BEFORE THE 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 201500273
AUTHORIZING APPLICANT TO MODIFY ITS	)	
RATES, CHARGES, AND TARIFFS FOR RETAIL	)	
ELECTRIC SERVICE IN OKLAHOMA	)	

RESPONSE TO EXCEPTIONS TO THE REPORT OF THE ADMINISTRATIVE LAW JUDGE OF OKLAHOMA GAS AND ELECTRIC COMPANY

January 11, 2017

TABLE OF CONTENTS

In accordance with OAC 165:5-13-5, Oklahoma Gas and Electric Company ("OG&E") hereby files this response to the exceptions to the Report and Recommendations of the Administrative Law Judge ("ALJ Report") issued in this cause on December 8, 2016, and modified by an Errata to Appendix C filed on December 16, 2016.

I. Introduction

The exceptions to the ALJ Report filed by other parties in this Cause fail to demonstrate that the ALJ's recommendations at issue are either unsupported by the record evidence or contrary to law. As explained herein and contrary to the arguments of the other parties, there is substantial evidence to support the ALJ's recommendations. There is a vast difference between a lack of substantial evidence in the record and a party's opinion as to the value of that evidence. *See In re Southwestern Bell Tel., L.P. v. State ex rel Okla. Corp. Comm'n,* 2007 OK 55, ¶ 36 ("In cases before the Commission involving the testimony of expert witnesses, a factual finding is supported by substantial evidence when the evidence is offered by a qualified expert who has a rational basis for his/her views, even if other experts disagree."). In sum, merely disagreeing with the evidence presented does not equate to a lack of substantial evidence or a failure by OG&E to satisfy the requisite burden of proof.

In this Response, OG&E addresses the parties' arguments to the extent practicable to demonstrate that the record does indeed support OG&E's positions and the ALJ's recommendations regarding subjects at issue. However, it should be noted that OG&E's failure to address a particular argument or issue does not indicate acquiescence regarding that argument or waiver of OG&E's position as set forth during the course of this Cause. OG&E submits the record in the present Cause supports a conclusion that OG&E has met its evidentiary burden and that the ALJ's recommendations, and OG&E's positions regarding issues in this Cause, are consonant with established law and supported by substantial evidence to an extent sufficient to withstand appellate review.

II. Capital Structure

1. The ALJ correctly recommended adopting the Company's proposed capital structure.

The ALJ recommended that the Commission adopt the Company's current capital structure of 53.31% equity to 46.69% debt. (ALJ Report, pp. 32-33). The ALJ observed, among other things, that maintaining this capital structure is necessary to ensure that OG&E "has a competitive [rate of return] attractive to investors." (*Id.* at 33).

The ALJ's recommendation is proper. The evidence shows that OG&E's capital structure is consistent with those in place at similarly situated utilities. (Hevert Direct, pp. 54-55, and Ex. RBH-10). Specifically, OG&E witness Robert Hevert calculated the average capital structure for each of the utility operating companies held by his proxy companies -- *i.e.*, 44 companies similar to OG&E -- over the last eight fiscal quarters. His analysis showed that the proxy group average capital structure over that period includes 52.85% common equity and 47.15% long-term debt. (*Id.*). The common equity ratios for these companies ranged over this period on average from 47.11% to 65.05%. (*Id.*). Thus, OG&E's capital structure is well within the range of those for the proxy group.

As Mr. Hevert also explained, utilities must confront unique circumstances uncommon to unregulated entities. Utilities must, for example, finance long-life assets that are large, "in the ground" types of investments. (Tr. Late P.M. 5/4/2016, p. rdh-264, lns. 8-16). These assets must be matched with long-life securities in a process that is exceedingly complex. (*Id.* at p. rdh-264, lns. 17-24). Thus, the capital structures utilized by similarly situated utilities -- utilities that face the same constraints and complex decisions -- provide direct support the ALJ's recommendation.

The AG contends, however, that the Commission should adopt a 50% equity/50% debt hypothetical capital structure for OG&E. (AG Exceptions, p. 7). The AG's position is based on the testimony of AG witness Solomon. (*Id.*). Mr. Solomon's testimony is unreliable; his analysis is demonstrably wrong. Mr. Solomon pointed to a Memorandum of Understanding ("MOU") signed by OG&E and accepted by the Commission in a 1996 proceeding. According to Mr. Solomon, the MOU required OG&E to maintain a "balanced" capital structure. (Solomon Responsive, p. 10, lns. 18-26). Mr. Solomon argued that OG&E's capital structure must be 50% debt and 50% equity in order to satisfy OG&E's agreement to maintain a "balanced" capital structure. (Solomon Responsive, p. 10, ln. 18 through p. 11, ln. 9).

Mr. Solomon is wrong on several fronts. The Commission has never required OG&E to maintain a 50% equity/50% debt capital structure. Since the date of the MOU and the Commission's Order in PUD 950000148 on November 1, 1996, there have been several general rate cases for OG&E in which the Commission has established, either through a litigated case or an approved stipulation, a capital structure for OG&E. In none of those cases has the Commission required a 50% equity/50% debt capital structure. (*See, e.g.*, Cause No. PUD 201100087, Order No. 599558 (July 9, 2012) (stipulated); Cause No. PUD 200500151, Order No. 516261(Oct. 20, 2005) (litigated)). Likewise, in no case has the Commission imposed any arbitrary, hypothetical capital structure on OG&E, whether a 50% equity/50% debt capital structure or otherwise. Instead, the Commission has always recognized and approved OG&E's actual capital structure. (*See* Cause No. PUD 200500151, Order No. 516261, p. 92 (adopting the Company's capital structure with a 55.69% equity component)).

In fact, Mr. Solomon's prior testimony shows that he previously did not believe that the 1996 MOU required OG&E to maintain a 50% equity/50% debt capital structure. Specifically, Mr. Solomon testified in the Company's 2005 rate case. In that case, he proposed a capital structure of 47.5% equity and 52.6% debt. (Tr. A.M. 5/10/2016, p. sd-43, lns. 1-11). If he believed the 1996 MOU had required the 50% equity/50% debt capital structure, Mr. Solomon would have recommended such a structure in his 2005 testimony. In any event, in the 2005 case, the Commission rejected Mr. Solomon's position, and instead approved a capital structure of 55.69% equity and 44.31% debt. (*Id.* at p. sd-43, lns. 12-15; *see also* Cause No. PUD 200500151, Order No. 516261, pp. 91-92).

Further, a specific long term capital structure requirement, as suggested by Mr. Solomon, would be contrary to the approach endorsed by the Oklahoma Supreme Court. Oklahoma has long recognized that "[a]n appropriate capital structure is one that balances properly the requirements of safety of investment, stability of dividends and availability of capital with low cost to the ratepayer." *Turpen v. Oklahoma Corp. Com'n*, 1988 OK 126, 769 P. 2d 1309, 1329. There is simply no authority that says that a balanced capital structure must be a 50% equity/50% debt capital structure.

Rather, capital structure optimization, as noted above, is dynamic in nature and requires the Company to contend with numerous constrains that are continually changing in response to market conditions. (Hevert Rebuttal, p. 99, lns. 16-18). The AG's contention that a "balanced capital structure" means a 50/50 ratio is far too simplistic in light of the inherent complexity of the analysis. As the Supreme Court observed, a "balanced" capital structure is one that balances competing interests. Most crucially, the AG's proposal would divest OG&E's management of its recognized discretion to establish a capital structure that appropriately balances the interests of the utility and ratepayers.

Even AG witness Solomon's own exhibit supports the reasonableness of the ALJ's recommended capital structure. In his Responsive Testimony, Mr. Solomon pointed to a range of common equity ratios approved for electric utilities in cases (other than limited issue generation rider cases) before state commissions since January 2015. (Solomon Responsive, p. 11, lns. 15-18 and Ex. JBS-2). Mr. Solomon's exhibit demonstrates that for vertically integrated utilities, like OG&E, the state commissions approved equity ratios in excess of 50% in a majority of cases. (Solomon Responsive, Ex. JBS-2). Of the 26 total capital structures identified on Exhibit JBS-2, fourteen are at 50% equity or higher and eight are above 50% equity. (Ex. JBS-2, lines 3, 4, 5, 6, 8, 10, 12, 14, 15, 20, 22, 24, 25, and 26). Thus, neither Commission practice nor the testimony of its own witness supports the AG's unreasonable position. The ALJ properly rejected the AG's position, as should the Commission.

OIEC and OER argue that the ALJ should have recommended that the Commission order OG&E to adopt a "more balanced" capital structure before its next rate case, specifically asserting that OG&E should be ordered to "bring its equity ratio in line with the averages of other utilities." (OIEC Exceptions, p. 17; OER Exceptions, p. 5).[1] OIEC contends that if the Company does not adopt an equity ratio of "about 50%," the Commission should impute a capital structure in a future rate proceeding "both as recommended by OIEC/OER witness Parcell and Staff witness Garrett." (OIEC Exceptions, p. 17). In support, OIEC points to: (a) the average ratios for "electric utilities under rate orders in 2015" discussed by Mr. Parcell; and (b) FEA witness Walters' testimony about equity ratio average for all electric utilities and vertically integrated utilities "over the last ten years." (OIEC Exceptions, pp. 17-18).

None of the testimony upon which OIEC relies demonstrates that the Company's current capital structure is unreasonable. As an initial matter, Staff witness Garrett suggested that the Commission should impute a capital structure of 40% equity and 60% debt in a future case. (Garrett Responsive, p. 11, lns. 5-9; p. 118). The ALJ correctly rejected that position, noting that Mr. Garrett did not show "that such a ratio would attract investment capital to OG&E." (ALJ Report, p. 32). Indeed, the evidence shows that such a dramatic shift in the Company's capital

[1] OIEC and OER do not, however, take issue with the ALJ's capital structure recommendation for purposes of this proceeding.

structure would threaten OG&E's financial integrity. At hearing, Mr. Garrett acknowledged that Moody's ultimate credit rating relies heavily upon a company's financial strength, with that metric accounting for approximately 40% of Moody's weighted grade. (Tr. P.M. 5/9/2016, p. sj-73, ln. 14 through sj-74, ln. 8 and Trial Ex. 44). Mr. Garrett admitted that a company with a 60% debt capitalization would be consistent with a "Ba" rating, which is not considered an investment grade. (*Id.* at p. sj-74, lns. 9-19 and Trial Ex. 44). As Mr. Hevert explained, "utilities are capital-intensive enterprises that must access the external capital markets when and as needed." (Hevert Rebuttal, p. 19, lns. 16-17). Mr. Garrett's proposed capital structure would thus greatly impair the Company's ability to do so at a reasonable cost. (*See id.* at p. 63, ln. 20 through p. 65, ln. 15).

OIEC's reliance on Mr. Parcell's and Mr. Walters' testimony to support its argument that the Commission should impute a capital structure that is "in line" with other utilities fares no better. Like the AG's proposal, OIEC's recommendation would divest the Company's management of its discretion to address financing constraints that are dynamic in nature and that continually change in response to market conditions. (Hevert Rebuttal, p. 65, ln. 16 through p. 66, ln. 11). In *Turpen*, the Supreme Court of Oklahoma upheld a utility's chosen capital structure, noting that good faith on the part of public utility managers is presumed absent a showing of inefficiency or imprudence on their part. 769 P.2d at 1330. No witness has shown anything close to imprudence or inefficiency by OG&E. Thus, the Commission should uphold OG&E's chosen capital structure.

In any event, as explained above, there is no basis for imputing a capital structure where the Company's current structure is well within the range of those used by similarly situated utilities. (Hevert Direct, p. 54-55 and Ex.. RBH-10; Solomon Ex. JBS-2, lines 3, 4, 5, 6, 8, 10, 12, 14, 15, 20, 22, 24, 25, and 26). As noted, Mr. Hevert looked to the capital structures of 44 utility operating companies from his proxy group to assess the reasonableness of OG&E's capital structure. (Hevert Direct, p. 54-55, and Ex. RBH-10). By contrast, Mr. Walters only looked at the average capital structures of the *parent* companies in his proxy group. (Walters Responsive, p. 12, lns. 9-10 and Ex. CCW-2). Further, while Mr. Parcell cited to data for operating companies, the data he relied on relates to electric utilities generally, rather than to the capital structures of the similarly-situated proxy companies in Mr. Hevert's analysis. (Parcell Responsive, p. 18, ln. 12 through p. 19, ln. 6 and Ex. DCP-1, Schedule 10, pp. 4-8). Thus, Mr. Hevert's analysis is more appropriate for purposes of the capital structure comparison and shows that OG&E's capital structure is reasonable. In short, the evidence shows that OG&E's capital structure is already "in line" with those of similarly situated utilities.

For these reasons, the Commission should adopt the ALJ's recommendation here and refuse to order OG&E to arbitrarily adopt a capital structure before its next rate case.

III. Return on Equity

1. The ALJ's recommended ROE of 9.87% is reasonable and supported by substantial evidence.

The ALJ's ROE recommendations are eminently reasonable and supported by substantial evidence, including the testimony of OG&E witness Hevert and the other ROE experts.

(Exceptions to the Report of the Administrative Law Judge of Oklahoma Gas and Electric Company ("OG&E Exceptions"), pp. 2-6). Several parties take issue with the ALJ's 9.87% recommendation and argue in favor of unreasonably low ROEs. Their arguments are meritless. Even the highest of their ROE recommendations -- 9.30% -- would be one of the lowest ROEs awarded for a vertically integrated electric utility in more than 35 years. These parties' unduly low proposals are not only grossly out-of-step with prevailing industry trends and investor expectations, they also rely on flawed and unreasonable assumptions. The Commission should reject their arguments and adopt the ALJ's 9.87% ROE recommendation.

a. The ALJ properly considered multiple approaches and the recommendations of multiple experts in reaching his conclusions.

FEA claims that the ALJ's recommended ROE is unreasonable because it "is not within any of the expert witnesses' recommended ranges." (FEA Exceptions, p. 3). OIEC makes the identical argument. (OIEC Exceptions, p. 12). Similarly, several parties characterize the ALJ's ROE recommendation as being only based on a recent award in a case before the Texas Public Utilities Commission involving Southwestern Public Service Company ("SPS"). The parties here claim that the ALJ's ROE recommendation is not based on the evidence of record. (AG Exceptions, pp. 4-5; FEA Exceptions, pp. 4-5; OIEC Exceptions, p. 16; Staff Exceptions, pp. 4-5). The AG even goes so far as to boldly assert that "[t]here is *no* evidence to support the ALJ's reasoning."[2] (AG Exceptions, p. 3 (emphasis added)). These parties are wrong. The record amply supports the ALJ's findings.

In reaching his ROE recommendations, the ALJ looked at multiple models and data points. As a general matter, this approach was unquestionably reasonable. Indeed, the Oklahoma Supreme Court recognized long ago that, in establishing a rate of return, the "Commission is under no set rule or formula, for ratemaking is not an exact science." *Public Serv. Co. of Oklahoma v. Oklahoma Corp. Comm'n*, 688 P. 2d 1274, 1282 (1983). And as the ALJ stated, "the cost of equity is not directly observable but must be estimated from quantitative and qualitative information." (ALJ Report, p. 24 (citing Mr. Hevert's testimony)).[3] Since the empirical models used to estimate ROEs "are all subject to limiting assumptions or other constraints" and "no individual model is more reliable than all others under all market

---

2 The AG argues that the Commission cannot adopt the ALJ's recommendation under the Oklahoma Supreme Court's decision in *Lone Star Gas Co. v. Corp. Comm'n of State of Okla.*, 1982 OK 79, 648 P. 2d 36. (AG Exceptions, p. 3). That case, however, is inapposite. Indeed, the Court there held that the Commission erred when it adopted, "without any supporting evidence or reasoning," a rate of return based on a 13.25% ROE. *Lone Star*, 648 p. 2d at 40. In that case, "the staff simply presented the Commission a range of options on the [ROE] calculation, giving no testimony as to the desirability of one option over the other," and the Commission then adopted one of those options without further explanation. *Id.* Unlike in *Lone Star*, the ALJ's recommendations here are supported by the testimony of multiple experts and industry data.

