

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

FILED
MAY 16 2018

**COURT CLERK'S OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA**

**RESPONSIVE TESTIMONY
OF
MARK E. GARRETT**

**COST OF SERVICE/
RATE DESIGN ISSUES**

**ON BEHALF
OF**

**OKLAHOMA INDUSTRIAL ENERGY CONSUMERS ("OIEC")
AND OKLAHOMA ENERGY RESULTS, LLC ("OER")**

May 16, 2018

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I. WITNESS IDENTIFICATION AND PURPOSE OF TESTIMONY

1 **Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A: My name is Mark E. Garrett. My business address is 4028 Oakdale Farm Circle,
3 Edmond, Oklahoma 73013.

4

5 **Q: WHAT IS YOUR PRESENT OCCUPATION?**

6 A: I am the President of Garrett Group, LLC, a firm specializing in public utility regulation,
7 litigation and consulting services.

8

9 **Q: ARE YOU THE SAME MARK E. GARRETT WHO SUBMITTED TESTIMONY**
10 **ON MAY 2, 2018 IN THE REVENUE REQUIREMENT PHASE OF THIS**
11 **PROCEEDING?**

12 A: Yes, I am.

13

14 **Q: WERE YOUR EDUCATIONAL BACKGROUND AND YOUR PROFESSIONAL**
15 **EXPERIENCE RELATED TO UTILITY REGULATION PROVIDED IN THAT**
16 **TESTIMONY?**

17 A: Yes, they were.

18

19 **Q: HAVE YOUR QUALIFICATIONS BEEN ACCEPTED BY THIS COMMISSION**
20 **IN PROCEEDINGS DEALING WITH COST OF SERVICE AND RATE DESIGN**
21 **ISSUES?**

1 A: Yes, they have. A more complete description of my qualifications and a list of the
2 proceedings in which I have been involved are attached to my Revenue Requirement
3 Testimony filed May 2, 2018.

4
5 **Q: ON WHOSE BEHALF ARE YOU APPEARING IN THESE PROCEEDINGS?**

6 A: I am appearing on behalf of Oklahoma Industrial Energy Consumers (“OIEC”) and
7 Oklahoma Energy Results, LLC (“OER”).

8
9 **Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

10 A: The purpose of my testimony is to address the cost of service and rate design issues
11 identified in OG&E’s rate case application and to provide the Commission with
12 recommendations for the resolution of these issues.

13 **II. SUMMARY OF TESTIMONY AND RECOMMENDATIONS**

14 **Q: PLEASE SUMMARIZE YOUR TESTIMONY AND RECOMMENDATIONS.**

15 A: My rate design testimony and recommendations are summarized as follows:

- 16 1. The purpose of a cost of service study is to allocate a utility’s costs
17 among its customer classes. The costs that each class causes on the
18 utility’s system are compared with the revenues collected from that class.
19 When the revenues collected from each class fully cover the costs caused
by that class, rates are said to be set at *cost-of-service*.
- 20 2. When rates are not set at cost-of-service, some customers are paying costs
21 that are caused by other customers. Over-payments and under-payments
22 among the classes are referred to as *inter-class subsidies*.
23

- 1 3. Rates set at cost-of-service among all customers are preferable for many
2 reasons. They are more equitable because customers pay the actual costs
3 incurred to serve them. They are more efficient because they send better
4 price signals to customers who can adjust their usage accordingly.
- 5 4. OG&E's proposed revenue allocation in this application is not cost-based.
6 Inter-class subsidies promote the inefficient use of electricity, which
7 ultimately results in economic waste, overall higher energy prices,
8 reduced productivity and lower employment levels. The Commission
9 should work to eliminate price subsidies to the greatest extent possible.
- 10 5. State regulatory commissions widely recognize the importance of cost-
11 based rates; however, they often find it difficult to eliminate existing
12 subsidies when large rate increases are required. As such, the best time to
13 eliminate an inter-class subsidy and to implement cost-based rates is
14 when a rate *decrease* is warranted, as is the case here.
- 15 6. OIEC and OER have recommended a \$120 million rate decrease. The
16 Attorney General has recommended a \$99 million decrease. The
17 Commission has a unique opportunity to set rates at cost of service and to
18 remove the entire inter-class subsidy. In my testimony, I explain the
19 reasons this is the right time to align all customer classes at cost-of-
20 service rates. I have provided analysis on the impact of implementing
21 cost-of-service rates based on the OIEC and OER recommended
22 decreases.
- 23 7. I recommend the Commission order the addition of a Standard LPL Rate
24 Class in addition to the existing TOU rates available for the LPL class.
25 Currently, the only rates available to LPL customers are TOU rates,
26 which place an unfair burden on large, high-load factor customers that are
27 unable to shift load off peak. Oklahoma's large industrial customers
28 should have a choice to utilize the rate structure that best fit their usage
29 patterns.
- 30 8. OG&E has proposed a new rider ("FTCPTC") to address federal taxes
31 combined with a rider for recovery of Production Tax Credits ("PTCs").
32 I agree in general with the Company's FTCPTC as a means to flow tax
33 benefits back to ratepayers, however, with respect to the PTC component,
34 I recommend that OG&E defer rider treatment until the Company's next
35 rate case.
- 36 9. OG&E is requesting regulatory asset treatment for the Sooner Units 1 and
37 2. I testify that regulatory asset treatment is not appropriate for these
38 costs.

