BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

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

Rebuttal Testimony

of

David W. Smith

on behalf of

Oklahoma Gas and Electric Company

June 5, 2018

Q. **Would you please state your name and business address?**

A. My name is David W. Smith. My business address is 321 North Harvey, Oklahoma City, Oklahoma, 73102.

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

A. I am employed by Oklahoma Gas and Electric Company ("OG&E" or "Company") as a Senior Costing Analyst.

Q. **What is your educational background and professional experience?**

A. I graduated with a bachelor's degree in economics from the University of Central Oklahoma. I have completed further education at the graduate level in areas of both Finance and Economics. I worked approximately five and a half years as a public utility regulatory analyst for the Oklahoma Corporation Commission ("OCC"). While at the OCC, I testified to numerous rate filings, Cost of Service Studies ("COSS"), and cost trackers. I joined OG&E in 2010 as a Senior Costing Analyst.

Q. **What is the purpose of your Rebuttal Testimony?**

A. The purpose of my testimony is to respond to AARP witness Ron Nelson and his assessment of the Company's Zero-Intercept Study.

Final Order and Update to the Zero-Intercept Study

Q. **Did OG&E Comply with the Final Order No. 662059 in Cause No. PUD 201500273?**

A. Yes. The Company complied with Final Order No. 662059 and updated its Zero-Intercept Study. The Company used the same methodology as approved in Cause No. PUD 200800398, to which was fully testified to in detail and approved in PUD 201100087, but now refines how it classifies its primary distribution system (the "Primary System") assets. Specifically, the Company classified its primary distribution assets as 100% demand related.

Q. **Why did the Company classify its Primary System as 100% demand-related?**

A. The Company undertook a nine month long project in conjunction with its professional distribution engineers to accurately reflect the actual design, operation, and use of system as constructed. The Company's engineers design the Primary System to serve local area loads. The primary distribution system is different from the secondary system in that it is used by all local area customers as opposed to the specific customers that utilize the Secondary System.

Q. **Did Mr. Nelson or any other witness argue against the new Primary System classification?**

A. No.

Q. **How does the Company plan, design, and operate its entire distribution system?**

A. The Company plans its Primary System for local area loads, which are 100% demand related. For the Secondary System, the Company plans, designs, and operates its system to address the needs of specific customers, thereby making the costs associated with these customers both demand and customer related.

Q. **What is the purpose of classifying electric distribution costs as both customer and demand-related?**

A. The costs a utility incurs to connect a customer to the distribution grid without regard to the level of customer load is reasonably classified as customer-related and allocated based on number of customers. The purpose of this classification is to allocate costs according to cost causation. The customer-related portion of the distribution system makes service available to a specific customer, making the balance of distribution system costs demand related. The demand related cost component – those that are not customer-related – has a cost causation based on the level of power demanded by customers above the minimum customer-related level. These costs should be allocated on demand and are appropriate to recover through volumetric charges.

Q. **Is it widely accepted, in the electric utility business, that electric distribution costs should be classified as both customer and demand related?**

A. Yes. It is widely accepted at the state, regional, and national levels that distribution costs are driven by two factors: 1) the number of customers on the distribution system, and 2) the demand those customers place on the system. The Electric Utility Cost Allocation Manual ("NARUC Electric Manual") clearly states that only demand and customer components should be considered in classifying distribution costs. Specifically, the NARUC Electric Manual states: “To insure that (distribution) costs are properly allocated, the analyst must first classify each account as demand-related, customer-related or a combination of both.”[1] The NARUC Electric Manual states that in order to classify the demand and customer related costs, a utility must use one of the following methods: the minimum size-of-facilities method, or the minimum-intercept cost (zero-intercept) method.[2]

Q. **How does witness Nelson propose to classify these distribution costs?**

A. As discussed in the Rebuttal Testimony of Company witness Satterwhite, Mr. Nelson recommends that this Commission consider adopting the basic customer approach using what appears to be based on a peak and average demand method to allocate the demand component of the Secondary System[3].

Q. **Why does the Company believe this is incorrect?**

A. The use of a peak and average demand method to allocate the demand component of the Secondary System is advocating the use of a generation allocator (peak and average)

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[1] *Electric Utility Cost Allocation Manual*, January 1992, p.89.

[2] *Ibid.*, p. 90.

[3] Responsive Testimony of Ron Nelson, pg. 13, ln 10-11. Mr. Nelson then on pg. 14, ln 15-16, and pg. 15, ln 1, footnote 6, and pg. 15, ln 8-11, footnote 8, establishes what he is recommending the Commission to consider, a basic customer approach using a peak and average demand allocation which the NARUC Electric Manual recommends as a generation allocation method, not a distribution method. It should also be noted that in Mr. Nelson’s own footnote 8 on pg. 15 reference to pg. 41 in NARUC Electric Manual is a chapter for production generation, not distribution. Further, in footnote 8, Mr. Nelson again misapplies basic cost-of-service principals in the NARUC Electric Manual by suggesting that a Marginal Cost of Service approach supports the use of a peak and average or basic customer approach, when in fact OAC:165-70-9-10 requires an Embedded Cost of Service study.