3 After noting that the ALJ relied on Mr. Hevert for the proposition that the cost of equity "is not directly observable but must be estimated," OIEC strangely argues that this proposition is unsupported because "Mr. Hevert's testimony was not credible." (OIEC Exceptions, pp. 12-16). While there are many disputes in this case, the fact that ROE must be estimated is not one of them. All but one of the ROE witnesses agreed at least on that point, including OIEC/OER witness Parcell, who used three models to estimate ROE in this case and testified that using multiple methods helps to confirm where a reasonable range of returns might be. (Tr. A.M. 5/9/2016, p. 62, lns. 7-10).

conditions," the ALJ properly considered the evidence as a whole to arrive at an independent recommendation. (*Id.*). The ALJ correctly did not limit his analysis by rigidly adhering to one expert's recommendation to the exclusion of the rest of the record evidence.

The ALJ's methodology is also supported by the experts for the Company, Staff and the intervenors. These experts agreed that it is important to consider a variety of models when calculating ROE. (*See, e.g.*, Hevert Rebuttal, p. 79, lns. 10-13 ("[P]ractitioners and academics alike recognize . . . that strict adherence to any single approach, or the results of a single approach, can lead to flawed or misleading conclusions."); Tr. A.M. 5/9/2016, p. 62, lns. 7-10, (Parcell Cross) (multiple methods help confirm where a reasonable range of ROEs might be); Tr. P.M. 5/9/2016, p. sj-25, ln. 23 through p. sj-26, ln. 2, (Garrett Cross) (using multiple models is the generally accepted practice among experts and investors in the field to determine a proper ROE); Tr. P.M. 5/10/2016, p. rdh-18 (Walters Cross) (it is proper to use multiple methods to estimate the appropriate return on equity)).

Further, there is no support for the claim that the ALJ failed to give due consideration to the evidence of record. As expressly stated in the Report, the ALJ's recommendation was "based on a mix of evidence from different models" that he reviewed to "identify appropriate benchmarks for ROE even if [his specific recommendation was] not adopted by a particular witness." (ALJ Report, p. 24). While the ALJ could and should have marshaled more evidence from the record in favor of his findings (*see* OG&E Exceptions, pp. 2-6), the ALJ's ROE analysis -- spanning ten pages of the Report -- shows that the he did far more than simply look to SPS's recently authorized ROE to make his recommendations. (ALJ Report, pp. 21-31).

In the Report, the ALJ, among other things: (1) set out the experts' recommendations; (2) discussed their various models; (3) discussed the witnesses' proxy groups; (4) explained the legal standards; (5) engaged in detailed discussions of the assumptions underlying the models; (6) discussed prevailing industry trends; and (7) explored current market conditions. (*Id.*). On the basis of all that, the ALJ made his recommendations. (*Id.* at 30). To be sure, the ALJ should have gone further and explained that his specific 9.87% proposal and his range of reasonableness found even greater support in the record than what he articulated. (OG&E Exceptions, pp. 2-6). But the arguments of those parties seeking to paint the ALJ's analysis as simplistic and detached from the record simply do not hold water even upon a cursory review of the ALJ's lengthy analysis.

Indeed, with one exception discussed below, the parties criticizing the ALJ's ROE recommendation fail to point out that the upper boundary of the ALJ's range of reasonableness -- 10.0% -- is directly supported by calculations performed by OIEC/OER witness Parcell. (ALJ Report, p. 30 (using Mr. Parcell's Comparable Earnings model)). OIEC, for example, complains at length about Mr. Hevert's purportedly "inflated" estimates, but ignores that *the highest ROE value relied upon by the ALJ was derived, in part, from OIEC's witness' testimony*. (OIEC Exceptions, pp. 12-16). Accordingly, OIEC (or any party) can hardly argue that the ALJ's recommendation is unsupported by the evidence.

What is more, the ALJ's specific recommendations find abundant support in the record that was unmentioned by the ALJ. Indeed, as OG&E demonstrated in its Exceptions and as shown further below, the ALJ's findings are supported by: (1) recent authorized returns for vertically integrated utilities; (2) the authorized returns for utilities with credit ratings similar to OG&E's; (3) the returns authorized for utilities operating in similar regulatory jurisdictions; and (4) many of the other witnesses' calculations, as modified by Mr. Hevert's reasonable adjustments. (OG&E Exceptions, pp. 2-6).

b. The ALJ did not err by looking to SPS's authorized ROE to inform his specific recommendations.

As noted, several parties claim that the ALJ erred by looking to SPS's 9.70% ROE award in a 2015 rate case to inform the ALJ's specific ROE recommendation and the lower boundary of the ALJ's range of reasonableness. (*See* AG Exceptions, pp. 4-6; FEA Exceptions, pp. 4-5; Staff Exceptions, pp. 2-3; OIEC Exceptions, p. 16). Staff goes so far as to argue, on the basis of Staff witness Garrett's testimony, that looking to the authorized ROEs from other jurisdictions is entirely improper. (Staff Exceptions, pp. 2-3). These parties' positions are belied by common commission practice and the evidence of record.

Commissions, experts and investors frequently look to ROEs authorized in other jurisdictions when determining or estimating an appropriate ROE for a particular utility. (*See, e.g.*, Tr. P.M. 5/9/2016, p. sj-36, ln. 18 through p. sj-37, ln. 1 (Garrett Cross) (admitting that commissions and testifying experts review other companies' authorized ROEs to inform their judgment)). Even the Federal Energy Regulatory Commission ("FERC"), which has traditionally relied on the Discounted Cash Flow ("DCF") analysis, looks to ROEs authorized by state commissions to inform its ROE awards. (*See* Opinion No. 551, 156 FERC ¶ 61,234, P 250, FERC Docket No. EL14-12-002, Order on Initial Decision (Sept. 28, 2016) (holding that a study of state-authorized ROEs showed that a mechanical application of the DCF methodology would be improper)). As Mr. Hevert explained, "Authorized returns . . . are based [on] the methods and data used by investors, reflect regulators' objectives of balancing investors' interest with those of ratepayers and, therefore, are relevant data points." (Hevert Rebuttal, p. 16, lns. 29-31).

Admissions elicited at hearing further support this notion. OIEC/OER witness Parcell conceded, for example, that looking to the ROE awards of other commissions can provide "assistance" and "comfort" when determining the reasonableness of an ROE recommendation. (Tr. A.M. 5/9/2016, p. 63, lns. 3-7). Even Staff witness Garrett conceded that investors rely on authorized ROEs, admitting that they look to information published by respected services such as Value Line to gather relevant information and that Value Line publishes information concerning a company's awarded ROE. (Tr. P.M. 5/9/2016, p. sj-33, ln. 10 through p. sj-36, ln. 17). He also acknowledged that allowed ROEs are material to investors, recognizing that such information appears in OG&E's filings to the Securities and Exchange Commission. (*Id.* at p. sj-35, ln. 21 through p. sj-36, ln. 17). Simply put, the ALJ's use of a regional benchmark to inform his recommended ROE was neither improper nor unusual. Thus, the Staff's suggestion that the Commission should not refer to ROEs authorized elsewhere is unsupported and, if adopted, would make this Commission an outlier among regulatory commissions across the country.

Regarding the ALJ's specific reference to the SPS ROE, Staff also argues, without any cited support, that the ROE authorized there is inapposite. Staff contends that SPS is a smaller company and that "smaller utilities tend to present greater risk."[4] Thus, Staff concludes the ROE for OG&E should be less than SPS's ROE. (Staff Exceptions, p. 6). This unsubstantiated argument is belied by data related to Staff witness Garrett's own proxy group. SPS is a subsidiary of Xcel Energy, one of Mr. Garrett's proxy companies. (*See* Garrett Responsive, Ex. DG 1-3; Hevert Rebuttal, Ex. RBH-16R). One of Xcel Energy's other subsidiaries, Public Service Company of Colorado, was awarded a 9.83% ROE in 2015. (Hevert Rebuttal, Ex. RBH-16R). Xcel Energy discloses in its publicly available Form 10-K that Public Service Company of Colorado provides electricity service to approximately 1.4 million customers, more than three times the amount of SPS's customers and less than twice as many customers as OG&E serves. (Xcel Energy Inc., Annual Report (Form 10K), p. 8 (Feb. 9, 2016)). Yet, its authorized return was higher than SPS's and is almost exactly in line with the ALJ's recommendation here.

Ironically, while intervenors, the AG and Staff strenuously object to the ALJ's purported overreliance on a single case to inform his recommended ROE, those parties have no qualms about relying on a single case -- Public Service Company of Oklahoma's ("PSO") recently authorized 9.50% ROE -- to criticize the ALJ's recommendation. (*See* AG Exceptions, pp. 5-6; FEA Exceptions, pp. 8-9; OIEC Exceptions, pp. 3, 13, 17). Notwithstanding that PSO's ROE was based on a different record and different facts, the Commission's recent ROE awards do not show that the ALJ's recommendation is unreasonable. Indeed, in July 2016, the Commission approved an ROE of 10.00% and a capital structure consisting of 54.96% common equity for CenterPoint Energy Oklahoma Gas. Cause No. 201600094, Order No. 654461, p. 8 (July 19, 2016). CenterPoint Oklahoma is, of course, a gas utility. But the evidence in this proceeding shows that gas companies historically require *lower* ROEs than electric utilities. Indeed, FEA witness Walters testified that local gas distribution companies "are typically less risky than electric utilities." (Tr. P.M. 5/10/2016, pp. rdh-10-rdh-11). An exhibit to Mr. Parcell's testimony listing aggregate ROE data collected by Regulatory Research Associates reinforces that point. (Parcell Responsive, Ex. DCP-1, Schedule 10, p. 4). That data shows that in nearly every year since 2001, the average authorized ROE for gas utilities has been lower than for electric utilities. (*Id.*). In 2015, for example, the average ROE authorized for electric utilities was 9.85% while the average for gas utilities was 9.60%. (*Id.*).

In any event, the evidence here also shows that neither SPS's awarded ROE (9.70%) nor the ALJ's recommended ROE (9.87%) are out-of-step with returns authorized for vertically integrated electric utilities in recent years. Mr. Hevert, for example, demonstrated that in 38 cases decided from 2014 through 2015, the average authorized return for vertically integrated electric utilities was 9.84%, and in 12 (*i.e.*, about a third) of those cases, the authorized ROE was 10.0% or higher. (Hevert Rebuttal, p. 12, lns. 1-4). And several intervenor witnesses admitted that authorized returns for vertically integrated companies averaged over 9.70% in 2015. (*See* Tr. A.M. 5/9/2016, p. 68, ln. 13 through p. 69, ln. 7 (Mr. Parcell admitting that authorized ROEs for vertically integrated utilities averaged 9.74% in 2015 and that in five cases, commissions authorized ROEs above 10.0%); Tr. A.M. 5/10/2016. p. sd-59, ln. 21 through p. sd-60, ln. 3 (Mr. Solomon admitting that ROEs authorized in 2015 for vertically integrated utilities averaged over 9.70%); Tr. P.M. 5/10/2016, p. rdh-16 through rdh-17 (Mr. Walters admitting that authorized

---

4 According to Staff, SPS serves about 321,000 customers as compared to OG&E's 821,000. (Staff Exceptions, p. 6.)

ROEs for vertically integrated utilities averaged 9.74% in 2015 and that in five cases, commissions authorized ROEs above 10.0%)). Additionally, the average authorized return for the utilities in Staff witness Garrett's proxy group in 2015 was 9.69% for all companies and 9.73% for vertically integrated companies. (Hevert Rebuttal, Ex. RBH-16R). The claims of the parties attacking the ALJ's reliance on SPS's 9.70% ROE ring particularly hollow in light of this evidence.

Additionally, Mr. Hevert demonstrated that reasonable adjustments to the opposing ROE witnesses' flawed assumptions would produce ROE estimates ranging from 9.78% to 9.83%. (Hevert Rebuttal, p. 146, ln. 9 through p. 147, ln. 2 and Table 12). Those adjusted estimates support the ALJ's recommendation here and further undermine the attacks on the ALJ's use of the SPS ROE as a point of reference.

c. The 10% upper boundary of the ALJ's range of reasonableness is not an "outlier."

FEA contends that the ALJ erred by using the upper end of Mr. Parcell's Comparable Earnings ("CE") model (10.0%) to support the upper boundary of the ALJ's range of reasonableness. (FEA Exceptions, pp. 5-6). Specifically, FEA refers to Mr. Parcell's result as an "outlier" and argues that the ALJ should have instead considered the mid-point or bottom of Mr. Parcell's CE estimate to establish the upper boundary of the ALJ's range of reasonableness. (*Id.*). As a matter of logic, however, it would make little sense for the ALJ to establish the *upper* end of his range of reasonableness by relying on the *lower* values of Mr. Parcell's CE model. Further, FEA's characterization of Mr. Parcell's 10.0% result as an "outlier" is baseless. As shown above, a 10.0% ROE would be in line with recent ROE awards for vertically integrated companies; in fact, about a third of ROE awards for such companies were 10% or higher during 2015. (Hevert Rebuttal, p. 12, lns. 1-4). Indeed, Mr. Parcell himself did not characterize this result as an "outlier." He expressly used his CE results, combined with his DCF results, to establish his recommended range. (Parcell Responsive, pp. 30-31). This was in contrast to his Capital Asset Pricing Model ("CAPM") results -- which Mr. Parcell did identify as an "outlier" and thus excluded from his consideration. (Tr. A.M. 5/9/2016, p. 62, lns. 11-24). FEA's argument finds no basis in the record or in Mr. Parcell's testimony.

d. The ALJ appropriately relied on Mr. Hevert's multi-stage DCF analysis in further support of the upper boundary of his recommended range of reasonableness.

FEA and OIEC assert that the ALJ erred by using Mr. Hevert's multi-stage DCF analysis to partially support the upper boundary of the ALJ's range of reasonableness, claiming that Mr. Hevert's long-term growth rate of 5.22% is excessive. (FEA Exceptions, p. 6; OIEC Exceptions, p. 15). Even ignoring that the ALJ's upper boundary is also directly supported by Mr. Parcell's CE model, the ALJ properly based his recommendation in part on Mr. Hevert's analysis. Mr. Hevert's long-term growth rate is reasonable. In fact, the evidence shows that other witnesses' recommendations relied upon similar growth rates. (OG&E Exceptions, p 5). Mr. Parcell admitted at hearing that all five of his calculated DCF values that fell within his ultimate recommended range were derived using growth rate figures greater than 5%. (Tr. A.M.

5/9/2016, p. 78, ln. 21 through p. 79, ln. 6; Parcell Responsive, Ex. DCP-1, p. 4). FEA's own witness, Mr. Walters, also acknowledged that there were more values in his Constant Growth DCF calculation (applying consensus analysts' growth rates averaging 5.53%) that fell within his recommended DCF range than there were for his DCF models using other growth rates. (Tr. 5/10/2016, p. rdh-23 through p. rdh-26; Walters Responsive, Exs. CCW-3 to CCW-9). And of the three growth calculations that Mr. Walters used, only the calculations using consensus analysts' growth rates of 5.53% produced mean and media values for his proxy group within his recommended range of ROEs. (Tr. 5/10/2016. p. rdh-23 through p. rdh-26). Thus, FEA's position is belied by the evidence of record and the admissions of its ROE witness.

2. The other parties' alternative ROE recommendations should be rejected because they are unduly low and unreasonable.

The parties opposing the ALJ's recommended ROE predictably argue that the Commission should instead adopt their witness' ROE proposal. (*See* AG Exceptions, p. 7 (recommending Mr. Solomon's 8.9% (with the Company's current capital structure) or 9.25% (with an imputed 50/50 capital structure) proposals); FEA Exceptions, pp. 8-9 (recommending Mr. Walters' 9.30% proposal; OIEC Exceptions, p. 17 (recommending Mr. Parcell's 9.0% proposal); Staff Exceptions, p. 6 (recommending Mr. Garrett's 9.25% proposal)). Taken together, the recommendations of these parties range from 8.90% to 9.30%. The adoption of any one of these unduly low proposals would threaten the Company's ability to compete for investors' dollars, as the ALJ recognized. (ALJ Report, p. 30 (finding that investors would not be attracted to investing at such a low ROE and that "such a drop is extreme in the current economy.")). Further, these ROE estimates are premised on flawed and unreasonable assumptions, and in one case, premised upon no mathematical calculations whatsoever. The Commission should reject these parties' proposals and adopt the ALJ's 9.87% recommended ROE.