1
2 10. Regulatory asset treatment is a cost-tracker mechanism in which costs
3 between rate cases are either recovered directly through a rider, or
4 deferred through a regulatory asset and recovered in a subsequent
5 proceeding. In effect, cost-tracker treatment encompasses both riders and
6 deferred accounting (regulatory asset) mechanisms.

7 11. Regulatory commissions traditionally approve cost-trackers only under
8 "extraordinary circumstances." Commissions consider cost trackers and
9 riders an exception to the general rule for cost recovery and place the
10 burden on a utility to demonstrate why certain costs require special
11 treatment.

12 12. OG&E's environmental compliance costs presented in this cause do not
13 meet the criteria for regulatory asset treatment. The circumstances
14 typically required for approval of cost-trackers arise for costs that are:

- 15 (1) Largely outside the control of the utility;
16 (2) Unpredictable and volatile;
17 (3) Substantial and recurring; *and*
18 (4) Causing severe financial consequences to the company.

19 In my opinion, OG&E's environmental compliance costs do not meet any
20 of these four criteria. OG&E's environmental compliance costs are not
21 outside the control of management; they are not unpredictable or volatile;
22 they are not recurring costs; and, they are not so significant as to cause
23 severe financial harm to the Company. OG&E has not shown that special
24 circumstances exist to justify tracker mechanism for these costs. For these
25 reasons, I recommend the Commission deny regulatory asset treatment
26 for these costs.

III. COST OF SERVICE

III. A. PURPOSE OF A COST OF SERVICE STUDY

1 **Q: WHAT IS THE PURPOSE OF A COST OF SERVICE STUDY?**

2 A. The purpose of a cost of service study is to allocate a utility's costs among the various
3 customer classes receiving service.
4

5 **Q: PLEASE DESCRIBE HOW A COST OF SERVICE STUDY IS PERFORMED.**

6 A: Each customer class is allocated its proportional share of the total system costs based on
7 the level of costs the utility incurs to provide service to that class. Cost of service studies
8 consider data from all facets of utility operations, including accounting records,
9 engineering analyses, resource planning, load research and customer billing data. The
10 studies relate each component of the revenue requirement to measurable characteristics,
11 such as customer demand, energy usage, and number of customers in a class. After the
12 costs are allocated to the classes, the revenues produced by each class are compared with
13 the class cost levels to determine which classes are under-paying and which classes are
14 over-paying their respective costs. From this comparison, we learn which classes need
15 rate increases and which classes need rate decreases to bring all the classes to the same
16 rate of return, or to *equalized rates of return*. When the revenues collected from each
17 class fully cover the costs caused by that class then rates are said to be set at *cost-of-*
18 *service*. When rates are not set at cost-of-service, then some customers are paying costs
19 caused by other customers. We describe these over-payments and under-payments
20 among the classes as *inter-class subsidies*.

1
2 **Q: WHY IS IT IMPORTANT TO CORRECTLY ALLOCATE COSTS TO THE**
3 **INDIVIDUAL CUSTOMER CLASSES?**

4 A: When costs are correctly allocated to the individual classes, rates can be developed to
5 recover the actual cost of providing service to each class. These cost-based rates are
6 equitable because customers pay only the costs incurred to serve them. Cost-based rates
7 are also more efficient in that they ultimately tend to reduce the overall cost to the
8 electric provider. This efficiency occurs because cost-based rates send better price
9 signals to customers, who then make better choices in rationing their use of electricity.
10 Conversely, rates that are not cost-based tend to promote inefficiencies. These
11 inefficiencies occur when prices are set below cost for certain customers. Artificially
12 lower rates tend to cause the subsidized customers to increase consumption of energy
13 based on incorrect price signals. Ultimately, the increased consumption brought about
14 from artificially lower rates causes the utility to increase its overall cost over time to
15 meet the increase in demand to serve subsidized customers.

