**

13 A. I hold a Bachelor of Business Administration degree in Accounting and a Master
14 of Business Administration degree from Henderson State University in
15 Arkadelphia, Arkansas. Before joining Staff in September 2008, I served as an
16 auditor and financial analyst in the finance industry. During this time I served as
17 a guest lecturer on financial statement and ratio analysis for the Small Business
18 Administration at its national annual Micro Loan Conference. I have served as
19 an adjunct faculty member for John Brown University teaching Accounting,
20 Financial Mathematics, Financial Management, and Economics. Since joining
21 Staff I have attended “The Basics - Practical Skills for the Changing Electric,
22 Natural Gas, Telecommunications and Water Industries” jointly sponsored by the

1 New Mexico State Center for Public Utilities and the National Association of
2 Regulatory Utility Commissioners. I have previously filed testimony before this
3 Commission on matters concerning utility company rate cases.

4 **PURPOSE OF TESTIMONY**

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

6 A. The purpose of my Direct Testimony is to make recommendations regarding
7 Oklahoma Gas and Electric Company's, (OG&E or Company) filing made
8 pursuant to Act 310 of 1981, as amended by Act 1000 of 2015, Ark. Code Ann. §
9 23-4-501, *et seq.* (Act 310). Specifically, I will address OG&E's Environmental
10 Compliance Plan Rider (ECP Rider), the procedures for the conduct of this
11 proceeding, and the calculation of the revenue requirement in the ECP Rider. In
12 so doing, I will also address the Direct Testimony of OG&E witness, Donald R.
13 Rowlett. However, I will not make a recommendation regarding the
14 appropriateness of costs for ratemaking purposes at this time. That
15 determination will be made at the time of OG&E's next general rate case.

16 **SUMMARY OF OG&E'S ACT 310 REQUEST**

17 **Q. Please summarize OG&E's May 8, 2015 filing.**

18 A. In its filing, OG&E requested that the Commission take notice of and review
19 OG&E's Act 310 surcharge as filed and waive the necessity of any security
20 deposit relative to any possible refunds. Specifically, OG&E requested approval
21 of its proposed interim surcharge for the recovery of costs incurred in order to
22 comply with emission limits for nitrogen oxides (NOx) established in the Federal

1 Clean Air Act (CAA) for regional haze requirements, also known as the Regional
2 Haze Rule. In accordance with the requirements of Title 40 of the Code of
3 Federal Regulations (CFR) Part 51, the Oklahoma Department of Environmental
4 Quality (ODEQ) created the Oklahoma State Implementation Plan, (SIP) which
5 was approved, in part, on December 28, 2011 by the Environmental Protection
6 Agency (EPA). The approved sections of the SIP designate those facilities in
7 Oklahoma currently not in compliance with emission standards. The approved
8 sections also contain the requirement for the use of Best Available Retrofit
9 Technology (BART) in the control of NOx emissions. In direct response to this
10 designation and requirement, OG&E began installing Low NOx burners with
11 over-fire air (LNB/OFA) systems at seven of its units designated by the SIP as
12 not currently meeting emission standards. The affected coal units are Sooner
13 Units 1 & 2 and Muskogee Units 4 & 5, and the affected natural gas units are
14 Seminole Power Plant Units 1, 2 and 3. As of the date of this filing, installation of
15 the LNB/OFA systems had been completed at the four coal units and was in
16 process for the three gas units. Under the ECP Rider, OG&E began collecting
17 \$489,934 annually from its Arkansas retail customers with the first billing in June
18 2015.

19 **ACT 310**

20 **Q. Please describe Act 310.**

21 A. Act 310 allows for interim recovery of costs incurred by a utility as a direct result
22 of legislative or administrative regulations relating to the public health, safety, or

1 environment. Those costs must be, among other requirements, necessary in
2 order to provide service, incurred with respect to existing facilities, reasonably
3 incurred, not included in the utility's current rates, do not include increases for
4 employment compensation or benefits, and cannot be recovered in a prompt and
5 timely fashion under existing regulatory procedures. Act 310 affords a utility rate
6 recovery by means of a surcharge immediately upon filing.