As an initial matter, while there are methodological differences between them, the recommendations of the ROE witnesses upon whom Staff, the AG and the other intervenors rely can, as a practical matter, be judged against the highly observable and relevant benchmark of the returns authorized for vertically integrated electric utilities. When viewed in this context, however, the recommendations of these witnesses are all strikingly low for vertically integrated companies. Even the highest of their recommendations, 9.30%, would be one of the lowest authorized ROEs for vertically integrated utilities since 1980. (Hevert Rebuttal, p. 11, lns. 9-14; Tr. 5/4/2016, p. rdh-263, lns. 15-25; *see also* Tr. P.M. 5/9/2016, p. sj-37, ln. 9 through sj-39, ln. 2 and Trial Ex. 41 (Mr. Garrett agreeing that lowest awarded ROE for vertically integrated utilities since 1979 is 9.0%); Tr. A.M. 5/9/2016, p. 63, ln. 13 through p. 64, ln. 14 (Mr. Parcell admitting adoption of 9.0% recommendation would be tied for the lowest ROE award for a vertically integrated company since 1980); Tr. A.M. 5/10/2016, p. sd-52, lns. 12-17 (Mr. Solomon unable to recall any case for vertically integrated electric utility where a commission authorized an ROE of less than 9.0% since at least 1980); Tr. P.M. 5/10/2016, pp. rdh-17-rdh-18 and Trial Ex. 47 (Mr. Walters admitting that only one commission has authorized an ROE as low as 9.0% for a vertically integrated utility in last 35 years and that his 9.30% recommendation is lower than average ROE awarded for gas utilities in 2015)).

The data from recent years also weighs heavily against these witnesses' recommendations. None of their recommendations come anywhere near the 9.84% average award for vertically integrated companies from 2014 to 2015. (Hevert Rebuttal, p. 12, lns. 1-4). Nor do they begin to approach the 9.74% average for vertically integrated companies in 2015. (*See, e.g.*, Tr. A.M. 5/9/2016, p. 68, ln. 13 through p. 69, ln. 7 (Parcell Cross)). Adopting these unusually low recommendations -- all of which fall far below prevailing trends for vertically integrated utilities -- would be unreasonable and threaten OG&E's financial integrity and its ability to attract capital in the market.[5] In fact, for all of the arguments by those opposing the ALJ's recommendations that such recommendations are outliers, the fact is adopting any one of their witnesses' ROE recommendations would produce a result that would be an outlier of results from commissions across the country.

Beyond being far below the average returns authorized for vertically integrated utilities, Staff's, the AG's, and the other intervenors' recommendations are also premised on the unreasonable analyses of their witnesses. For example, none of them took into account whether their models provided useful and reliable information in light of prevailing market conditions. As Mr. Hevert explained, current markets are affected by historically low levels of 10-year and short-term U.S. Treasury bond yields and by the Federal Reserve's unprecedented holding of over $4 trillion of U.S. Treasury bonds and other securities. (Hevert Rebuttal p. 49, lns. 6-17). These conditions continue to put downward pressure on long term interest rates and have caused investors to invest in utility stocks. These factors have, in turn, put downward pressure on results arising from certain well used ROE models, particularly for DCF analyses. Indeed, these "anomalous" market conditions were recently identified by FERC as a reason to have "less confidence" in DCF derived zones of reasonableness. Opinion No. 551, 156 FERC ¶ 61,234, P 119, FERC Docket No. EL14-12-002, Order on Initial Decision (Sept. 28, 2016). In light of such market conditions, it is no wonder that the overwhelming majority of DCF results obtained by Messrs. Parcell, Garrett, Solomon and Walters were below (or well below) the lowest ROEs awarded in decades. These witnesses' analyses are briefly discussed separately below.

a. The AG's 8.90% recommendation

The AG contends that, if the Commission adopts the ALJ's capital structure, the Commission should adopt Mr. Solomon's 8.90% ROE recommendation. (AG Exceptions, p. 7). Mr. Solomon's proposal, however, is flawed for several reasons that warrant its rejection by the Commission.

Mr. Solomon relied on a Two Stage DCF model to calculate his recommended 8.90% ROE. Apart from the flaws in his calculation, Mr. Solomon's recommendation should be rejected for another reason. By relying upon only a single model for his recommendation, Mr. Solomon ignores that it is important to consider a wide range of information and analytical results in determining the authorized ROE. This is because the cost of equity cannot be

---

[5] OG&E explained in its Exceptions that the returns authorized for vertically integrated utilities, like OG&E, are the relevant consideration here. (OG&E Exceptions, pp. 3-4). As compared to vertically integrated companies, distribution-only utilities have fundamentally different risk profiles and, all else equal, require a lower ROE. (*Id.*). Therefore, comparisons between OG&E and distribution-only companies are of a little value.

observed; it must be estimated. As previously shown, the other ROE witnesses all agree on this point. Indeed, Mr. Solomon acknowledged that academic literature similarly supports the use of other methods besides the DCF method and that investors use multiple methods to project ROEs. (Tr. A.M. 5/10/2016, p. sd-62, ln. 10 through p. sd-63, ln. 21).

Mr. Solomon's exclusive use of the DCF method purports to be based on the fact that FERC uses that method. (Solomon Responsive, p. 34, lns. 9-10; Tr. A.M. 5/10/2016, p. sd-65, lns. 1-8). But Mr. Solomon admitted at hearing that even FERC has come to a different conclusion and now uses other methods for its ROE calculations in addition to the DCF method. (*Id.*, p. sd-65, lns. 1-19). For reasons noted above, the ALJ also acknowledged that FERC has now started using other models to place its ROE estimates. (ALJ Report, p. 25 (citing the FERC Order 531 series of cases)).

Further, Mr. Solomon could not identify a commission which had authorized an ROE of less than 9.0% for a vertically integrated electric utility since at least 1980. (Tr. A.M. 5/10/2016, p. sd-57, lns. 12-17). Indeed, as Trial Exhibit 41 shows, there are none.

As indicated by his abnormally low result, Mr. Solomon's application of the DCF model was patently unreasonable. Mr. Solomon's Two Step DCF model produced a range of ROEs for his proxy group of 6.77% to 9.64%. (Tr. A.M. 5/10/2016, p. sd-56, lns. 9-11). However, when the low end of Mr. Solomon's DCF range, 6.77%, is compared with OG&E's 5.62% cost of debt, one would conclude that equity investors would require a premium of only 1.5% over debt. (*Id.* at p. sd-56, ln. 15 through p. sd-57, ln. 6). This is an absurd result. Moreover, seven out of the ten ROEs calculated by Mr. Solomon to establish his ROE range are less than 9.0%, with some being *more than 200 basis points below 9.0%.* (*Id.* at p. sd-57, lns. 7-11). Mr. Solomon's results thus betray his unreasonable application of the DCF model. The Commission should therefore reject the AG's 8.90% ROE recommendation.

b. OIEC's 9.0% recommendation

OIEC asserts that OG&E's ROE should be set at 9.0% "based on the substantial evidence of the case." (OIEC Exceptions, p. 6). But rather than attempting to justify a 9.0% ROE, OIEC instead takes aim at OG&E witness Hevert. (OIEC Exceptions, pp. 12-16).[6] OIEC offers nothing other than its bare assertion that the Commission should reject the ALJ's recommendation in favor of a 9.0% ROE. In any event, the record shows that OIEC's criticisms of Mr. Hevert are wrong and that Mr. Parcell's 9.0% recommendation should be rejected.

Regarding Mr. Parcell's recommendation, his 9.0% ROE proposal is based on the mid-point results of his application of the Constant Growth DCF and CE models, with his ultimate

[6] OIEC points to several decisions where Mr. Hevert's recommendations were not adopted and then asserts that "there has never been a final order issued by a public utility commission which adopted Mr. Hevert's final recommended ROE." (OIEC Exceptions, p. 13). OIEC misrepresents the portion of the transcript it cites for that proposition. In responding to OIEC's counsel's question, Mr. Hevert stated that no commission has adopted the exact estimate he recommended but that "there are a number of instances where the ordered ROE [was] within my range." (Tr. A.M. 5/5/2016, p. SJ-35, lns. 17-22).

recommendation being placed at the lower end of his 8.85% to 9.5% range. (Parcell Responsive, p. 3, lns. 6-8). There are, however, a number of flaws with Mr. Parcell's analyses as well as with his decision to adjust his recommended ROE downward.

First, Mr. Parcell's Constant Growth DCF analysis relied on historic earnings per share ("EPS") growth rate, book value growth rate, and dividend growth rate assumptions. At hearing, however, Mr. Parcell recognized that authoritative sources have detailed the hazards of relying on historic growth rates, admitting that authorities have found that "past growth rates in earnings or dividends may be misleading." (Tr. A.M. 5/9/2016, p. 76, lns. 3-16 and Trial Ex. 38, p. 292). The well-recognized authoritative text *New Regulatory Finance* by Dr. Roger Morin, in a section entitled "Hazards of Historical Growth Rates," warns: "[S]ince past growth rates may reflect changes in the underlying relevant variables, they cannot reasonably be expected to continue in the future or may fail to capture known future changes." (Trial Ex. 38, p. 292). Indeed, as Mr. Hevert testified, since the growth component of the Constant Growth DCF model is forward looking, historical growth rates are inappropriate, and to the extent historical growth influences investors' expectations, it already will be reflected in analyst's consensus earnings estimates. (Hevert Rebuttal, p. 22, lns. 9-12).[7]

The other model to which Mr. Parcell gave weight was his CE Model. Mr. Parcell's CE analysis produced a range of 9.0% to 10.0%. (Parcell Responsive, p. 5, lns. 1-11). The midpoint of that range, 9.50%, established the upper boundary of Mr. Parcell's ultimate recommended ROE range. (*Id.*). While the top end of Mr. Parcell's CE range results in estimates that are far more in line with the prevailing trends for vertically integrated utilities than his overall 9.0% recommendation, there are still substantial doubts about the assumptions underlying his CE model. For example, Mr. Parcell's CE model is based on his assumption that the earned ROE is the sole determinant of the market-to-book ratio. (Hevert Rebuttal, p. 138, lns. 12-14). But that assumption is unsupported by empirical evidence. (Hevert Rebuttal, p. 138, ln. 11 through p. 139, ln. 3).

As referenced above, Mr. Parcell placed his 9.0% recommendation at the low end of his estimated range. Mr. Parcell asserted that doing so was appropriate in large part because OG&E has a "substantial array of riders and other favorable regulatory mechanisms," and more specifically, because "OG&E recovers 43 percent of its revenues through . . . riders[.]" (Parcell Responsive. p. 31, lns. 6-15). But the fact that OG&E recovers such revenue through riders is not a reason to lower the Company's ROE. Indeed, Mr. Parcell admitted at hearing that OG&E recovers approximately a third of its total revenue through a fuel adjustment clause for fuel and purchased power. (Tr. A.M. 5/9/2016. p. 88. lns. 13-16). And, under questioning by Vice

[7] Mr. Hevert also demonstrated that, over the long term, dividend growth can only be sustained by earnings growth. (Hevert Rebuttal, p. 22, ln. 19 through p. 23, ln. 3 and p. 130 lns. 7-16; Hevert Direct, p. 19, ln. 15 through p. 20, ln. 5). Mr. Hevert also conducted statistical regression analyses to determine which measures of growth, if any, were related to utility stock valuation levels. (Hevert Rebuttal, p. 30, ln. 5 through p. 31, ln. 6 and Table 2). His results demonstrated that only EPS growth rates have a statistically significant relationship to valuation levels. (*Id.* at p. 31, lns. 7-12). Dividend per share, book value per share, and fundamental growth rates were not related to valuation levels. (*Id.*). Thus, Mr. Hevert's analyses show that investors rely on projected earnings growth rates in making investment decisions. For this reason, projected EPS growth rates are the appropriate measure of growth for the purpose of DCF models. (*Id.*).

Chairman Murphy, he conceded that most electric utilities recover their fuel costs through a fuel adjustment clause. (*Id.* at p. 99, lns. 3-5). He further admitted that he performed no analysis of what percentage of revenues other companies recover through their riders. (*Id.* at p. 88, ln. 17 through p. 89, ln. 5).[8] Thus, OG&E is not dissimilar to its peers. There was no reasonable basis for Mr. Parcell to adjust his recommended ROE downward. The Commission should reject OIEC's reliance on his 9.0% ROE recommendation.

Notably, OIEC's criticisms of Mr. Hevert are based on Mr. Parcell's comments, which are demonstrably wrong. For example, OIEC criticizes Mr. Hevert's DCF and Risk Premium analyses because Mr. Hevert used estimated (*i.e.*, projected) earnings per share ("EPS") growth rates. (OIEC Exceptions, p. 15). However, as shown, between Mr. Parcell's historic data and Mr. Hevert's projected data, Mr. Hevert's approach is preferred among independent, well respected authorities. (Tr. AM. 5/9/2016, p. 76, lns. 3-16 and Trial Ex. 38, p. 292).

OIEC, again on the basis of Mr. Parcell's testimony, also claims that Mr. Hevert's long-term growth rates are excessive. (OIEC Exceptions, p. 15). But the record shows that Mr. Parcell's estimates in fact rely upon similar estimates of growth. Indeed, as previously noted, all five of Mr. Parcell's calculated DCF values that fell within his recommended range were derived using growth rate figures greater than 5%. (Tr. A.M. 5/9/2016, p. 78, ln. 21 through p. 79, ln. 6; Parcell Responsive, Ex. DCP-1, p. 4). OIEC's criticisms of Mr. Hevert's growth rates are thus belied by its witness' own calculations.

OIEC's third criticism of Mr. Hevert relates to his CAPM calculations. (OIEC Exceptions, pp. 15-16). But Mr. Parcell, on which OIEC relies, is hardly credible support for that criticism. Mr. Parcell admitted that he had to reject his own CAPM calculations because they produced results that were clearly too low. (Tr. A.M. 5/9/2016, p. 62, lns. 11-24 (Parcell Cross); Parcell Responsive, p. 3, ln. 1).

Because Mr. Parcell's criticisms of Mr. Hevert's analyses are wrong, OIEC's arguments go begging. The Commission should reject OIEC's criticisms of Mr. Hevert. The Commission should also reject Mr. Parcell's recommended ROE.

c. Staff's 9.25% ROE recommendation

Staff asserts that the Commission should adopt Mr. Garrett's proposed 9.25% ROE. (Staff Exceptions, p. 6). Staff claims that its recommendation was "closely estimated through the use of various financial models," (Staff Exceptions, p. 3), and that Mr. Garrett "supported [his] recommendations with measured and careful expert analysis" that was "based upon cogent data." (*Id.* at 4, 6). There is, quite literally, no support for Staff's arguments. Mr. Garrett admitted at hearing that his 9.25% recommendation is wholly unsupported by *any* of his calculations, which were all significantly lower than 9.25%. (Tr. P.M. 5/9/2016, p. SJ-32, lns. 9-14). In fact, 9.25% is 192 basis points higher than even his highest DCF value for his proxy group, 269 basis points higher than his average DCF value, and 340 basis points higher than his

[8] As for the "other favorable regulatory mechanisms" that purportedly reduce the Company's risk, Mr. Parcell could identify only one, with an impact of about $46 million. (*Id.* at p. 97, ln. 19 through p. 98, ln. 9).

average CAPM value. (*Id.* at p. SJ-32, ln. 15 through p. SJ-33, ln. 5). Staff's proposal must be rejected on this basis alone; there is simply no evidence in support of it.

d. FEA's 9.30% recommendation

FEA contends that the Commission should adopt a 9.30% ROE, as proposed by FEA witness Walters. (FEA Exceptions, pp. 8-9). Like OIEC, FEA fails to articulate specific reasons why Mr. Walters' calculations are reasonable. Instead, it claims that Mr. Walters showed in Table 5 of his Responsive Testimony that "adjustments" to Mr. Hevert's analyses produce more reasonable ROE estimates. (*Id.* at 8). Mr. Walters' Table 5 does not, however, represent simple "adjustments" to Mr. Hevert's analyses; it merely summarizes the results of Mr. Walters' independent, flawed calculations. (Walters Responsive, pp. 42-43 and Table 5). The record shows numerous reasons for rejecting Mr. Walters' 9.30% ROE recommendation.

Mr. Walters' 9.30% proposal falls at the midpoint of his recommended 9.00% to 9.60% range, as established by his DCF, CAPM, and Risk Premium analyses. (Walters Responsive, p. 42, ln. 18 through p. 43, ln. 4). Mr. Walters' recommendation, like those of the other witnesses, is strikingly low compared to the ROEs allowed for OG&E's industry peers. Indeed, Mr. Walters recognized at hearing that his 9.30% recommended ROE, if adopted, would be an outlier among ROEs authorized for vertically integrated utilities during the last 35 years. (Tr. P.M. 5/10/2016, p. rdh-16 through rdh-17).