16 For many utilities, such as OG&E, the problem is exacerbated when the
17 subsidized customers are typically the utility's most inefficient users of electricity, the
18 residential class,¹ and the subsidy providers are typically the utility's most efficient users

¹ Residential customers generally have a lower load factor (average use compared to peak use) than the large industrial classes, meaning that the utility must maintain more excess capacity to service residential customers than it does the higher load-factor classes.

1 of electricity, the large industrial customers.² This creates a situation where distorted
2 price signals cause the system's inefficient users (residential customers) to use more
3 electricity and its efficient users (industrial high load-factor customers) to use less.³
4 Over time, this creates a more costly system for all users when additional capacity is
5 continually being added to keep up with the artificially-created increased demand during
6 peak hours. The only party that actually benefits from the artificially higher demand
7 brought about from the distorted price signals is the utility, since the utility gets to earn a
8 return on the additional capital investment needed to meet the higher demand.
9

10 **Q: WHAT ARE PRICE SIGNALS AND HOW DO THEY HELP ACHIEVE**
11 **IMPORTANT RATE DESIGN OBJECTIVES?**

12 A: Price signals are the price level information communicated from energy producers to
13 consumers in competitive energy markets. In regulated electric power markets, price
14 levels are administratively determined by a public utility commission for each rate class.
15 The function of a price signal is to establish the level of production at which supply and
16 demand will match. In competitive energy markets, there is a continual dialogue
17 between energy producers and consumers, where energy producers send cost production
18 signals to consumers, and consumers in turn signal back to producers the prices at which
19 they are willing or able to purchase energy.

² Large industrial customers generally have very high load factors meaning that it takes less excess capacity to serve these customers. Also, industrial customers have a built-in profit incentive to use power as efficiently as possible.

³ When distorted price signals cause industrial customers to scale back on energy consumption, the result can be reduced industrial activity, lower overall productivity and loss of jobs in the state's economy.

1
2 **Q: IS THE PROPER ROLE OF PRICE SIGNALS SUBSTANTIALLY DIFFERENT**
3 **IN REGULATED ENERGY MARKETS?**

4 A: No. The role of regulated price signals is ultimately the same. The Commission simply
5 acts as an intermediary in the communication process between consumers and the utility
6 to ensure that the utility's costs are set at just and reasonable levels. However, since
7 price signals are communicated to each ratepayer class through filed tariffs, which are
8 developed and implemented at discrete time intervals when there is a rate case, the
9 communication process for regulated energy markets is not immediate. It is nevertheless
10 important that customers of regulated utilities receive accurate price signals.

11
12 **Q: WHY ARE ACCURATE PRICE SIGNALS IMPORTANT?**

13 A: Rates for each customer class need to reflect OG&E's true cost to serve each class so
14 that consumers within each class will make energy usage decisions based upon actual
15 costs. Otherwise, consumer demand or usage patterns will be distorted, and OG&E will
16 not have the most accurate measure of demand for purposes of resource planning.

17
18 **Q: WHAT IS THE TYPICAL RELATIONSHIP BETWEEN ENERGY COSTS AND**
19 **DEMAND?**

20 A: Like most energy commodities, energy usage is somewhat elastic. As prices increase,
21 consumers typically seek options to reduce usage or demand.

1 **Q: WHY ARE COST-BASED RATES AND PROPER PRICE SIGNALS**
2 **PARTICULARLY IMPORTANT ON OG&E'S SYSTEM AT THIS TIME?**

3 A: High utility rates put tremendous financial pressures on industrial customers. This
4 problem is further exacerbated by price subsidies. When distorted price signals cause
5 industrial customers to reduce energy consumption, this often means a reduced productivity,
6 shifting production to lower-cost facilities, or cutting jobs. In short, every dollar that industrial
7 companies pay for electricity above the actual cost of that electricity is a dollar not
8 available to provide jobs and industrial growth in Oklahoma. For this reason, the
9 Commission should work to eliminate price subsidies to the greatest extent possible.