applied to the Distribution System. Distribution assets are vastly different than generation assets and a generation allocator used on these assets is patently incorrect, per the NARUC Electric Manual.[4]

Q. **Mr. Nelson is asking the Commission to consider using the peak and average method, but did he provide a result when using this method?**

A. No. As mentioned above, Mr. Nelson's responsive testimony asked the Commission to consider his peak and average method, despite it being an inacceptable method under the NARUC Electric Manual. However, Mr. Nelson has provided no results relating to his recommendation when using this method. Contrary to his own testimony where he asks the Commission to consider using the peak and average method, he did not use that method in the COSS he submitted in this Cause. In theory, his peak and average allocation technique is a methodology designed to recognize how utilities incur generation system costs to serve all customers. Distribution system costs are incurred based on local area demands or individual customer maximum demands and are not incurred based upon demands at system peak. Recommending a peak and average methodology to recover distribution system costs is a serious misapplication of the cost causation principles included in the NARUC Electric Manual.

Q. **Do you have concerns that Mr. Nelson lacks familiarity with OG&E's Cost of Service Study to apply his own recommendation?**

A. Yes. As provided in response to data request OGE-AARP DR-1-3, Mr. Nelson supplied his Cost of Service study using the Company's cost of service model, which did not use his recommended peak and average method for distribution system costs. This draws serious question to Mr. Nelson's ability to apply his recommendation to his own COSS for OG&E's customers, let alone demonstrate how the change in allocation methodology has merit and would be beneficial to all classes. Mr. Nelson simply offers no explanation as to why his peak and average method – a generation allocation method – and his basic

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[4] *Ibid.*, p. 57.

customer method warrants such a radical departure from the Company's proven minimum system classification.

Q. **Have Mr. Nelson's recommendations been accepted in other jurisdictions?**

A. No. With respect to the regional and state prevalence of the classification, all Commissions in the four-state region (Minnesota, North Dakota, South Dakota and Wisconsin) accept the separation of distributions costs in to customer and demand-related components. Additionally, the Minnesota Public Utilities Commission has accepted the Minimum System method as a means to separate distribution facilities into demand and customer components since the 1980s[5].

NARUC Electric Manual/OG&E's Zero-Intercept

Q. **Did the Company Follow the NARUC Electric Manual?**

A. Yes. Contrary to Mr. Nelson's assertions[6], the Company did follow the NARUC Electric Manual in the process of updating its Zero-Intercept Study. Mr. Nelson seems to believe that utilities live in a perfect world where the NARUC Electric Manual applies perfectly to every situation; this is simply not the case. In fact, all utilities that follow the NARUC Electric Manual have slight deviations from the Manual by nature of a utility's unique accounting and engineering practices. In fact, the NARUC Electric Manual at page 22, states that each utility's choice of methodologies will depend on the unique circumstances of each utility.

Q. **Is Mr. Nelson correct in his assertion that the Company's Zero-Intercept fails to use the NARUC prescribed book accounting cost and is therefore incorrect?**

A. No. Mr. Nelson is correct that the Company did not use book accounting costs. However, OG&E's accounting system is based on mass property accounting and not accounting on each individual asset or work order. OG&E took engineering estimates, which represented average installation costs, and Geographic Information Systems

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[5] Docket No. E002/GR-15-826, Surrebuttal Testimony of Michael A. Peppin, pg. 3, 4-5.

[6] Responsive Testimony of Nelson, p. 30.

("GIS") data to approximate book counts and cost value for each type of asset. Moreover, each one of these engineering estimates were weighted against GIS counts of each inventory asset. GIS was necessary in order to obtain a level of granularity that mass property records lack. Further, GIS data makes a distinction between primary and secondary assets possible. This level of refinement in GIS gives a level of precision and detail that mass property record data cannot give. The result is a much more detailed analysis and level of precision in the Company's study.

Q. **Please provide a visual example of how the process above was utilized in the Zero-Intercept Study.**

A. As shown in Table 1 below, the estimate used and the accounting book values are within 2% for this example.

Table 1

GIS Transformer Counts	108,747
Engineering Cost Est. x GIS Counts =>	$ 288,592,696
<167KVA Property Plant Record =>	$ 204,331,254
Zero-Intercept Amount =>	$ 1,912
Property Plant Amount / GIS Count =>	$ 1,879
Scaled Result =>	2%

Q. **Should this Commission be concerned about the Company's regression analysis?**

A. No. The Company used the NARUC Electric Manual prescribed assumptions when conducting its regression analysis for its zero-intercept study. Mr. Nelson is incorrect that assumptions other than what is noted in the NARUC Electric Manual should be included. The Gauss-Markov test is used to identify whether additional variables included in a regression model contribute to improving the model. This is not necessary when using regression for the zero-intercept study as the Manual implicitly recognizes direct drivers of cost incurrance and identifies which variables should be incorporated.

Q. **Does this conclude your Rebuttal Testimony?**

A. Yes.