Mr. Walters relied on the median result of his Constant Growth DCF analyses to establish the low end of his ROE range, 9.0%. (Walters Responsive, p. 31, ln. 12 through p. 32, ln. 6). Mr. Walters, like Mr. Hevert, relied on analyst earnings growth estimates in applying the Constant Growth DCF model. Unlike Mr. Hevert, Mr. Walters contended that those estimates should be limited to a purportedly reasonable estimate of long-term "sustainable growth," which he determined was 4.2%. (Hevert Rebuttal, p. 105, lns. 9-20; Walters Responsive, p. 21, ln. 11 through p. 22, ln. 15). As explained above, however, despite his claims about the purportedly "sustainable" growth rate, Mr. Walters admitted that there were more values in his Constant Growth DCF calculation (applying consensus analysts' growth rates averaging 5.53%) that fell within his recommended DCF range than there were for his DCF models using other growth rates. (Tr. 5/10/2016, p. rdh-23 through p. rdh-26; Walters Responsive, Exs. CCW-3 to CCW-9). And of the three growth calculations that Mr. Walters used, only the calculations using consensus analysts' growth rates of 5.53% produced mean and media values for his proxy group within his recommended range of ROEs. (Tr. 5/10/2016, p. rdh-23 through p. rdh-26). Further, the relevant issue is whether investors rely on analyst growth rates in making their investment decisions, not whether Mr. Walters believes those rates are sustainable. (Hevert Rebuttal, p. 106, lns. 1-13). Empirical evidence demonstrates that projected EPS growth is the only measure of growth with a statistically significant relationship to utility stock valuation levels.[9]

Mr. Walters' CAPM analysis, relying on market risk premium estimates of 6.0% and 8.0%, a risk-free rate of 3.5% and a beta of 0.77, produced an ROE between 8.11% and 9.64%. (Walters Responsive, p. 42, lns. 11-16). But when Mr. Walters' market risk premium estimate is

---

9 *See* note 6 *infra.*

combined with his assumed risk-free rate, the expected market returns would range from 9.50% to 11.50%. (Hevert Rebuttal, p. 107, lns. 6-8). In contrast, the arithmetic average market return from 1926 through 2014 was 12.10%. (Walters Responsive, p. 40, lns. 18-20). Thus, Mr. Walters' 9.50% market return estimate is over 200 basis points below the long-term average market return, and it is also far below the 50-year rolling average return of approximately 12.00%. (Hevert Rebuttal, p. 107, lns. 13-16). The fundamental assumptions underlying Mr. Walters' CAPM recommendation are therefore at odds with the long-term market experience.

As for his Risk Premium Model, Mr. Walters' analysis is flawed primarily because it is biased downward due to Mr. Walters' choice to base the low end of his risk premium range (4.25%) on *his observation of a five-year period ending in 1991.* (Hevert Rebuttal, p. 113, lns. 8-11). As would be the case for any 26-year old data, risk premium estimates associated with 26-year old economic environments do not inform current market conditions. Notably, Mr. Walters admitted at hearing that *combining more recent risk premium data* (specifically the 5.43% 5-year rolling average as of 2015) with his calculated utility bond yield of 4.84% *would produce an estimated ROE above 10.0%.* (Tr. P.M. 5/10/2016, p. rdh-31; Walters Responsive, p. 36, lns. 15-17 and Ex. CCW-12).

e. Reasonable adjustments to the flawed assumptions underlying the other parties' ROE proposals would bring their ROE estimates in line with the ALJ's recommendation.

While the other parties' recommendations rely on the flawed analyses of their respective witnesses, the record shows that making certain reasonable adjustments to those witnesses' calculations produces results in ROE estimates that range from 9.78% to 9.83%. (Hevert Rebuttal, p. 146, ln. 9 through p. 147, ln. 2 and Table 12).[10] So adjusted, the other parties' ROE estimates would: (1) be within the range of recently authorized ROEs for vertically integrated companies; and (2) be squarely within the range of the ALJ's "range of reasonableness" and very near to his 9.87% recommendation. Thus, these reasonable adjustments to the other parties' witnesses' estimates show even further support for the ALJ's 9.87% recommendation.

IV. Depreciation

1. Mr. Spanos' Experience and Methodology, Including His Application of Informed Judgment, Makes His Depreciation Analysis The Most Reliable In The Record Here.

The opposition to the ALJ's depreciation recommendations is, in large part, based on an attack on OG&E witness John Spanos. For example, in its exceptions, OIEC claims that OG&E witness Spanos purportedly failed to substantiate his application of informed judgment. (*See* OIEC Exceptions, pp. 5, 8, 31, 33). In making these assertions, OIEC relies on the testimony of Mr. Pous, who makes similar arguments throughout his Responsive Testimony. Yet, in cases in which he testifies, Mr. Pous regularly makes claims that the company witnesses that he opposes

[10] The reasonable adjustments to the other witnesses' calculations are explained in detail in OG&E's exceptions. (OG&E Exceptions, p. 4, ln.1).

lack substantiation. (*See* Tr. A.M. 5/16/2016, p. sd-83, lns. 6-21; p. sd-91, lns. 1-4). And such claims are regularly rejected. (*See* Tr. A.M. 5/16/2016, p. sd-88, ln. 5 through p.sd-90, ln. 25; Spanos Rebuttal, p. 11, ln. 20 through p. 12, ln. 17). Such claims should be rejected here too, for two reasons: (1) they fundamentally misrepresent the nature of depreciation analysis which unquestionably involves subjective judgment (Trial Ex. 57, pp. 128-29) -- a fact admitted by several depreciation witnesses (Tr. A.M. 5/16/2016, p. sd-78, ln. 25 through p. sd-79, ln. 9 (Pous Cross); Tr. Late P.M. 5/18/2016, p. sd-18, ln. 17 through p. sd-19, ln. 3 (Andrews Cross); Tr. Late P.M. 5/18/2016, p. sd-50, ln. 14 through p. sd-51, ln. 19 (Garrett Cross)); and (2) Mr. Spanos provided substantial support for his views.

It is undisputed that informed judgment is a crucial part of any depreciation study. Indeed, a leading authority on depreciation analysis, the Public Utility Depreciation Practices Manual published by the National Association of Regulatory Utility Commissioners ("NARUC"), devotes an entire section to explaining the importance of this process. (Spanos Rebuttal, p. 7, ln. 16 through p. 8, ln. l; Trial Ex. 57). According to the NARUC Manual, informed judgment is based on a combination of general experience, knowledge of the properties under study, physical inspection, information gathering on the industry, past company studies, and other factors. (Trial Ex. 57, p. 128; ALJ Report, p. 63). The Manual expressly recognizes that "the use of informed judgment sometimes becomes a point of controversy in the regulatory setting because *some of the analyst's opinions cannot be quantified or easily supported*," making it "*sometimes impossible to pinpoint the reasons for making a decision* that diverges from a company's historical data or standard reference material." (Trial Ex. 57, p. 129; Tr. A.M. 5/16/2016, p. sd-80, lns. 14-25 (Pous Cross) (emphasis added)). Emphasizing the necessity of judgment to a depreciation study, the NARUC Manual further states, "The use of judgment can be a major factor in forecasting[,]" and "[i]t is the analyst's *responsibility* to apply any additional known factors" to determine the best estimates. (Trial Ex. 57, pp. 128-29 (emphasis added)). Given the fact that informed judgment may not be susceptible to exact "substantiation," Mr. Pous' call for such substantiation is misleading and wrong.

Notwithstanding the subjectivity of parts of his analysis, Mr. Spanos' views are reliable based on the many factors that went into that analysis. Mr. Spanos' experience -- and particularly his knowledge of OG&E's specific assets -- unquestionably placed him in the best position among the testifying experts to exercise informed judgment in making recommendations on the Company's appropriate depreciation expense. Over the course of 30 years, Mr. Spanos has conducted more than 500 depreciation studies and testified in more than 200 cases before 40 regulatory commissions. (Tr. A.M. 5/12/2016, p. 8, lns. 13-18; Spanos Direct, p. 2, lns. 19-23). The methods and procedures he utilized in this case are the same or substantially similar to those he has employed in the hundreds of other studies he performed. (Tr. A.M. 5/12/2016, p. 8, ln. 23 through p. 9, ln. 11). In no case has a commission rejected Mr. Spanos' methodology and procedures. (*Id.* at p. 9, lns. 12-17). By contrast, Mr. Pous admitted at hearing that commissions in past cases have found his analysis and methodology to be arbitrary, based on unreliable data, and contrived to support a particular result. (Tr. A.M. 5/16/2016, p. sd-82, ln. 25 through p. sd-83, ln. 5 (Pous Cross); *see also id.* at p. sd-102, ln. 23 through p. sd-103, ln. 5 (Pous Cross)).

In further contrast to Mr. Spanos' experience, Mr. Andrews had testified in only two cases, both in 2016. (Tr. Late P.M. 5/18/2016, p. sd-14, lns. 15-18). Mr. Cook had testified only three times on depreciation issues. (Tr. A.M. 5/17/2016, p. sd-28, ln. 2 through p. sd-29, ln. 6). And Mr. Garrett had testified on depreciation issues only three times and had not testified on depreciation issues prior to 2015. (Tr. Late P.M. 5/18/2016, p. sd-49, lns. 14-19). Both Mr. Andrews and Mr. Garrett also received their training in depreciation from individuals who work for Mr. Spanos. (Tr. Late P.M. 5/18/2016, p. sd-15, lns. 12-25 (Andrews Cross); *id.* at p. sd-49, ln. 20 through p. sd-50, ln. 9 (Garrett Cross)). Thus, Mr. Spanos' experience and methodology are the most reliable in this case.

Moreover, Mr. Spanos alone had extensive experience with and relied upon detailed information about OG&E's assets. He has conducted four depreciation studies on OG&E's behalf in the last 15 years, using a substantially similar methodology in each study. (Tr. A.M. 5/12/2016, p. 8, ln. 19 through p. 9, ln. 11). Mr. Spanos has participated in more than 30 site visits to inspect the Company's plant, analyzed the Company's current policies and outlook, interviewed operating personnel, and participated in discussions with management. (Spanos Direct, p. 5, lns. 1-8; Spanos Direct, Ex. JJS-2 at pp. III-2 to III-3; Tr. A.M. 5/12/2016, p. 8, ln. 23 through p. 9, ln. 11). In contrast, neither Mr. Pous nor any other witness physically inspected the assets subject to the depreciation study, discussed the assets with OG&E's field personnel, or interviewed OG&E's management regarding the Company's plans and policies related to the assets. (Tr. A.M. 5/16/2016, p. sd-78, lns. 10-17 (Pous Cross); Tr. A.M. 5/17/2016, p. sd-32, lns. 7-12 (Cook Cross); Tr. Late P.M. 5/18/2016, p. sd-21, lns. 4-21 (Andrews Cross); Tr. Late P.M. 5/18/2016, p. sd-51, ln. 20 through p. sd-52, ln. 4 (Garrett Cross)). Thus, in contrast to all of the other depreciation witnesses, Mr. Spanos had the most informed and detailed understanding of OG&E's assets and operations that affected the life of those assets.

As to OIEC's claims of a lack of substantiation, the record shows that Mr. Spanos has provided voluminous documentation in support of his recommendations (including a depreciation study spanning nearly 400 pages, nearly 50 pages of Rebuttal Testimony, and substantive responses to more than 150 data requests) and his judgment is buttressed by many years of experience, both in the industry generally and with OG&E specifically. Even to the extent that "some of the [Mr. Spanos'] opinions cannot be quantified or easily supported," (Trial Ex. 57, p. 129), that is no reason to reject his conclusions, as supported by Mr. Spanos' vast experience. Indeed, to do so would be to ignore the unequivocal teachings of the NARUC manual.

2. Production Plant Net Salvage

FEA and OIEC each raise an exception to the ALJ's recommendation that the Company collect half of the amount the ALJ calculated for terminal net salvage. (FEA Exceptions, p. 10; OIEC Exceptions, pp. 29-31). They contend that the record does not support the ALJ's recommendation because Mr. Spanos purportedly did not substantiate his estimates and because no site-specific decommissioning study has been conducted. (*Id.*). FEA even argues that future ratepayers would be wholly unaffected by denying the Company any recovery in this case. (FEA Exceptions, p. 10). These arguments are wrong. As discussed below, Mr. Spanos' estimates are well-supported by industry practice and his analysis of the decommissioning of assets similar to the Company's production plant. Further, to the extent OG&E's terminal net salvage costs are not recovered in rates set in this case, the record plainly shows that the cost burden will be unduly shifted to future ratepayers. [11] The Commission should reject claims to the contrary.

As an initial matter, OIEC contends that the ALJ's recommendation "is contrary to general rate-making principles under which costs to be recoverable must be both beneficial to ratepayers and fair." (OIEC Exceptions, p. 29). To support that statement, OIEC cites one case: *Lone Star Gas Co. v. State*, 1986 OK 53, ¶ 4, 745 P.2d, 723, 725. (*Id.*). The *Lone Star* case, however, has no bearing on the facts here and stands only for the unremarkable proposition that utilities should be afforded a fair return on assets that are used and useful to ratepayers.

The relevant dispute in *Lone Star* centered on whether the Commission erred by granting Lone Star a rate increase attributable to the gas utility's investment and operation deemed "used and useful to Oklahoma ratepayers," where the utility argued that the increase did not provide an adequate return for its *system-wide* cost of investment. (*Id.* at 724). The Oklahoma Supreme Court explained that 98.3% of Lone Star's system-wide demand was in Texas, with the utility's transmission system only encompassing a small portion of Oklahoma, accounting for the remaining 1.7% of its system utilization. (*Id.*) In addition, for various legal and operational reasons, the cost to Lone Star of operation and utility transmission in Texas was much higher than in Oklahoma. (*Id.*) Thus, the Court recognized that assessing a return on investment premised on Lone Star's average total cost of gas would unfairly impose upon Oklahoma ratepayers costs for which they received no corresponding benefit. Meanwhile, Texas ratepayers, who received the vast majority of the benefits, would enjoy a windfall. (*Id.* at 724-25). For these reasons, the Court rejected Lone Star's argument that "as long as each group of customers receives *any* benefit from its operation, a system-wide allocation of transmission plant in rate base is required." (*Id.* at 725). Rather, the Court found that "any alleged under recovery is not attributable to delivery of service to Oklahoma ratepayers" and held that the Commission properly "allocate[d] gas costs and rate charges to Oklahoma ratepayers in accordance with the used and useful test . . . and the relative benefits conferred to Oklahoma ratepayers." (*Id.* at 726 (internal citation omitted)).

Here, there is simply no question that OG&E's production plant is used and useful to Oklahoma ratepayers. Nor is the Company's recovery of terminal net salvage "unfair." As Mr. Spanos explained, the decision to segregate the terminal net salvage component was made in order to more accurately recover, in a systematic and rational manner, the full service value of production assets over the course of their service lives. (Tr. P.M. 5/12/2016, p. lw-54, ln. 6 through p. lw-55, ln. 10). Since so much of the cost occurs upon decommissioning, it only makes sense to recover those costs throughout the assets' full service lives. (*Id.*). By distributing these costs systematically and rationally over time, ratepayers are in fact benefitted as a whole. In fact, as demonstrated below, by not continuing to provide recovery of these costs, OG&E's current customers will enjoy a windfall, while OG&E's future customers will be

[11] To be sure, the ALJ erred by recommending that the Commission only authorize the recovery of half of his calculated amount for terminal net salvage. (*See* OG&E Exceptions, pp. 15-16). This unreasonably low amount of recovery would only unduly burden future ratepayers and prevent the Company from systematically and rationally recovering its costs. (*Id.*). But the ALJ correctly recognized that future customers would be even more disadvantaged if the Company is prevented from collecting any amount in this case.

unreasonably burdened. Thus, *Lone Star*, to the extent that it supports any party, supports OG&E's position here.

FEA utterly misses the mark when it contends that denying OG&E recovery of production plant net salvage in this proceeding will not burden future ratepayers. FEA notes that the Company has previously recovered terminal net salvage as a component of total net salvage and asserts that there is purportedly "no greater need today" to segregate this expense. (FEA Exceptions, p. 10). This argument is a non sequitur that demonstrates FEA's misunderstanding of the Company's proposal.