11 **Q: ARE COST-BASED RATES IMPORTANT FROM A RATEMAKING**
12 **PERSPECTIVE?**

13 A: Yes. From a ratemaking perspective, to be constitutionally valid, utility rates must be
14 *just, reasonable and non-discriminatory*. Rates that are *just* satisfy the Takings clause,
15 rates that are *reasonable* satisfy the Due Process clause, and rates that are *non-*
16 *discriminatory* satisfy Equal Protection. From a long line of Supreme Court cases
17 discussed in the *Hope* case in 1944 and the *Duquesne* case in 1989, the Court established
18 that cost-based rates are constitutionally valid rates.⁴ Because cost-based rates satisfy
19 constitutional requirements, state regulatory commissions, including Oklahoma, sets
20 rates based on the original cost of capital invested to provide utility service. Moreover, it
21 has been my experience that state regulatory commissions, including the Oklahoma
22 Corporation Commission, strive to allocate costs among customer classes in a manner

1 that reflects the actual cost of providing service to each class.⁵ Where there are
2 subsidies, commissions generally work to eliminate them.

III. B. OG&E'S COST OF SERVICE STUDY

3 **Q: PLEASE SUMMARIZE THE INFORMATION YOU REVIEWED IN**
4 **PREPARING YOUR TESTIMONY WITH REGARD TO COST OF SERVICE**
5 **STUDY AND RATE DESIGN?**

6 A. I reviewed OG&E's prefiled direct testimony and exhibits, its filed cost of service
7 studies and proposed rate design, and its responses to various discovery requests related
8 to cost of service and rate design issues.

9
10 **Q: DO YOU AGREE WITH ALLOCATION METHODOLOGIES UTILIZED BY**
11 **OG&E IN ITS COST OF SERVICE STUDY?**

12 A: Yes. OG&E has utilized appropriate cost allocation methodologies in its study. For
13 example, OG&E allocates production plant costs using a 4 Coincident Peak Average and
14 Excess method ("4CP A&E"). The 4CP methodology, which is based on the average of
15 the peak demand intervals in each of the four summer months, is an appropriate
16 methodology that is frequently used in regions with peak loads in the summer months.
17 OG&E also allocates transmission costs using a 4CP method which appropriately
18 reflects how transmission assets are used in Oklahoma.

⁴ See *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

⁵ See Page 294 of the Report & Recommendation of the Administrative Law Judge issued in Cause No. PUD 201100087 before the Corporation Commission of Oklahoma on May 30, 2012.

1 **Q: WHAT CONCERNS DO YOU HAVE WITH THE COMPANY'S FILED COST**
2 **OF SERVICE STUDY?**

3 A. While I agree with the methodologies used by OG&E in its filed cost of service study,
4 my concern is that OG&E's rate design proposed in this case, which I discuss in the next
5 section of this testimony, does not implement its cost of service study results. In other
6 words, it is not enough that OG&E allocate its costs to each customer class in a fair and
7 equitable manner, if the Company fails to design its rates to collect the costs allocated to
8 each class. By not following its cost of service study in its rate design proposal, OG&E
9 maintains significant inter-class subsidies in its proposed rates. As discussed earlier,
10 rates that are not cost-based rates tend to promote the inefficient use of electricity, which
11 ultimately results in economic waste, and higher energy prices.

IV. RATE DESIGN

IV.A. ELIMINATION OF THE INTER-CLASS SUBSIDY

12 **Q: WHAT RATE DESIGN ISSUES NEED TO BE ADDRESSED?**

13 A. The primary rate design issue that needs to be addressed is the elimination of the inter-
14 class subsidies. Although regulatory commissions generally recognize the need for cost-
15 based rates, they often find it difficult to eliminate existing subsidies in a rate case when
16 a large rate increase is proposed. Understandably, the best time for a commission to
17 eliminate an existing subsidy and implement cost-based rates is when a rate decrease is
18 warranted, as is the case here. OIEC and OER have recommended a \$120 million rate
19 decrease and the Attorney General has recommended a \$99 million decrease. These
20 significant recommended reductions in OG&E's revenue requirement are, in large part, a

result of the impact of the Tax Cuts and Jobs Act (“TCJA”) on OG&E’s revenue requirement. If the outcome of this case is a significant rate decrease, as it should be, that decrease should be used to eliminate the existing residential subsidy.