7 Because the unique provisions of Act 310 allow a utility to begin recovery
8 of a surcharge with no prior Commission review, it is imperative that the utility
9 provide in its initial filing more than mere conclusory statements in support of its
10 petition. A utility should, at the outset, provide full support and documentation
11 that those costs being recovered from ratepayers meet the explicit eligibility
12 requirements of Act 310. This initial burden rests squarely with the utility seeking
13 special recovery.

14 **Q. Did OG&E comply with the Commission's procedures for an Act 310 filing**
15 **as set forth in Docket No. 09-059-U as applicable in this particular case?**

16 A. Yes. The application filed by the OG&E states the Company will comply with the
17 procedures set out by the Commission in its Order No. 4 in Docket No 09-059-U,
18 except for those directives specific to said docket.¹ The procedures which apply
19 to OG&E are as follows:

20 1. That no finding of the Commission regarding the Act 310
21 Surcharge will be deemed a finding that the costs included
22 for recovery via the surcharge are necessary and
23 appropriate or in the public interest. Likewise, all costs

¹ Docket No. 15-034-U Application, p.5, Section 14

1 recovered under the surcharge will remain subject to refund,
2 with interest, until the prudence of said costs is ultimately
3 addressed in the Company's next general rate case
4 proceeding.

5 2. To file subsequent Act 310 Notices and/or amendments to
6 the Surcharge related to this project in the instant docket.

7 3. To fully cooperate with the APSC General Staff and
8 intervenors in their investigation of the Act 310 Surcharge
9 and any subsequent Act 310 Surcharge amendments filed
10 by the Company.

11 4. To reflect the Act 310 Surcharge, and any subsequent Act
12 310 Surcharge amendments filed as a separate line item on
13 the customer's bill labeled "Environmental Compliance
14 Surcharge."

15 5. To provide Staff supporting documentation and work papers
16 for a sample of projects determined by General Staff.
17 Further the Company will provide such documentation at the
18 time of filing any subsequent Act 310 Surcharge
19 amendments related to that sample of projects.

20 6. To the extent any additional cost items are included in
21 subsequent Act 310 Surcharge filings, to provide, at the time
22 of filing, similar justification in support of its inclusion of those
23 costs and documentation of each of those transactions.

24 7. To provide work papers to General Staff and intervenors in
25 electronic format with formulas and links intact where
26 possible.

27 The Direct Testimony of OG&E witness Rowlett was helpful in explaining
28 the Company's request and the components of the surcharge. OG&E also
29 provided additional support as requested in response to data requests, and
30 through both preliminary and subsequent informal discussions.

1 **Q. Ark. Code Ann. § 23-4-506 permits, but does not mandate, the Commission**
2 **to require reasonable security to assure prompt payment of any refunds**
3 **that may be ordered. Do you agree with the Company's request that**
4 **security not be required due to the small size of the amount to be collected**
5 **through the ECP Rider?**

6 A. Yes. My recommended Revenue Requirement for Rider ECP in the amount of
7 \$478,097 is approximately 0.54% of the Arkansas Rate Schedule Revenue
8 Requirement allowed in OG&E's last rate case, Docket No. 10-067-U. Therefore,
9 I do not recommend security as long as OG&E agrees to an immediate refund of
10 any over collections with interest, as provided for in the statute, until such time as
11 the rates are superseded by a subsequent Act 310 filing or until the effective date
12 new rates are implemented as a result of a general rate proceeding.

13 **STAFF'S REVENUE REQUIREMENT RECOMMENDATION**

14 **Q. Do you agree with the inclusion of the LNB/OFA technology costs in the**
15 **Act 310 surcharge?**

16 A. Yes. Based on my review of the testimony and supporting documentation, I
17 agree the project costs were incurred in order to comply with the regulations
18 described above.