To be sure, prior to this proceeding, the Company has been recovering terminal net salvage costs as a component of total net salvage. (Tr. A.M. 5/12/2016, p. 82, lns. 2-24; p. lw-55, lns. 11-22 (Spanos Cross); Tr. Late P.M. 5/18/2016, p. sd-25, lns. 3-10 (Andrews Cross); (Tr. A.M. 5/17/2016, p. sd-33, lns. 3-9 (Cook Cross)). But this is no longer so. In this case, terminal net salvage has been separated from the interim net salvage component in order to more accurately recover OG&E's costs. (Tr. P.M. 5/12/2016, p. lw-54, ln. 6 through p. lw-55, ln. 10). Because the Company is not proposing to recovery terminal net salvage costs in interim net salvage costs (as was previously done), if the Company is not allowed to separately recover terminal net salvage in this case, then it will recover *nothing* for that cost. Indeed, *FEA's own witness, Mr. Andrews, recognized as much:* at hearing, he agreed that if his recommendation of zero recovery was accepted, the Company would recover no portion of terminal net salvage, as it traditionally has. (Tr. Late P.M. 5/18/2016, p. sd-25, lns. 11-17; *see also* Tr. P.M. 5/12/2016, p. lw-55, lns. 11-22 (Spanos Redirect); Tr. A.M. 5/17/2016, p. sd-33, lns. 3-20 (Cook Cross)).

Precluding any recovery of any terminal net salvage costs, as OIEC and FEA propose, would result in a significant under-recovery of the overall service value of the Company's assets during the term that the rates set in this case are in effect. (Tr. P.M. 5/12/2016, p. lw-55, lns. 11-22 (Spanos Redirect)). To be sure, OG&E will ultimately recover those costs. As Staff witness Garrett stated, "[t]he Company will recover all of those dollars. It's just a question of timing." (Tr. Late P.M. 5/18/2016, p. sd-75, lns. 4-5 (D. Garrett Redirect)). But to the extent those costs are not recovered in rates set here, the cost burden will be unduly shifted to future ratepayers. (Tr. A.M. 5/12/2016, p. 47, lns. 12-17 (Spanos Cross)). FEA's position misunderstands the issues and is without merit.

Similarly, the arguments made by OIEC and FEA that the Company did not meet its burden of proof on this issue or that the ALJ's recommendation is not supported by substantial evidence misread the record. (OIEC Exceptions, pp. 29-31; FEA Exceptions, p. 10). Specifically, OIEC claims that Mr. Spanos estimated "net salvage value for steam plant based on a published study from 20 years ago," "assumed decommissioning costs . . . had not changed in 20 years," and relied only on one confidential study to support his estimates for other production plant and wind. (*Id.*). The record flatly rejects OIEC's claim. Quite the contrary, the evidence shows that the Commission should fully adopt Mr. Spanos' reasonable estimates. (OG&E Exceptions, pp. 15-16).

As Mr. Spanos explained, the estimate that he used for steam production plant -- $40/kW -- "is the most commonly utilized amount [for steam production plant] when considering all the industry estimates." (Tr. P.M. 5/12/2016, p. lw-15, lns. 10-11 (Spanos Cross)). This amount was initially established in a study presented to the American Gas Association and the Edison Electric Institute, two respected organizations in the field of public utilities. (*Id.* at p. lw-15, ln. 12 through p. lw-16, ln. 17 (Spanos Cross)). This study was the "initial step" in establishing decommissioning costs, and the study's estimates have since been supplemented and supported by other studies conducted by other well-known and well-regarded entities, such as Sargent & Lundy and Burns & McDonnell. (*Id.* at p. lw-18, ln. 10 through p. lw-19, ln. 16 (Spanos Cross)).

Mr. Spanos' estimates were also based on his experience with typical estimates used by others in the industry for each type of facility. (Spanos Rebuttal, p. 15, lns. 10-16). Mr. Spanos reviewed information regarding the decommissioning costs of 30 to 40 plants, excluded plants that were dissimilar to the Company's units, and determined based on this information that $40/kW would be a reasonable estimate for the decommissioning of OG&E's steam plant. (Tr. A.M. 5/12/2016, p. 76, ln. 25 through p. 77, ln. 23 (Spanos Cross)). Mr. Spanos followed a similar process for other production plant and wind. *(Id.)*.

Mr. Spanos was the only witness to provide decommissioning cost estimates in this proceeding. And using industry information, as Mr. Spanos did here, is an appropriate way to establish a reasonable estimate for terminal net salvage costs. (*Id.* at p. 25, ln. 19 through p. 26, ln. 3; p. 48, lns. 7-18; p. 57, ln. 23 through p. 58, ln. 3 (Spanos Cross)). Indeed, Mr. Spanos has previously used similar estimates as a component of depreciation studies accepted by commissions in other jurisdictions. (Tr. P.M. 5/12/2016, p. lw-56, ln. 21 through p. lw-57, ln. 17 (Spanos Redirect)). Thus, OIEC's claims that neither Mr. Spanos' estimates nor the ALJ's recommendation are supported by substantial evidence are baseless.

FEA broadly contends that OG&E should be prohibited from recovering any amount for terminal net salvage until a site-specific decommissioning study is performed. (FEA Exceptions, p. 10). OIEC makes similar assertions. (OIEC Exceptions, pp. 29-30). But the absence of a full-blown decommissioning study does not justify preventing the Company from recovering anything for terminal net salvage. Even OIEC/OER witness Pous has recommended that a utility recover terminal net salvage costs far exceeding zero in a case where the utility did not conduct a site-specific study. Indeed, in that case, Mr. Pous recommended that the utility recover production plant net salvage based on estimates of $30/kW for steam plant, $8/kW for other production plant, excluding wind, and $5/kW for wind. (Tr. P.M. 5/16/2016, p. lw-40, lns. 1-9 (Pous Cross); Spanos Rebuttal, p. 18, lns. 1-21). Simply put, the actual costs of decommissioning will not be known until the work is performed. (Tr. A.M. 5/12/2016, p. 36, ln. 8 through p. 37, ln. 10 (Spanos Cross)). Any decommissioning estimates (used now or any time until decommissioning is completed) will be subject to uncertainty. (Tr. A.M. 5/17/2016, p. sd-20, lns. 4-25 (Cook Cross)). And, as previously explained, to the extent OG&E's decommissioning costs are not recovered now, the cost burden will be unduly shifted to future ratepayers. It would be unreasonable and unfair to future ratepayers to deny the Company recovery of its reasonably estimated costs.

In short, OIEC's and FEA's arguments that the Company should get nothing for its terminal net salvage costs find no support in the record or in sound practice. The support for the recovery of this cost is indisputable. These costs are real costs that need to be recovered. Future generations of ratepayers will have to pay those costs, if they are not recovered in rates set here. Mr. Spanos' recommended levels of recovery are in step with industry practice. Thus, claims that OG&E should recover nothing should be rejected by the Commission.

3. Mass Property Service Lives

FEA, OIEC and Staff argue that the ALJ failed to consider the distribution asset service life proposals of Staff witness Garrett and FEA witness Andrews when the ALJ recommended reducing the Company's depreciation expense by $3.35 million for mass property accounts. (FEA Exceptions, pp. 9-10; OIEC Exceptions, p. 35; Staff Exceptions, p. 7). OIEC also asserts that the ALJ erred by recommending only half of Mr. Pous' proposed adjustment. (OIEC Exceptions, pp. 33-35). These parties' arguments should be rejected. Indeed, as OG&E previously demonstrated, the record does not support *any* adjustment -- including the ALJ's $3.35 million recommended reduction. (*See* OG&E Exceptions, pp. 11-15).

For the mass property accounts, the ALJ correctly recognized that "because each expert used the same statistical analyses, the differences between [their] estimates results from the application of informed judgment." (ALJ Report, p. 62 (citing Spanos Rebuttal, p. 27, lns. 10-12)). But the ALJ's recommended $3.35 million reduction cannot be reconciled with that statement. As demonstrated above, the bases of Mr. Spanos' opinions are far more reliable than those of any other depreciation witness in this case. As noted, Mr. Spanos is the only witness who had: (1) extensive experience studying and testifying about depreciation; (2) extensive experience with and relied upon detailed knowledge about OG&E's assets; and (3) a methodology that has been widely and uniformly accepted.

Mr. Garrett and Mr. Andrews recommended life adjustments to many accounts, in each case asserting that their proposed survivor curves should be adopted because their curves provide better mathematical fits to the historical data than Mr. Spanos' curves. (*See* Garrett Responsive, p. 21, lns. 12-18; Andrews Responsive, p. 14, lns. 5-7). As the ALJ correctly observed, however, "a survivor curve should not be taken at face value without considering what is happening in the account." (ALJ Report, p. 63). Indeed, both Mr. Andrews and Mr. Garrett admitted at hearing that mathematical analysis is only one component of a complete life study, and that judgment, as informed by developing familiarity with the physical plant at issue and an understanding of company plans and policies, plays an important role. (Tr. Late P.M. 5/18/2016, p. sd-18, ln. 17 through p. sd-19, ln. 3 (Andrews Cross); Tr. Late P.M. 5/18/2016, p. sd-50, ln. 14 through p. sd-51, ln. 19 (Garrett Cross)). But unlike Mr. Spanos, neither witness interviewed OG&E operating or management personnel regarding the plant's operating environment and the Company's policies, and neither witness inspected the Company's plant. In its initial Exceptions, OG&E demonstrated the dangers of rigid adherence to mathematical curve fitting—and the failure to apply informed judgment—by pointing to the manifestly unreasonable results of Mr. Garrett's analyses. (OG&E Exceptions, pp. 13-14 (describing Mr. Garrett's inexplicable, unsupported, and obviously flawed estimate for Account 368)). Thus, though Mr. Andrews and Mr. Garrett assert that they exercised judgment, their claims find no credible evidentiary support.

OIEC raises several arguments about the specific accounts for which Mr. Pous offered testimony.[12] For Account 350.2 (Transmission Land Rights), OIEC, quoting Mr. Pous, claims that the life estimate should be extended because "the Company's land rights are perpetual easements and will be utilized and maintained as long as there is an associated asset in service that resides upon that land right." (OIEC Exceptions, p. 34). Under that reasoning, Mr. Pous argued that the life estimate for this account should be increased to 100 years, representing a 25-year increase to the previously approved, currently in place 75-year estimate. (Pous Responsive, p. 48, ln. 24; Spanos Rebuttal, p. 37, lns. 14-17). However, Mr. Spanos explained that the estimated life for Land Rights should reflect the "overall life cycle similar to the assets that utilize the land," such as substation equipment, poles, towers, and conductors. (Spanos Rebuttal, p. 37, lns. 9-10). And the record shows that Mr. Pous' arguments about Account 350.2 have been rejected by other commissions for that very reason. (Tr. A.M. 5/16/2016, p. sd-98, lns. 5-19). As further explained by Mr. Spanos, the assets in this account have experienced little change over time, and Mr. Pous' proposal would inappropriately increase the average service life of these assets to be near the time at which the last of the assets will survive. (Spanos Rebuttal, p. 37, lns. 7-13). Thus, there is no reasonable basis for extending the current estimated life for this account by 25 years, as OIEC would have the Commission do.

For Account 353 (Station Equipment), OIEC's only asserted basis for extending the current 55-year estimate to 63 years is Mr. Pous' statement that "with improved maintenance and monitoring of equipment, overloading of assets such as transformers is minimized in comparison to the situation many decades ago." (OIEC Exceptions, p. 34). Mr. Pous' speculation, however, finds no basis in the record. Mr. Spanos' 60-year estimated service life, which represents a five-year increase to the current estimate, is already longer than the industry standard and is at the upper end of the industry range. (Spanos Rebuttal, p. 37, ln. 23 through p. 38, ln. 3). As Mr. Spanos explained, the historical data for this account does not support further extending his already conservative estimate. (*Id.* at p. 38, lns. 2-3 and Figure 3). Mr. Spanos also explained that, on the basis of his conversations with engineers and operating personnel around the country, he expects that new substation equipment will not last as long as older equipment, since the new equipment is being designed with tighter design tolerances. (Spanos Rebuttal, p. 38, ln. 4 through p. 39, ln. 13). Since the historical data does not reflect the shorter lives of the newer equipment, this weighs against further extending Mr. Spanos' conservative estimate for this account. (*Id.*). OIEC's position is therefore meritless.

For Account 355 (Poles and Fixtures), OIEC argues that the estimated service life should be extended because "the Company has been adding more steel poles, which last longer than wood poles." (OIEC Exceptions, p. 34). But the composition of poles is just one factor to consider regarding the life of these assets. Indeed, as Mr. Pous admitted, poles may be retired for several reasons entirely unrelated to what they are made of, such as changes in generation plants, highway relocations, and changes in voltage requirements. (Tr. 5/16/2016, p. sd-127, ln.

---

12 OG&E's exceptions filing discusses these accounts at length, demonstrating why Mr. Spanos' proposals are more reasonable in every instance. (OG&E Exceptions, pp. 14-15). The Company will not unnecessarily repeat all of those arguments here. Additionally, much of OIEC's argument for these accounts is premised upon its flawed assertion that Mr. Spanos failed to substantiate his judgment. (OIEC Exceptions, pp. 33-34). As demonstrated above, the record is otherwise.

14 through p. sd-128, ln. 10). Mr. Spanos also demonstrated that Mr. Pous' analysis fails to account for the retirement impact of ice storms in Oklahoma, which are neither anomalous nor unexpected. (Spanos Rebuttal, p. 41, lns. 10-14; *see also* Tr. P.M. 5/16/2016, p. lw-22, ln. 5 through p. lw-24, ln. 9 (Mr. Pous conceding that ice storms frequently occur in Oklahoma and in OG&E's service territory)). Mr. Spanos' proposal to retain the current 55-year life estimate for this account is more reasonable than Mr. Pous' unsubstantiated recommendation.

For Account 356 (Overhead Conductors and Devices), OIEC relies on Mr. Pous' statement that Mr. Spanos understated his estimated life proposal. Mr. Pous claimed that Mr. Spanos did not use an "approach to normalization" used in another case to "normalize" (*i.e.*, adjust downward) the data to account for the impact of ice storms. (OIEC Exceptions, p. 34). As he did for Account 355, Mr. Pous wrongly discounts the retirement impact of ice storms in Oklahoma on the assets in this account. (Spanos Rebuttal, p. 41, ln. 24 through p. 42, ln. 4). Further, Mr. Spanos' prior "approach to normalization" related to the analysis of a specific transaction for different assets under different circumstances for a different utility. (Spanos Rebuttal, p. 41, lns. 1-9). As Mr. Spanos testified, his approach to that transaction has no bearing on the analysis of OG&E's assets in Account 356. (*Id.*). That testimony was unrebutted.

The evidence simply does not support the proposals of Mr. Pous, Mr. Garrett, or Mr. Andrews. The ALJ erred by recommending any reduction to OG&E's depreciation expense for the mass property service life accounts. OIEC's, FEA's, and Staff's arguments in favor of an even larger reduction therefore must be rejected.

4. Mass Property Net Salvage

OIEC argues that the ALJ erred by adopting Mr. Spanos' net salvage recommendations for three accounts: Account 353 (Transmission Station Equipment), Account 355 (Transmission Poles and Fixtures), and Account 390 (Structures and Improvements). (OIEC Exceptions, pp. 36-38). Notably, only OIEC, on the basis of Mr. Pous' testimony, takes issue with these recommendations. (*Id.*). In fact, Mr. Pous was alone in his criticism of Mr. Spanos' net salvage estimates. Staff witness Garrett reviewed the Company's proposed net salvage percentages for each mass property account and found them to be reasonable. (Tr. Late P.M. 5/18/2016, p. sd-59, ln. 23 through p. sd-60, ln. 4). In any event, OIEC's arguments should be rejected because in each case they rely on Mr. Pous' excessive salvage values, which find no support in the record.