Q: HOW DOES AN OVERALL RATE DECREASE HELP WITH THE IMPLEMENTATION OF COST-BASED RATES?

A: When an overall rate decrease is ordered, the need for inter-class subsidies is mitigated or eliminated. This allows for the alignment of rates to match the costs actually caused on the system. This can be illustrated with rates proposed in this case. If the Commission were to adopt OIEC’s and OER’s recommendations for a \$120 million rate decrease, the inter-class subsidy could be eliminated without any increase to the Residential class (as shown in Table 1 below).

Table 1. OIEC/OER Proposed \$120 Million Decrease at <u>Actual Cost-of-Service</u> Rates				
Customer Group	Total Current Revenue	Total Proposed Revenue	Net Proposed Revenue	% Change
RES	\$ 946,993,899	\$ 911,645,448	\$ (35,348,451)	-3.7%
GS	183,079,485	165,643,358	(17,436,127)	-9.5%
OGP	21,463,287	18,173,847	(3,289,440)	-15.3%
PS	34,722,147	34,914,875	192,728	0.6%
PL	329,672,197	302,694,178	(26,978,019)	-8.2%
PL TOU	225,673,597	212,705,725	(12,967,872)	-5.7%
LPL	342,673,597	323,729,658	(18,953,661)	-5.5%
MP	9,138,307	8,494,998	(643,309)	-7.0%
Lighting	37,332,134	32,177,820	(5,154,314)	-13.8%
TOTALS	\$ 2,130,758,372	\$ 2,010,179,906	\$ (120,578,466)	-5.7%

Q: WHAT IS YOUR RECOMMENDATION REGARDING RATES AND REVENUE ALLOCATION FOR OG&E’S OKLAHOMA CUSTOMER CLASSES?

1 A: My recommendation is for the Commission to implement the rate decrease
2 recommended by OIEC and OER, and to bring all classes to their actual cost-of-service
3 rates. My recommendation for revenue distribution by class is shown in Table 1 above.

IV.B. ADDITION OF A STANDARD RATE CLASS FOR LPL CUSTOMERS

4 **Q: WHY IS THE ADDITION OF A STANDARD RATE CLASS FOR THE LPL**
5 **CUSTOMER CLASS NECESSARY?**

6 A: In the past, large power and light (“LPL”) customers have always had a choice between
7 standard rates and time-of-use (“TOU”) rates. However, the only rates now available to
8 LPL customers are TOU rates. This places an unfair burden on the large, high-load
9 factor customers causing them to subsidize the other lower load-factor customers in the
10 LPL class. This is inconsistent with the principle of cost-based rates. High load factor
11 customers are the most efficient users of the electric system. Moreover, they help bring
12 down costs for all customers by adding more low-cost base load to the system. High
13 load factor customers, though, do not have the flexibility to shift load off peak, because
14 they run at near full capacity 24 hours a day. TOU rates are designed to encourage
15 customers to move off peak by charging higher prices during the on-peak hours. Herein
16 lies the penalty. Since high load factor customers do not have the flexibility to shift load
17 off peak, they are forced to pay the punitive on-peak rates in OG&E’s TOU tariff.

18
19 **Q: HOW SHOULD OG&E’S RATE CLASSES BE DESIGNED?**

20 A: With most utilities, and with OG&E in the past, TOU rates have always been optional
21 rates that can be selected by customers who have the flexibility of moving load off peak

1 to the lower cost hours. TOU rates help the system run more efficiently by encouraging
2 customers with flexibility to decrease load on-peak when power is the most expensive.
3 Since high load factor customers cannot shift load off peak, there is typically a standard
4 rate class for these customers, where all demand-related costs are collected through a
5 demand charge and all energy-related costs are collected through an energy charge. This
6 allows high load factor customers to pay their full cost of service without penalizing
7 them for having a steady, cost-efficient load.

8
9 **Q: WHAT IS YOUR RECOMMENDATION?**

10 A: I recommend a standard rate class for LPL customers in addition to the existing LPL
11 TOU rate class. This would make the TOU rate optional, as it should be. I also
12 recommend that all demand-related costs be collected in the demand charge, as they
13 should be, and all energy-related costs be collected in the energy charge in the standard
14 rate class. OG&E should provide the standard rate class tariff to the parties for their
15 review in their compliance filing after the final order is issued in this case.