19 **Q. Are you recommending any modifications to OG&E's determination of its**
20 **annual Revenue Requirement?**

21 A. Yes. I am recommending changes to Allowance for Funds Used During
22 Construction (AFUDC), Retirements, Accumulated Depreciation (A/D),

1 Depreciation Expense, Property Taxes and the allocation factors used by the
2 Company.

3 **Q. Please explain your changes to AFUDC?**

4 A. OG&E included in its revenue requirement calculation an adjustment to reduce
5 AFUDC by \$27,634 in recognition of the Arkansas jurisdictional Rate of Return of
6 5.93%, including the Return on Equity (ROE) of 9.95%, from OG&E's last rate
7 case, Docket No. 10-067-U. In my calculation, I only recognize the impact of the
8 Arkansas jurisdictional ROE, which resulted in a reduction in AFUDC of \$19,648.
9 My recommended level of AFUDC is \$7,986 more than the Company's.

10 **Q. Please discuss your adjustment for retirements.**

11 A. In response to Staff data request APSC-003, the Company indicated that some
12 of its boiler equipment included in its last rate case was retired as a direct result
13 of these projects. Consistent with the treatment OG&E would have been
14 afforded had this project been included in its last rate case, I reduced Gross
15 Plant-In-Service (GPIS) and A/D by \$711,870 in recognition of these retirements.
16 While there is no effect on net plant, the related depreciation expense is reduced.
17 This adjustment was not made by the Company.

18 **Q. Please explain the difference between your adjustment to A/D and the
19 Company's.**

20 A. My adjusted total for A/D of \$37,105 varies from the Company's total of
21 (\$661,831) largely due to my inclusion of \$711,870 for retirements. Additionally,
22 my adjustment to A/D includes an increase of \$12,851. This increase is the

1 result of my correction of a small formula error in the Company's original
2 depreciation calculations for January 2014.

3 **Q. What changes did you make in your calculation of depreciation expense?**

4 A. While I utilized the same methodology as the Company, my total differs from the
5 Company due to my increase to GPIS for the AFUDC adjustment mentioned
6 above. Additionally, I included a reduction to depreciation expense related to
7 retirements. These two differences resulted in my depreciation expense being
8 \$11,965 less than the Company's.

9 **Q. Please discuss your property tax expense.**

10 A. I determined property tax expense by applying a 1% tax rate from the Company's
11 most recent rate case to net plant. My property tax expense of \$333,210 is
12 \$95,313 less than the Company's \$428,523 amount due to two factors.

13 The first factor which contributed to this difference is the Company's use
14 of GPIS in its calculation, while I use net plant. My use of net plant is consistent
15 with the cost approach used by the Tax Division of the APSC in determining the
16 annual tax assessment. The 1% tax rate was determined by dividing the actual
17 Arkansas property tax paid by the fair market value of plant from the Company's
18 most recent rate case. The 1% rate was also used by OG&E in its calculation.

19 The second factor is that the Company included Construction Work-In-
20 Progress (CWIP) in its calculation. The amount of property tax associated with
21 the project during the construction period is properly included as a component of
22 the plant's construction cost once the project is closed to plant and is in service.

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1 However, to include property taxes related to CWIP in expense is not
2 appropriate. Therefore, my calculation was based on net plant only and did not
3 include CWIP.

4 **Q. What is the total effect of these adjustments to the revenue requirement to
5 be recovered through the Act 310 surcharge?**

6 A. As shown in my Direct Exhibit WM-1, my recommended changes will result in an
7 Arkansas Revenue Requirement of \$478,097, which is \$11,837 less than the
8 Company's amount of \$489,934

9 **COST ALLOCATION AND RATE DESIGN**

10 **Q. How did OG&E allocate the ECP Rider's revenue requirement between rate
11 classes?**

12 A. According to the Direct Testimony of Company witness Rowlett, the revenue
13 requirement is allocated to the Arkansas jurisdictional retail customer classes
14 based on the production demand allocator (PDA) approved in the Company's last
15 base rate case.