As a general matter, OIEC totally disregards the historical data related to these accounts, arguing that such data "is not a valid predictor of future expectations" or that it does not have "significant value." (*Id.* at 36-37). Mr. Pous made similar claims in his testimony, arguing that, since historical net salvage percentages tend to vary from year to year, "a much greater level of subjectivity is required." (Pous Responsive, p. 79, lns. 18-22). As Mr. Spanos explained, however, he did investigate the Company's transactions and incorporated his consideration of those transactions into his recommendations, a fact which Mr. Pous chose to ignore. (Spanos Rebuttal, p. 45, lns. 1-6). Further, given Mr. Pous' lack of familiarity with OG&E's specific assets and their operating environments, he can hardly argue that he was better positioned than Mr. Spanos to undertake the subjective analyses he claims are required. In any event, as a matter of simple logic, it makes little sense to ignore the Company's actual data, as OIEC and Mr. Pous do here, when making recommendations concerning the Company's assets. But OIEC's eagerness to distance itself from the historical data is unsurprising; its witness' excessive salvage recommendations are belied by the data for every disputed account. By contrast, the Company's actual experience -- *i.e.*, the historical data -- provides strong statistical support for Mr. Spanos' estimates. (Spanos Rebuttal, p. 45, lns. 7-12).[13]

For Account 353 (Transmission Station Equipment), the ALJ found that "Mr. Spanos' value of -30% [net salvage] is the appropriate percentage." (ALJ Report, p. 64). The ALJ's recommendation is well-supported by the record. The Company's historical data shows that the overall net salvage value for Account 353 is -58%, which is more than twice the currently approved estimate of -25%. (Spanos Rebuttal, p. 44, lns. 5-13). Mr. Spanos' recommended -30% net salvage is thus an appropriate and gradual change towards the level indicated by the historical data.

OIEC contends that the Commission should adopt Mr. Pous' -10% recommendation for Account 353. OIEC argues that relying on 24 years of the Company's actual data is too "simplistic." (OIEC Exceptions, pp. 36-37). But that data shows that Mr. Pous' proposed value is far too low to appropriately and rationally recover OG&E's costs for this account. Indeed, at hearing, Mr. Pous admitted that: (l) the overall average salvage value for the account from 1991 to 2014 was -58%; (2) in the last 5 years, the average salvage value has been -417%; (3) the 3-year rolling averages from 2005 through 2014 have been equal to or less negative than -202%; and (4) for the 24 years from 1991 through 2014, there were only 5 years with positive net salvage values, the most recent of these being more than 10 years ago. (Tr. P.M. 5/16/2016, p. lw-25, ln. 4 through p. lw-27, ln. 4).

Mr. Pous' -10% recommendation was based on data relating solely to other utilities and failed to take into consideration any Company-specific data. (Pous Responsive, p. 85, lns. 25-29). By contrast, Mr. Spanos' analysis considered the current approved estimate, the recent trends in the Company's account, industry averages, and future expectations. (OG&E Response to OIEC DR 4-7). Thus, Mr. Spanos arrived at his estimate by incorporating a number of relevant data points. It is OIEC that relies on a "simplistic" approach. The Commission should adopt the ALJ's recommendation.

For Account 355 (Transmission Poles and Fixtures), the ALJ recommended Mr. Spanos' -60% net salvage proposal. (ALJ Report, p. 64). OIEC argues that the Commission should reject the ALJ's recommendation and adopt Mr. Pous' -50% net salvage estimate. (OIEC Exceptions, p. 37 (citing Pous Responsive, p. 87-88)). In support, OIEC offers only the bare assertion that the ALJ "again erroneously relied on historical averages." (*Id.*). But similarly to Account 353, OIEC's reliance on Mr. Pous' -50% net salvage proposal cannot be reconciled with the statistical data. The overall average salvage value for Account 355 is -97%, and the five-year average is -132%. (Spanos Rebuttal, p. 43 and Table 2). Mr. Spanos' -60% net salvage

---

[13] To be sure, Mr. Spanos did not simply recommend that the Commission adopt the historical average salvage value for each of these accounts. Rather, Mr. Spanos "tempered [his] estimates to be more in line with estimates for other utilities and to incorporate a degree of gradualism." (Spanos Rebuttal, p. 44, lns. 15-19). But the fact remains that there is no basis in the actual data to support Mr. Pous' extreme deviations from the Company's experience, no matter how much OIEC would prefer that the Commission disregard the statistics.

recommendation (the same estimate currently in place for this account) is more reasonable and more in line with the actual data. Thus, the ALJ correctly rejected Mr. Pous' position, finding that "the Commission should adopt OG&E's historical averages rather than speculate about future savings." (ALJ Report, p. 64).

As for Account 390 (Structures and Improvements), OIEC once again contends that the ALJ should not have relied on OG&E's statistical data. (OIEC Exceptions, p. 37). Again, Mr. Pous' recommendation finds no support in that data. For this account, Mr. Spanos proposed -- and the ALJ recommends -- maintaining the currently applicable 0% net salvage estimate. (Spanos Rebuttal, p. 43 and Table 2). By contrast, Mr. Pous proposed 15% net salvage. (*Id.*). The ALJ recognized that the key difference between Mr. Spanos and Mr. Pous here is that "Mr. Pous assumes that OG&E will be able to profit from the sale of buildings in this account." (ALJ Report, p. 64). Yet, the overall net salvage value for Account 390 is 1% and the five-year average is 0%. (*Id.* (citing Spanos Rebuttal, p. 43, lns. 6-9 and Table 2)). Mr. Spanos' recommendation is thus far more in line with the overall salvage value and the Company's recent experience with the account.

The historical data notwithstanding, Mr. Pous' proposal is flawed because land is non-depreciable and thus is not properly considered in a net salvage determination. (Spanos Rebuttal, p. 46, lns. 2-5; ALJ Report, p. 64). In its exceptions, OIEC attempts to refute this statement, arguing that Mr. Pous was "looking at the expected future sale of *buildings* [in the account]."[14] (OIEC Exceptions, p. 37 (emphasis added)). As Mr. Spanos explained, however, "the sale of larger facilities in this account generally results in far more value for the land, which is non-depreciable, than for the structures themselves." (Spanos Rebuttal, p. 46). The ALJ agreed. (ALJ Report, p. 64).

Mr. Pous' analysis also overlooks that many assets in the account are retired prior to the final retirement or sale of the building. (Spanos Rebuttal, p. 46, lns. 6-9). The retirements that occur over the life of a building or structure are often significant and reduce the salvage value upon retirement. (*Id.*). For these reasons, OIEC's argument should be rejected. The ALJ's recommendation to adopt Mr. Spanos' proposal is proper and should be adopted by the Commission.

5. Service Lives for Wind Units

Staff, the AG and OIEC each contend that the ALJ erred by recommending that the Commission adopt Mr. Spanos' 25-year estimated service life for OG&E's wind units. (Staff Exceptions, pp. 7-8; AG Exceptions, pp. 11-13; OIEC Exceptions, pp. 31-32). Collectively, these parties rely on the assertions of Staff witness Garrett, AG witness Cook, and OIEC/OER

---

[14] OIEC, citing Mr. Pous' testimony, also vaguely asserts that the record demonstrates that the sale of buildings, not land, results in positive salvage for this account because "there was no investment listed for Account 389 (General Plant Land)." (OIEC Exceptions, pp. 37-38 (citing Mr. Pous' testimony)). This statement is, however, actually a reference to a portion of Mr. Pous' testimony relating to past cases Mr. Pous does not cite involving different utilities that Mr. Pous does not name. (Pous Responsive, p. 91). Mr. Pous' statement has nothing to do with OG&E and thus has no bearing on the record before the Commission. The Commission should disregard OIEC's reliance on Mr. Pous' unsupported statement.

witness Pous to argue that the ALJ should have instead adopted a 30-year service life for the Company's wind units. (*Id.*). None of these witnesses, however, have specific knowledge of OG&E's wind units as developed through site inspections and/or interviews with Company personnel. (Tr. P.M. 5/16/2016, p. lw-31, lns. 17-20 (Pous Cross); Tr. Late P.M. 5/18/2016, p. sd-51, lns. 20-25; p. sd-52, lns. 16-23 (D. Garrett Cross); Tr. A.M. 5/17/2016, p. sd-32, lns. 7-12 (Cook Cross); Spanos Rebuttal, p. 23, lns. 18-23). For example, Mr. Cook could not correctly identify of the number of units operated by OG&E; he did not know when those units were put in service, the location of the units, or any of the units' manufacturer, model or nameplate capacity. (Tr. A.M. 5/17/2016, p. sd-36, ln. 23 through p. sd-41, ln. 13 (Cook Cross)). Mr. Garrett did not know how many units OG&E had. He too could not name the nameplate capacity of any unit. (Tr. Late P.M. 5/18/2016, p. sd-54, lns. 3-11(Garrett Cross)). In fact, these witness appeared to have little knowledge of wind units at all: both believed it was possible to have a single wind unit alone that could generate over 200 MW. (Tr. A.M. 5/17/2016, p. sd-41, lns. 1-13 (Cook Cross); Tr. Late P.M. 5/18/2016, p. sd-54, lns. 6-17 (D. Garrett Cross)).

As for the ALJ's adoption of Mr. Spanos' proposal, the AG and OIEC contend that the ALJ erred because Mr. Spanos failed to substantiate his 25-year recommendation for OG&E's wind units. (AG Exceptions, p. 12; OIEC Exceptions, pp. 31-32). This claim is directly refuted by the record. As an initial matter, Mr. Spanos explained that a 25-year life span is the industry standard for wind units, as developed through studies considering these units' economic lives.[15] (Tr. P.M. 5/12/2016, p. lw-53, ln. 14 through p. lw-54, ln. 5). More importantly, Mr. Spanos participated in discussions with management and operators concerning OG&E's specific assets and has physically inspected the Company's wind units to inform his opinion. (*See* Tr. A.M. 5/12/2016, p. 109, ln. 21 through p. 111, ln. 1). Contrary to the AG's and OIEC's claims, Mr. Spanos' recommendation is the only one supported by any direct knowledge of the Company's assets.

Indeed, the statements and "studies" relied upon by Staff's, the AG's and OIEC's witnesses to make their service life recommendations are wholly unrelated to the wind units actually operated by OG&E -- as the ALJ aptly pointed out. (ALJ Report, p. 60). These materials are also unreliable because they provide no detail regarding the rationale for or methodology used to reach any conclusion about a wind unit's life. Staff, for example, claims that Mr. Garrett "provided evidence that, on average, wind turbines were continuing to produce three-quarters of their output after 19 years in service." (Staff Exceptions, p. 6 (citing Garrett Responsive, p. 20, lns. 7-10)). In the very next sentence of his testimony, however, Mr. Garrett stated, "[t]his means that turbines will operate effectively *up to 25 years*." (Garrett Responsive, p. 20, ln. 10 (emphasis added)). Additionally, the *only* material that Mr. Garrett relied on for his 30-year recommendation was an article from a university's website discussing research

---

[15] Staff, the AG and OIEC each assert that Mr. Spanos has recommended life spans longer than 25 years for wind units in some cases. (AG Exceptions, p. 12; OIEC Exceptions, p. 32; Staff Exceptions, p. 6). These parties rely on a discovery response Mr. Spanos provided in a 2011 case that Mr. Pous and Mr. Garrett briefly referenced in their respective testimony. (*Id.*). This discovery response is not in evidence in this proceeding, and none of these parties discusses the types of wind units or their operating conditions that were at issue in the cases where Mr. Spanos purportedly recommended a longer estimated life. Nor do they even cite the specific cases. These parties' statements concerning that discovery response do nothing to undermine the judgment, as informed by his specific knowledge of OG&E's wind units, that Mr. Spanos exercised in this case.

performed by others at the university. (Tr. Late P.M. 5/18/2016, p. sd-55, lns. 1-14). Mr. Garrett admitted that he did not cite the actual report, that the article he relied on provides no specifics about the methodology or assumptions used, and that his 30-year recommendation was not based on any data specific to OG&E's wind units. (*Id.* at p. sd-55, lns. 11-20 and p. sd-59, lns. 18-22).

In the same vein, Mr. Pous admitted to relying on a manufacturer's promotional material that was not based on any independent research or study. (Tr. P.M. 5/17/2016, p. lw-36, ln. 11 through p. lw-37, ln. 25). Similarly, Mr. Cook admitted that the research cited in support of his testimony did not: (1) relate to any specific OG&E wind unit; (2) provide any information about the methodology used to determine a wind unit's life; and (3) did not identify what type of wind units were studied. (Tr. 5/17/2016, p. sd-46, lns. 14-23). Thus, in rejecting these witnesses' recommendations, the ALJ correctly recognized that they failed to provide any evidence about the life span of units that "are the same or similar to those used at any OG&E wind farm or that any of the study sites have similar wind conditions to those of OG&E wind farms." (ALJ Report, p. 60).

In any event, the arguments of Mr. Pous, Mr. Garrett and Mr. Cook for extending the service lives of OG&E's wind units are fundamentally flawed. Each witness chose to rely on assertions that a hypothetical wind turbine could theoretically remain in service for longer than 25 years if its major components (such as the nacelle, gearbox and rotors) were replaced over time. These assertions are wrong for at least two reasons.

First, such arguments about a wind unit's theoretical physical life ignore that a wind turbine's economic life, not its physical life, is the crucial consideration for depreciation analysis. (Spanos Rebuttal, p. 24, lns. 12-28; Tr. P.M. 5/16/2016, p. lw-31, ln. 21 through p. lw-23, ln. 3 (Pous Cross)). Simply put, just because OG&E may be able to extend the life of individual units by replacing their major components does not mean it would be economically rational to do so. As explained by Mr. Spanos, the capital costs associated with reconditioning a wind unit will often lead to retirement, especially as newer, more efficient turbines come to market. (Spanos Rebuttal, p. 24, ln. 12 through p. 25, ln. 20). Mr. Garrett admitted as much at hearing. (Tr. Late P.M. 5/18/2016, p.sd-55, ln. 25 through sd-59, ln. 17).

Second, these witnesses' views contradict the very definition of depreciation. As Mr. Andrews noted, depreciation can be defined in part as: "the loss in service value not restored by current maintenance." (Andrews Responsive, p. 6, lns. 5-19; *see also* Cook Responsive, p. 6, lns. 6-17). Replacing major components of a wind unit (such as a nacelle, gearbox or rotor) cannot be considered "maintenance." (Tr. A.M. 5/17/2016, p. sd-23, lns. 1-12, (Cook Cross), (acknowledging the distinction between current maintenance and retrofits and replacements)). Thus, given that under the scenarios discussed in some of the materials presented by Messrs. Garrett and Cook, major components would be replaced before 30 years (Garrett Responsive, p. 20, ln. 4 ("turbines will operate effectively *up to* 25 years) (emphasis added)); (Cook Responsive, p. 20, ln. 20 through p. 21, ln. 3 (25-year life can be extended with "retrofits and replacement components")), the 30-year recommendations made by these witnesses are demonstrably wrong.

Further, even the materials cited by those witnesses opposing Mr. Spanos' 25-year recommendation note that the industry generally expects wind units to last 25 years or fewer, (Cook Responsive, Ex. ECC-3, p. 9 ("Wind turbines are still often developed for a 20-year design life")), or major components of a wind unit to last 25 years, (Tr. Late P.M. 5/18/2016, p. sd-54, ln. 22 through p. sd-55, ln. 24 (Garrett Cross)). Thus, 25 years is a reasonable estimate for the life span of a wind unit. The Commission should adopt the ALJ's recommendation.

V. Incentive Compensation

1. The ALJ correctly found that OG&E should be allowed to recover 100% of its short term employee incentive compensation and 25% of its long term employee incentive compensation.

a. Short-Term Incentive Compensation ("STI")

OG&E requested recovery of 100% of STI with a four-year average total amounting to $14,209,108 for the Oklahoma jurisdiction. PUD agreed with the level of recovery requested by OG&E. (ALJ Report, p. 43 (citing Thompson Resp. Test., p. 27)) The ALJ recommended allowing 100% of STI based on the four year average of $14,209,108. (*Id.* at 44.) In filed exceptions, the OIEC/OER, the AG and the AARP argue that the ALJ erred in not disallowing 50% of the short term incentive compensation. (OIEC Exceptions, pp. 19-22; AG Exceptions at pp. 9-11; AARP Exceptions at pp. 8-9).

In his Report and based upon substantial evidence in the record, the ALJ correctly found that "a public utility should be allowed to recover reasonable compensation for employees performing necessary functions for the provisioning of regulated services." (ALJ Report, p. 44) OG&E pays its employees based on both salary and incentive compensation and not only competes with utilities, but also other employers across Oklahoma and the region. The ALJ was correct to recognize the importance of OG&E using compensation surveys to identify the appropriate mix of salary and incentive compensation that is needed for the Company to compete with other employers and attract the talent OG&E needs to provide its services.

The OIEC and AG seem to argue that this Commission should ignore the evidence and arguments provided by OG&E and simply do what it has done in previous OG&E cases. But, they gloss over the fact that OG&E's incentive compensation is a <u>necessary</u> cost to attract and retain employees. OG&E Witness Ruden testified about OG&E's challenges in recruiting and hiring a quality workforce and the need to offer total compensation that includes incentive compensation. (Ruden Direct at pp. 7-9). Witness Ruden also detailed how OG&E uses multiple compensation studies to determine the appropriate competitive compensation packages with the appropriate blend of base salary and incentive compensation. (Ruden Direct at pp. 9-11).