V. OTHER RATE DESIGN ISSUES

V. A. FEDERAL TAX CHANGE AND PRODUCTION TAX CREDIT RIDER

16 **Q: WHAT IS THE PURPOSE OF OG&E'S NEW FEDERAL TAX CHANGE AND**
17 **PRODUCTION TAX CREDIT ("FTCPTC") RIDER?**

18 A: When the Tax Cuts and Jobs Act ("TCJA") took effect on January 1, 2018, OG&E's
19 federal income tax rate dropped from 35% to 21%. OG&E began recording a regulatory
20 liability for the difference between 35% and 21% in the provision for income taxes. In

1 accordance with Commission Order No. 671982, issued in Cause No. PUD 201700569,
2 the Company will accrue a carrying charge on that liability at the 7.0667% weighted cost
3 of capital. OG&E proposes that the amounts accumulated in the regulatory liability be
4 returned to customers through an income tax rider.⁶

5 The FTCPTC rider is the mechanism by which OG&E proposes to track and
6 return excess deferred income tax to customers. OG&E has recorded accumulated
7 deferred income taxes ("ADIT") for temporary differences between book and tax
8 income. These differences are currently based on a 35% federal corporate income tax
9 rate. As result of the TCJA, the deferred income tax liability must be restated at the
10 21% income tax rate. OG&E proposes that this remeasured amount, the excess ADIT,
11 should be recorded as a regulatory liability and returned to customers through the
12 FTCPTC rider. Finally, OG&E proposes to include Production Tax Credits in this rider.
13 Thus, according to OG&E, the FTCPTC Rider will include three factors:

- 14 1. Federal Tax Change factor,
- 15 2. Amortization of the Regulatory Liability factor, and
- 16 3. Production Tax Credit ("PTC") factor.⁷

17 **Q: DO YOU AGREE WITH THE COMPANY'S PROPOSED TREATMENT OF**
18 **THE FEDERAL TAX CHANGE?**

19 **A:** Yes. The TCJA reduced tax rates for corporations such as OG&E from 35% to 21%
20 effective January 1, 2018. This tax reduction generated two sources of savings for
21 ratepayers: (1) the tax rate reduction from 35% to 21% produced a lower annual tax

⁶ See Direct Testimony of D. Rowlett at pages 18-19.

⁷ See Direct Testimony of D. Rowlett at pages 20-21.

1 expense to be included in rates, and (2) the tax rate reduction produced excess
2 accumulated deferred income taxes ("ADIT") that were collected from ratepayers at the
3 35% rate but will be remitted to the IRS at the lower 21% rate; this excess ADIT must be
4 returned to ratepayers, generally over the life of the assets that created the ADIT balance.
5 In this rate case, OG&E has incorporated the first item, the rate change from 35% to
6 21%, by calculating its revenue requirement using the 21% tax rate. OG&E has also
7 included the second item, the amortization of its excess ADIT balances, by including an
8 amortization of both the protected and unprotected excess ADIT balances in its proposed
9 FTCPTC rider. OG&E has also included a refund, through the FTCPTC rider, of the
10 TCJA rate change impacts from January 9, 2018 forward, in accordance with
11 Commission Order No. 671982 in Cause No. PUD 2001700569, the Commission's
12 TCJA order for OG&E. In my opinion, OG&E is passing all of the TCJA tax benefits
13 back to ratepayers in this case, either through base rates, for the rate change itself, or
14 through the FTCPTC rider, for the amortizations of the excess ADIT and post-January 9,
15 2018 deferred benefits.

16
17 **Q: DO YOU AGREE WITH INCLUDING THE PTC'S IN THE RIDER?**

18 **A:** Not at this time. Currently, the PTCs are included in base rates. My understanding is
19 that the PTCs do not begin to materially decline until 2020. At that time, they should be
20 removed from base rates and included in the FTCPTC rider. Since the Company has
21 stated it plans to file a rate case next year, the PTCs could be included in the rider in that
22 case.

1
2 **V. B. REGULATORY ASSET FOR ENVIRONMENTAL COMPLIANCE COSTS**

3 **Q: IS THE COMPANY RECOMMENDING A REGULATORY ASSET FOR**
4 **ENVIRONMENTAL COMPLIANCE?**

5 A: Yes. OG&E is requesting regulatory asset treatment for the environmental compliance
6 costs and operating costs of the scrubber assets on its Sooner Units 1 and 2, which are
7 planned to be placed in service in 2018, after the 6-month cutoff date. The requested
8 regulatory asset would accumulate the revenue requirement associated with these
9 projects after the projects go into service. The Company would then seek recovery of
10 these costs in its next general rate case proceeding.