16 **Q. Do you agree with Mr. Rowlett on this description of the process used by
17 the Company?**

18 A. Not entirely. While I do agree the Company used the correct Arkansas
19 Jurisdictional Allocator of 10.9927%, I do not believe the PDAs used by the
20 Company are correct.

21 **Q. Please explain why you disagree with the PDAs used by the Company.**

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1 A. During my review, I observed that the PDAs being used by the Company did not
2 match the approved PDAs from the Company's most recent rate case. I was
3 informed by Company personnel that the PDAs had been recalculated due to
4 OG&E's contract with a large wholesale client that was due to expire June 2015.
5 In an effort to reflect this change, the Company recalculated its PDAs by
6 including the wholesale capacity from the expiring contract in their retail capacity
7 totals. However, Ark. Code Ann. § 23-4-503 clearly requires that the amount of
8 the interim surcharge be calculated as if the investments and expense had been
9 included in the utility's most recent rate case. In order to comply with this
10 directive, all surcharge calculations must use the allocation factors, billing
11 determinants, rate of return, depreciation rates, and property tax rates from the
12 Company's most recent rate case. Accordingly, I disagree with the Company's
13 recalculation of allocation factors and recommend compliance with Act 310,
14 consistent with the Commission's determination in previous Act 310 proceedings.

15 **Q. Do you have any recommendations regarding rate design?**

16 A. Yes. In OG&E's filing, once the revenue requirement was determined for each
17 customer class, the specific charge was calculated using the Arkansas retail
18 jurisdictional kWh for each class from the Company's most recent rate case.
19 However, the Power and Light class includes both kWh and kW billing
20 determinants. Due to the complexity of those calculations, I am recommending
21 the Company use the rate structure developed and approved in the last rate

1 case, as shown in Direct Exhibit WM-2, to determine the ECP class factor for this
2 rate class.

3 **Q. What is the estimated impact of the ECP Rider on OG&E customers?**

4 A. The rate impact of the ECP surcharge on OG&E's rate classes is discussed on
5 page 10 of OG&E witness Rowlett's Direct Testimony. The ECP Rider Factor by
6 Class will have to be modified to reflect the use of the correct PDAs. While my
7 total revenue requirement and allocation factors differ from the Company, my
8 recommendations will have a minimal effect on these bill impacts.

9 **ECP RIDER**

10 **Q. Did you review the tariff and do you recommend any changes?**

11 A. Yes. The purpose of the ECP Rider, as stated in OG&E witness Rowlett's Direct
12 Exhibit DRR-1, is to recover the Arkansas retail jurisdictional portion of the
13 annual revenue requirement for expenditures related to environmental
14 compliance projects. The Allocator Percentage for each rate class shown in the
15 rider should be revised to reflect the impact of using the correct PDAs as
16 discussed above. Additionally, in OG&E's Direct Exhibit DRR-1, the sentence in
17 section 78.5 regarding the Arkansas Jurisdiction ECP Revenue Requirement,
18 which states, "All prudently incurred project expenditures made by the Company
19 and not recovered in existing approved base rates shall be recovered as part of
20 this rider." should be modified. As stated earlier, the prudence of said costs will
21 be decided in the Company's next rate case and not in this docket. Any
22 assertion of prudence prior to that point would be premature. The language in

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1 the sentence can simply be modified to state “Only those project expenditures
2 included in Docket No. 15-034-U shall be recovered as part of this rider.” I
3 recommend approval of the ECP Rider with the modifications noted above.

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

5 A. Yes, it does.

CERTIFICATE OF SERVICE

I, Fran Hickman, hereby certify that a copy of the foregoing has been served on all parties of record by electronic means or first class mail, postage prepaid, on the 10th day of August, 2015

/s/ Fran C. Hickman
Fran C. Hickman