No party offered evidence that OG&E's incentive compensation levels are too high or imprudent. They simply argue that the costs, which may be necessary and reasonable, should not be recovered from customers. But, if these costs are necessary and reasonable to attract and retain employees in a competitive job market, it should be included in rates. It should also be noted that this Commission has allowed full recovery of short term incentive compensation for both CenterPoint and Oklahoma Natural Gas.[16] CenterPoint has actually received 100% of its short term incentive compensation since 2006.[17]

OG&E believes that there is substantial evidence to support the ALJ's conclusion that 100% of short term incentive compensation should be recovered. In her written, pre-filed testimony, OG&E witness Ruden established that one of OG&E's primary goals is "to provide reliable, safe and reasonable cost electric service to our customer" and the attendant difficulties meeting that obligation as a result of the "ongoing changes in regulatory compliance requirements, customer expectations and technology which impact how we will operate as a business in the future." (Ruden Direct, p. 3) To meet OG&E's goal of high-level, low cost service to customers, it is necessary "to retain a talented, highly motivated, and experienced work force and that requires "competitive, but reasonable, compensation and benefits to our existing members in light of the competition we face from other utilities and industries." (Ruden Direct, p. 3) As stated above, Witness Ruden details OG&E's challenges in recruiting and hiring a quality workforce and the need to offer total compensation that includes incentive compensation. (Ruden Direct at pp. 7-9). Lastly, to determine whether compensation levels are reasonable and market competitive, OG&E "uses data provided by independently verified third-party salary surveys, and compares the Company's salaries to the external market data." (Ruden Direct, p. 4).

Contrary to arguments contained in the exceptions by OIEC and the Attorney General, OG&E submits that there is also substantial record evidence to demonstrate customers receive a benefit from the short-term incentive compensation program that supports the ALJ's recommendation. OG&E Witness Ruden testified that OG&E's approach to compensation is to "focus[] on the development of compensation programs that are performance-based and align with the business strategy." (Ruden Direct, p. 3) In that regard, Ruden stated that OG&E's "STI plan is provided to motivate and reward our members to drive performance, particularly in the areas of safety, customer service and fiscal responsibility." (Ruden Direct, p. 4) Concerning measurement of member performance, Ruden stated "[t]he STI performance measures are designed using a balanced scorecard approach which includes a combination of operating performance measures and traditional financial measures to give members a more balanced approach to successful organizational performance." (Ruden Direct, pp. 3-4). Those measures include Customer Satisfaction, Safety, Operating and Maintenance Expense ("O&M"), and Earning Per Share. (Ruden Direct Test., p. 4) Witness Ruden testified that a healthy utility with reasonable investor returns compared to its peers ultimately lowers costs to customers through better credit metrics and lower cost of capital. (Ruden Direct, p. 5, lns. 3-7).

---

16 *See In the Matter of the Application of CenterPoint Energy Resources Corp., D/B/A CenterPoint Energy Oklahoma Gas for Approval of its Performance-Based Rate Change Plan Calculations For the Twelve Month Ended December 31, 2014*, Order No. 646583, Cause No. PUD 201500118; *In the Matter of the Application of Oklahoma Natural Gas Company, a Division of One Gas, Inc., For Review and Change or Modification in its Rates, Charges, Tariffs, and Terms of Conditions and Service*, Order No. 648326, Cause No. PUD 201500213.

17 Order No. 646583, Cause No. PUD 201500118, ALJ Report at p. 7, ¶ 14.

It is simply common sense to recognize that customer satisfaction, safety and lower O&M costs benefit customers. But, like those operating metrics, financial metrics like earnings per share also benefit customers because a well-run the utility with strong earnings has lower costs and better credit metrics. When all OG&E employees are striving toward these goals, the Company will be in a stronger position to provide excellent service at reasonable costs.

OG&E submits that record evidence shows that OG&E's workforce and customer interests are aligned to an extent justifying recovery of 100% of short-term incentive costs. OG&E's actions to incent higher levels of customer satisfaction, greater safety on the job, lower levels of O&M, and an increased financial condition of the Company inure to the benefit of customers. The ALJ observed that OG&E's "balance scorecard" approach to performance measurement and the fact that scorecard utilized operating performance measures and traditional performance measures. (ALJ Report, p. 43) For the above-stated reasons, OG&E submits the ALJ did not err in recommending recovery of 100% of OG&E STI costs.

b. Long-Term Incentive Compensation ("LTI")

OG&E's original rate increase request included $5,977,907 to recover 100% of its long-term incentive plan ("LTI") available to corporate officers and executives. In his Report, the ALJ relied upon and adopted the recommendation of PUD, which included only 25% of the long-term incentive compensation and was calculated to be $1,494,476.75. (ALJ Report, p. 44.) While OG&E believes the current employment marketplace supports the inclusion of 100% LTI in total compensation packages to attract and retain key employees, OG&E submits that the ALJ did not err in recommending recovery of 25% of OG&E's long-term incentive compensation for the reasons discussed below. Indeed, there is substantial evidence in the record to support the recommendation of the ALJ.

First, as noted above, no party offered evidence that OG&E's incentive compensation levels are too high or imprudent. OIEC/OER and the AG object to the ALJ's recommendation for inclusion of long-term incentive compensation in rates based on the allegation that customers do not benefit from payment of long-term incentives. However, the record in the case shows that offering long-term incentives is essential to providing a competitive compensation package for OG&E's executives and directors and those employees critical to the long-term success of the Company. Customers benefit if the performance measures are strong because OG&E will attract more investors and have access to cheaper capital, lowering the cost of providing service to customers (Ruden Direct, p. 6, lns. 18-20).

In her written testimony, OG&E Witness Ruden provided testimony regarding how LTI is critical for OG&E competing for talent and attracting and retaining employees. (Ruden Direct, p. 7). It should be noted that OG&E's competition for skilled employees includes more than local utility companies. (Ruden Direct, p. 7) In the geographic area in which OG&E operates, it competes with not only other utilities, but also energy-sector companies that offer competitive compensation packages (with heavy emphasis toward incentive compensation) and attractive work environments that include, among other things, on-site fitness centers and dining facilities. (Ruden Direct, p. 7) In addition to the competition with other energy companies, OG&E must also deal with the pressure of attrition through retirement. (Ruden Direct, p. 7) Currently, approximately one-fourth (1/4) of OG&E's workforce is eligible for retirement (Ruden Direct, p. 8) Challenges exist to fill jobs such as specialty engineering, IT security, senior analysts, and skilled positions such as instrument and control technicians and control operators. (Ruden Direct, pp. 7-8). An attractive LTI plan is a key way to attract and retain key employees.

Witness Ruden also discussed the goals of incentive compensation: "to incent or drive behavior" and "to motivate performance by providing rewards for specific results." (Ruden Direct, p. 4). Not only is incentive compensation designed to attract and retain employees, but LTI is specifically "intended to drive business decision making that results in long-term company performance and promotes shareholder and customer value" and to align the interests of employees to the goals of the Company. (Ruden Direct, p. 4, 6) Witness Ruden further explained that this is the reason the relevant performance period for review of results is more than one year and also why this type of incentive is only offered to those members who can influence long-term business results. (Ruden Direct, p. 6)

As explained by Witness Ruden, customers benefit from lower costs of service when a utility is financially strong. The financial strength of a utility directly translates into increased investment and lower cost of capital. The ability to attract competent employees by means of competitive compensation packages also directly affects the performance of the Company and level of service that customers receive. Through her testimony, Witness Ruden demonstrated the alignment of interests between managers, shareholders, and customers that justifies recovery of expenses for LTI. For these reasons, OG&E submits that that the ALJ did not err in recommending recovery of 25% of long-term incentive compensation costs.

VI. Payroll and Payroll Tax

1. The ALJ correctly identified a methodology for most accurately determining a proper level of payroll expense and payroll tax expense to apply to future rates.

Ignoring the substantial record in this cause and the ALJ's description of his review of the same, OIEC and OER claim that the ALJ's recommendation regarding payroll expense based on a December 2015 payroll is contrary to law and is unsupported by substantial evidence.

In fact, the ALJ observed that OG&E's payroll calculation methodology is consistent with the approach utilized by the Company previously and accepted by this Commission (ALJ Report, p. 41). He also notes that the AG agreed with the methodology used by the Company but, based on updated information provided by the Company, recommended a decrease in OG&E's request by $565,523, resulting in a pro forma $5,481,700 increase to payroll expense and taxes when compared to the test-year-end balances. (ALJ Report, p. 42) Relying on the evidence presented, the ALJ also specifically found that the methodology supported by OG&E and the AG "most reasonably approximates the payroll expense, which should be recovered in prospective rates. (ALJ Report, p. 42) OG&E submits that the ALJ identified the correct methodology for most accurately determining a proper level of payroll expense to apply to future rates.

OG&E witness Jason Thenmadathil provided pre-filed Direct and Rebuttal Testimony and provided live testimony during the hearing that supported the payroll calculation recommended by the ALJ. In that testimony, Mr. Thenmadathil described the process OG&E used to formulate his recommendation. Mr. Thenmadathil testified that he "calculated the annual salary of our employees that were working at the company on December 31, 2015. It represents the annual salary or our employees." (Tr. P.M. 5/11/16, p. 90). Mr. Thenmadathil stated that he did not simply take the last month of 2015 and annualize the employee salaries because to do so would have resulted in a number that failed to include the pay increases OG&E employees received at the end of December. (Tr. P.M. 5/11/16, pp. 90-91). Mr. Thenmadathil further noted that simply annualizing December salaries would also fail to account for employees that either end employment or begin employment in December. (Tr. P.M. 5/11/16, p. 91). Mr. Thenmadathil stated that his methodology provided the most recent information available as of the end of the *pro forma* period and that is the methodology employed in OG&E's last three rate cases and approved by this Commission in Cause No. PUD 2005001151. (Tr. P.M. 5/11/16, p. 91).

In his Report, the ALJ noted that he utilized his best judgment to determine the "fair cost to customers when new rates go into effect" and based his ultimate determination on OG&E's and the AG's methodology as it "most reasonably approximates the payroll expense, which should be recovered in prospective rates." (ALJ Report, p. 42). The ALJ's approach is consistent with Mr. Thenmadathil's choice of methodology and his intent to provide up-to-date information as set forth in his written testimony wherein he states his "methodology takes into account the actual level of employees and their associated pay rate during the final pay period, thereby considering all employee additions, retirements, and pay-raises within the six-month-post-test-year." (Thenmadathil Rebuttal, p. 6).

A review of OIEC/OER's argument in support of its claim of error reveals it is nothing more than a recount of the testimony of its witness regarding his recommendation as to how the payroll expense should be calculated for prospective rates. (OIEC Exceptions, pp. 26-27). There is no citation to any authority suggesting the methodology used by OG&E and recommended by the ALJ is contrary to established law. Neither is there a showing that there is a lack of record evidence in support of that methodology or the ALJ's recommendation. A review of the record, as described above, demonstrates that Mr. Thenmadathil testified extensively as to the methodology used to set prospective payroll expense and that there was a rational basis for his decision to use that methodology. OIEC/OER's claim of error is no more than a mere disagreement with the outcome which, standing alone, is insufficient to demonstrate a lack of substantial evidence. *See In re Southwestern Bell Tel., L.P. v. State ex rel Okla. Corp. Comm'n*, 2007 OK 55, ¶ 36.

OG&E submits that the ALJ's determination regarding payroll expense (and associated payroll tax expense) is supported by the record evidence and most accurately represents known and measurable changes from the test year expenses. As such, the ALJ's recommendation constitutes the most accurate forecast of OG&E's payroll expense, provides the most fair estimation of costs for customers that should be included in prospective rates, and is neither unlawful nor lacking evidentiary support.

VII. Corporate Allocation Adjustment

1. The ALJ correctly found that the cost of services previously paid for in part by Enable and now reallocated to OG&E constitute core administrative functions required by OG&E.

OIEC argues that the ALJ erred in recommending an adjustment to O&M expense to reflect an increase in OG&E's share of the cost of certain administrative services provided by OG&E's holding company. (OIEC Exceptions, p. 40). In the ALJ Report, the ALJ agreed that this increase was due to core administrative functions in which OG&E's affiliate Enable no longer shares the costs. The ALJ recommended an increase of O&M expense of $3,938,926 to reflect this shift in allocated costs to OG&E. (ALJ Report, p. 51). OIEC argue that these costs are unreasonable and not supported by the evidence.

As described in OG&E testimony, the Company included this adjustment to reflect an increase in OG&E's share of the cost for certain administrative services provided by OGE Energy Corp. The adjustment resulted from a change in the services allocated to Enable Midstream Partners LLC during the test year. (Thenmadathil Direct, p. 11; Updated Response to OIEC D.R. 2-16). During the hearing on the merits, the Company updated its requested increase based on corporate allocations and reduced the amount from $6,057,685 to $3,938,926. The $2,118,759 decrease was based on actual costs allocated to Enable at the end of the six month post-test year period. (Tr. A.M. 5/9/2016, pp. 13-14).

OG&E Witness Scott Forbes testified that, since 1986, OG&E has been sharing the costs of administrative services such as auditing, accounting, finance, treasury, human resources, risk, information technology and supply chain service with its affiliate, Enogex. (Forbes Rebuttal, p. 3 and 6). A change to the sharing of those costs began in May 2013 with the formation of Enable Midstream Partners that resulted from the combining of Enogex and CenterPoint Energy's mid-stream business. (*Id.* at pp. 3-4). Upon the formation of Enable, OGE Energy Corp. entered into a three-year service agreement to continue providing to Enable the same administrative services previously provided to Enogex. (*Id.* at p. 4).

Mr. Forbes stated that all the cost increases were caused by services cancelled by Enable no later than the end of December 2015 and that the effect of those cancellations were immediate. (Forbes Rebuttal, p. 5; Tr. P.M. 5/10/2016, p. 70; 92). Mr. Forbes also stated those services are "integral" to the operations of a company such as OG&E and that it is common for utility holding companies to provide those services so as to "reduce the cost of having redundant administrative costs when a company has multiple subsidiaries." (Forbes Rebuttal, p. 6). Further, Mr. Forbes disagreed with the assertion that OG&E could reap a "windfall" if administrative services were reduced or eliminated, stating: "[T]he remainder of the allocations primarily deals with fixed information technology and related infrastructure costs, which can't be eliminated, as OG&E relies on that technology and infrastructure." (*Id*). It should be noted that no party produced any evidence that the costs of the services provided by OGE Energy Corp. to OG&E were imprudent or unreasonable.

Based on the substantial evidence in the record, the ALJ correctly found that the services previously paid for in part by Enable and now reallocated to OG&E constitute core administrative functions required by OG&E. The ALJ was also correct in finding that OG&E customers have benefited from a sharing of administrative costs since 1986 (Forbes Rebuttal, p. 3) and that the other parties presented no credible evidence showing either that OG&E's request was unreasonable or that OG&E could receive any kind of windfall. (ALJ Report at p. 51). In fact, Mr. Forbes stated during the hearing that "customers have received a fantastic deal for the last 30 years by having a number of necessary costs offset." (Tr. 5/1/2016, p. rdh-71)

VIII. Amortization of Smart Meter Stranded Assets and Web Portal

1. The ALJ correctly identified the appropriate amortization period for OG&E's Smart Grid stranded assets and the Smart Grid Web Portal costs.

The OIEC argues that the ALJ erred in finding that OG&E's Smart Grid stranded assets and the Smart Grid Web Portal costs be amortized over a six-year period. (OIEC Exceptions pp. 41-42). These costs involve the stranded assets associated with analog meters that were replaced by smart meters in 2010, 2011 and 2012, as well as the costs for implementing the Smart Grid informational portal in 2010. The six year period is consistent with this Commission's Order No. 576595 in Cause No. PUD 201000029.

The OIEC, which is the only party opposing this adjustment, proposed an amortization period of fifteen years as opposed to OG&E's request for a six-year amortization period. (M. Garrett Responsive, p. 62, lns. 16-18). The OIEC argues that the Company should be penalized for failing to file a 2013 rate case (*Id.* at p. 62, lns. 9-12), and that a 15 year amortization period is the same amortization period ordered by the Commission for PSO's stranded assets resulting from that Company's smart meter deployment. (*Id.* p. 62, lns. 18-19). However, OIEC witness Garrett admitted during cross examination that the amortization period ordered by the Commission in the PSO cause was approximately 10 years. (Tr. P.M. 5/18/2016, pp. 18-19). .

OG&E believes that the Commission should adopt the ALJ's recommendation regarding this amortization period. First, the ALJ was correct that OIEC provided no valid rationale to support their fifteen year amortization period. No persuasive evidence has been provided to justify a longer amortization period. Second, the ALJ was correct that the six year amortization period is consistent with a previous Commission settlement and order. Finally, the ALJ was correct in finding that it is inappropriate to adjust amortization periods in order to penalize the Company for some parties' belief that OG&E should have filed a 2013 rate case. The Commission should adopt the ALJ's recommended adjustment to reflect a six year amortization period related to these expenses.

IX. Net Gain on Sale of Utility Assets

1. The ALJ identified the correct amount of gain on the sale of assets to be considered in this proceeding and the appropriate amortization period to credit customers for that gain.

The AG, OIEC, and OER claim the ALJ erred regarding his recommendations as to net gains on the sale of assets. More specifically, the AG argues that the ALJ erred regarding his recommendation as to the correct amount of gain on the sale of the assets at issue (*i.e.*, limiting the amount of gains to the sale and repurchase of McCain facility turbine rotor and the sale of distribution facilities to the Choctaw Nation), while OIEC/OER argue that the ALJ erred in recommending a thirty-year (30) amortization period for the gain on the sale of that rotor. As discussed below, OG&E believes that the ALJ identified the correct amount of the gain and the correct amortization period and his recommendations on this issue should be adopted.

a. The Amount of Gain on Sale of Asset

The AG argues that all gains realized from the retirement or sale of assets since OG&E's last rate case should be included as a reduction to rate base or a total company reduction of $1,262,322. (AG Exceptions, pp. 8-9; Farrar Responsive, pp. 6-7). During the hearing, OG&E witness Scott Forbes testified that only gains occurring during the pro forma test year period and only gains on those assets that are actually included in rate base may properly be included as a reduction to rate base. (Forbes Rebuttal, p.7, lns. 1-11). According to Mr. Forbes, the only gains on assets that meet such criteria are the $962,500 gain on the sale and repurchase of a McClain facility turbine rotor in December, 2015 and the $119,654 gain on the June 30, 2015 sale of distribution facilities to the Choctaw Nation. (Tr. P.M. 5/10/2016, pp. rdh-75 to rdh-78). Including the gains from these assets in rate base would reduce total company rate base by $1,082,154.

The ALJ recommended the Commission adopt $1,082,154 as the correct amount of the gain on sale of assets as proffered by Witness Forbes. (ALJ Report, p. 38). OG&E submits that the ALJ's recommendation regarding the amount of the gain on sale of assets is supported by the record.

b. Amortization Period

As noted above, OIEC and OER claim the ALJ erred in recommending a thirty-year amortization period for the gain on the sale and repurchase of the McClain facility turbine rotor and assert that the recommendation is unsupported by evidence and unfair to ratepayers. During the hearing, OG&E proposed an amortization period of 30 years, which matches the remaining life of the asset actually placed in rate base. (Tr. P.M. 5/10/2016, p. rdh-89). OIEC/OER believes that the gain should be amortized over a two-year period.

During cross-examination, OIEC/OER Witness Garrett stated his belief that a two-year amortization period was proper based on his assertion that "accounting rules don't allow" amortization of gains over a longer period of time. (Tr. A.M. 5/18/2016, p. 88, lns. 11-13). However, Mr. Garrett was unable to cite to a particular accounting rule in that regard. (Tr. A.M. 5/18/2016, p. 89, lns. 23-25). OG&E witness Scott Forbes, Chief Accounting Officer, testified that the gain should be amortized over the 30 year life of the McClain plant. (Forbes Rebuttal, p. 7, lns. 16-17). During redirect examination, Mr. Forbes explained that, from an accounting perspective, thirty years is the appropriate amortization period because "it would match the time frame the asset is being used, which resulted in the gain. It would be a clear matching concept." (Tr. P.M. 5/10/2016, p. rdh-89).

In considering the issue, the ALJ observed "the gain here is unusual in origin. OG&E ordered a new rotor from its manufacturer. Another utility had rotor failure and badly needed OG&E's new rotor. OG&E accommodated the other utility by switching places in the manufacturer's delivery queue. The result was that OG&E paid a reduced price for a rotor when it was delivered. The resulting savings are what the other parties are calling a gain." (ALJ Report, p. 53). Based on the facts and the benefit to customers from OG&E's actions, the ALJ recommended amortization of the gain over the remaining life of the plant. (ALJ Report, p. 53).

OG&E submits that OIEC/OER have failed to show that the ALJ's recommendation is unsupported by the record evidence. Instead, OIEC/OER's argument in this regard is again a disagreement with the outcome, not a showing of a lack of record evidence. Further, regarding fairness to customers and OIEC/OER's reliance upon Witness Garrett's testimony that "OG&E does not have a rotor; as it sold it. Therefore, the rotor has no useful life" (Tr. 5/18/2016, p. 11), OG&E would show that both Mr. Forbes testimony and the recommendation of the ALJ discuss the *repurchase* of a rotor. (Forbes Rebuttal, p. 7, ln. 18). As noted by the ALJ, it's the difference between the price of the original rotor and the second, repurchased rotor that constitutes the gain at issue. (ALJ Report, p. 53). Thus, the decision to amortize the gain over the life of the rotor is not unfair to customers as, according to Mr. Forbes, "[t]he rotor will be used in a future outage at McClain, and is expected to be in service through the expected retirement in 2046." (*See* Forbes Rebuttal, p. 7, lns. 20-21). OG&E submits that no error resulted from the ALJ's recommendation regarding the proper amortization period.

X. <u>Outside Services Costs</u>

OIEC and OER claim that the ALJ erred in recommending that OG&E not be required to refund OG&E Shareholders' Association ("Shareholder") legal fees that were erroneously included in OG&E's cost of service. (OIEC Exceptions, pp. 44-47; OER Exceptions, pp. 9-10). As noted in OIEC/OER's Exceptions, OG&E acknowledged during the hearing that reimbursement of Shareholder legal fees had been erroneously included in its cost of service in this proceeding as well as prior OG&E rate case proceedings. In fact, this error was actually identified by OG&E during the discovery process and brought to the other parties' attention. As further noted, OG&E witnesses testified that the $295,788 at issue for the current test year should be removed. The ALJ recommended that the $295,788 adjustment recommended by OG&E be adopted but, relying upon the "Settled Rate Doctrine," found that the issue of collection of Shareholder legal expenses under prior orders should not be revisited. (ALJ Report, p. 71). OIEC/OER's claim of error is premised upon its assertion that OG&E's recovery of Shareholder expenses in past years was "unlawful and void" and, therefore, the Settled Rate Doctrine does not apply.

Pursuant to the provisions of 17 O.S. § 121, this Commission is authorized to determine the amount of a refund due and any interest owing in cases in which a public service corporation "charges an amount for any service rendered ... in excess of the lawful rate in force at the time such charge was made" and "to whom the overcharge should be paid." It is important to note that the pertinent statutory language refers to *charges in excess of lawful rates* and *overcharges*. OIEC/OER's necessary basis for its argument is that no matter whether the prior charges were made as a result of mistake, those mistaken charges were in excess of the lawful rate and, therefore, within the purview of 17 O.S. § 121. However, this premise has been soundly rejected by the Oklahoma Court.

In *Turpen v. Oklahoma Corporation Commission*, the court addressed the issue of retroactive ratemaking, stating the following:

> In general, rate regulation is prospective. Future rates are set on the basis of forecasts of income, expenses and profits. The focus of ratemaking is on whether proposed rates are just and reasonable, *not on accounting for mistakes in past rates*. Accounting for mistakes in past rates in the setting of future rates, or retroactive ratemaking, was rejected by this court in *Southwestern Public Service Co. v. State*. In that case we held that the Commission erred when it ordered a rebate of excessive charges made by a subsidiary to its parent utility company for fuel purchases covering the period prior to the effective date of the order determining the charges to be excessive. The court in *Southwestern Public Service Co.* pointed out that the utility's fuel purchases from its subsidiary conformed to a previous Commission order. Clearly, the Commission was attempting to account for mistakes in past ratemaking in the settling of future rates and thereby engaging in prohibited retroactive ratemaking.
> *Turpen*, 1988 OK 126, ¶ 76 (emphasis added).

As was the case in *Southwestern Public Service Co.*, the charges at issue in the present case were mistakenly made, prior collections were pursuant to a previous valid Commission order, and the excessive charges have occurred prior to the issuance of a final order in this case. Based on *Turpen* and 17 O.S. § 121, the ALJ's recommendation regarding the present issue was not only proper, it was mandated by law. OIEC/OER's recommendation to require a refund of the prior legal fees would require impermissible retroactive ratemaking by this Commission. Thus, the ALJ's recommendation did not constitute error.

XI. Plant Held For Future Use

The ALJ recommended including a limited amount of plant held for future use in rate base. The ALJ stated that "[w]here a transmission and distribution system is capable of expansion, the prudent operator should acquire property to accommodate system growth and higher acquisition costs caused by escalating real estate prices." (ALJ Report, p. 36). The ALJ however further recognized that it was appropriate to remove the cost of land held for more than ten years. *Id.* The ALJ recommendation was supported in testimony by Commission Staff and agreed to by OG&E. In their exceptions, both the AG and the OIEC argued that such a recommendation was contrary to law and general ratemaking principles. These arguments are erroneous. Not only do ratemaking principles and case law support the inclusion of plant held for future use in rate base, but the evidence shows that inclusion of OG&E's recently acquired land in rate base is a reasonable and appropriate business activity that is beneficial to customers.

The Regulation of Public Utilities: Theory and Practice by Charles F. Phillips, Jr., 1988 Public Utility Reports, Inc. is considered by some as an authoritative text on public utilities, as conceded by witness Mark Garrett, who owns a copy of that text although he states he does not cite it "very often." (Tr. A.M. 5/18/2016, p. 21, lns. 18-25; p. 24, lns. 16-18). That text provides:

> Property held for future use is the amount of investment in property and plant which is not being used currently by a utility to provide service. Generally, such property is land, purchased when available, for potential future use (such as an office building or a generating site). **The rule that most commissions follow in deciding whether to include or exclude such property is one based upon a time limitation; that is, if the property has an expected in service date within a reasonable time period (commonly 2-10 years), it is included in the rate base.** *The Regulation of Public Utilities: Theory and Practice* at 334-35 (emphasis added).

The standard in Oklahoma regarding inclusion of property held for anticipated future use was stated in *Southwestern Public Service Company v. State*, 637 Okla. 136, P.2d 92, 98 (1981), as follows:

> In determining whether property held by a utility for anticipated future use should be included in the rate base, there is yet another factor to be weighed, i.e., whether the purchase of the property in question was made in pursuance of honest and reasonable business judgment in carrying out some definite plan, for example, whether the expenditure was dishonest, wasteful or imprudent. This is a question of fact to be determined from the evidence.

The evidence in this proceeding shows that the ALJ's recommendation is consistent with these authorities. OG&E has acquired various parcels of land with the plan to incorporate that land in its plans for in-service "used and useful" plant. Those parcels were identified in WP C-13. This workpaper identified the intended use and estimated in service date for the property. Only land or easements acquired within the last 10 years were recommended for inclusion in rate base. Moreover, there is no evidence, or even suggestion, in this proceeding that the acquisition of any land or easement was dishonest, wasteful, or imprudent. OG&E believes that failure to purchase the best locations in advance, particularly in growth areas, creates risk of higher costs to customers associated with rerouting of transmission lines and access easements to build substations. (Thenmadathil Rebuttal, p. 3, lns. 8-15).

The ALJ correctly found that OG&E had a plan for its land held for future use, limited the amount of land held for future use in rate base to that property held less than 10 years, and correctly recognized that these assets provide benefits to customers through cost mitigation by planning and purchasing property in advance. OG&E requests that the Commission adopt the ALJ recommendation regarding plant held for future use.

WHEREFORE, OG&E requests this Commission reject the arguments in the other parties' exceptions as described herein and adopt the ALJ recommendations with the few modifications discussed in OG&E's exceptions.

Respectfully submitted,

OKLAHOMA GAS AND ELECTRIC COMPANY

By William L. Humes

Kimber L. Shoop, OBA No. 19571
Patrick D. Shore, OBA No. 8205
William L. Humes, OBA No. 15264
John D. Rhea, OBA No. 18984
Oklahoma Gas and Electric Company
P.O. Box 321, MC 1208
Oklahoma City, Oklahoma 73101
Telephone: 405-553-3023
Facsimile: 405-553-3198
shoopkl@oge.com
shorepd@oge.com
humeswl@oge.com
rheajd@oge.com

and

William J. Bullard, OBA No. 1302
Williams, Box, Forshee & Bullard, PC
522 Colcord Dr.
Oklahoma City, Oklahoma 73102
405-232-0080
bullarwj@oge.com

and

David A. Kutik, OBA # 20446
Jones Day
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
Telephone: (216) 586-3939
Facsimile: (216) 579-0212
dakutik@jonesday.com

Attorneys for Applicant

CERTIFICATE OF SERVICE

This is to certify that on the 11th day of January, 2017, a true and correct copy of the above and foregoing motion was transmitted to the following:

Brandy Wreath
Judith Johnson
Natasha Scott
Fairo Mitchell
Patrick Ahern
Oklahoma Corporation Commission
P.O. Box 52000
Oklahoma City, Oklahoma 73152
b.wreath@occemail.com
j.johnson2@occemail.com
n.scott@occemail.com
f.mitchell@occemail.com
p.ahern@occemail.com

Dara M. Derryberry
Office of the Attorney General of Oklahoma
313 N.E. 21st Street
Oklahoma City, Oklahoma 73105
Dara.Derryberry@oag.ok.gov

Thomas P. Schroedter
Pat Nixon
Hall, Estill, Hardwick, Gable, Golden & Nelson, PC
321 S. Boston, Suite 200
Tulsa, Oklahoma 74103
tschroedter@hallestill.com
pnixon@hallestill.com

Jack G. Clark, Jr.
Clark, Wood & Patten, PC
3545 N.W. 58th Street, Suite 400
Oklahoma City, OK 73112
cclark@cswp-law.com

Ronald E. Stakem
Cheek & Falcone, PLLC
6301 Waterford Blvd. Suite 320
Oklahoma City, OK 73118
rstakem@cheekfalcone.com

Deborah Thompson
OK Energy Firm, PLLC
P.O. Box 54632
Oklahoma City, Oklahoma 73154
dthompson@okenergyfirm.com

Rick D. Chamberlain
Behrens, Wheeler & Chamberlain
6 N.E. 63rd Street, Suite 400
Oklahoma City, OK 73105
rchamberlain@okenergylaw.com

OG&E Regulatory Information
reginfor@oge.com

Cheryl A. Vaught
Scot A. Conner
Vaught & Conner, PLLC
1900 NW Expressway, Suite 1300
Oklahoma City, OK 73118
cvaught@vcokc.com
sconner@vcokc.com

Jon W. Laasch
Jacobson & Laasch
212 East Second
Edmond, OK 73034
jonlaasch@yahoo.com

Marc Edwards
Jim Roth
Phillips Murrah P.C.
Corporate Tower, 13th Floor
101 N. Robinson
Oklahoma City, OK 73102
medwards@phillipsmurrah.com
jaroth@phillipsmurrah.com

Thad Culley
Keyes, Fox & Wiedman LLP
436 14th Street, Suite 1305
Oakland, CA 94612
tculley@kfwlaw.com

Lee W. Paden
PO Box 52072
Tulsa, OK 74152
lpaden@ionet.new

George Wright
Gregory M. Quinlan
1601 Gordon Cooper Drive
Shawnee, OK 74801
Greg.quinlan@potawatomi.org

Jacquelyn L. Dill
Dill Law Firm, P.C.
3133 NW 63rd Street
Oklahoma City, OK 73116
jdill@dilllawfirm.com

Casey A. Roberts
Laurie Williams
85 Second Street, Second Floor
San Francisco, CA 94105
Casey.Roberts@sierraclub.org
Laurie.Williams@sierraclub.org

Mr. Thomas A. Jernigan
FLOA/JA – ULFSC
139 Barnes Drive, Suite 1
Tyndall AFB, FL 32403-5319
thomas.jernigan.3@us.af.mil

William L. Humes