11
12 **Q: ARE OG&E'S ENVIRONMENTAL COMPLIANCE EXPENDITURES THE**
13 **TYPES OF COSTS THAT TYPICALLY QUALIFY FOR REGULATORY ASSET**
14 **TREATMENT?**

15 A: No. OG&E's environmental compliance expenditures presented in this cause do not
16 meet the criteria typically required for approval of regulatory asset treatment.

17
18 **Q: WHAT ARE THE TYPES OF COSTS THAT TYPICALLY QUALIFY FOR**
19 **REGULATORY ASSET TREATMENT?**

20 A: Regulatory asset treatment is a form of cost-tracker treatment in which costs between
21 rate cases are either recovered directly through a rider, or deferred through a regulatory
22 asset and recovered in a subsequent proceeding. In effect, cost-tracker treatment

1 encompasses riders and deferred accounting (regulatory asset) mechanisms. Thus, costs
2 that would typically qualify for regulatory asset treatment are the same type of costs that
3 would qualify for cost-tracker. According to the National Regulatory Research
4 Institute's (NRRI) white paper published in 2009,⁸ public utility commissions
5 traditionally approve cost-trackers under "extraordinary circumstances." Commissions
6 consider cost trackers / riders an exception to the general rule for cost recovery and place
7 the burden on a utility to demonstrate why certain costs require special treatment.

8 According to the NRRI, the circumstances typically required for approval of
9 cost-trackers occur when costs are:

- 10 (1) Largely outside the control of the utility;
- 11 (2) Unpredictable and volatile;
- 12 (3) Substantial and recurring; and
- 13 (4) Causing severe financial consequences to the company.

14 Based on these criteria, fuel costs historically have been viewed as good candidates for
15 either rider recovery or deferred accounting treatment because fuel cost levels can be in
16 part beyond even a prudent utility's control. They can also be volatile and significant in
17 size. A second example may be major storm-related expenses for costs incurred to
18 restore power after a major weather occurrence. As such, they are considered emergency
19 costs largely outside of the control of the utility and significant in size, and the rider
20 recovery or deferred accounting treatment enables utilities to either expedite storm cost
21 recovery or defer the costs for future recovery, but either way, avoiding the financial
22 impacts of the cost increases themselves.

⁸ Costello, Ken, NRRI, "How Should Regulators View Cost Trackers?" published in September 2009.

1 **Q: DO YOU AGREE WITH THE NRRI CRITERIA?**

2 A: Yes. I agree that these are the appropriate criteria to apply when evaluating a utility's
3 request for a cost-tracker mechanism, either through a rider or a deferred asset approach.
4

5 **Q: DO OG&E'S ENVIRONMENTAL COSTS MEET THESE CRITERIA?**

6 A: No. In my view, in order to qualify for cost-tracker treatment, the costs should meet all
7 of the NRRI requirements. OG&E's environmental compliance costs neither
8 unpredictable nor volatile. To the contrary, these costs are known, predictable and
9 completely stable. Also, these costs are non-recurring in the sense that OG&E will only
10 incur these costs one time. Further, these environmental compliance costs are not so
11 significant that they will cause severe financial consequences to the Company.
12

13 **Q: WHY IS IT IMPORTANT THAT A UTILITY DEMONSTRATE SEVERE**
14 **FINANCIAL CONSEQUENCES OR HARDSHIP TO JUSTIFY COST-**
15 **TRACKER RECOVERY?**

16 A: It is widely recognized that cost-tracker mechanisms shift risk away from the utility and
17 tend to reduce a utility's incentive to control costs. For this reason, commissions should
18 reserve cost-tracker recovery for *extreme* or *special* circumstances where there is a
19 substantial risk to the financial health of the utility. In this case, OG&E has made no
20 showing that special circumstances exist or that it would suffer financial distress without
21 a tracker mechanism.

1 With respect to these environmental costs, OG&E has failed to show that
2 traditional ratemaking—that is, addressing these costs through general rate case
3 recovery—would cause OG&E any financial distress. Certainly, it may be easier for
4 OG&E to manage its overall costs between rate cases with a tracker mechanism for
5 environmental cost recovery, but that is not a sufficient reason to justify OG&E’s
6 request. Indeed, providing a utility the incentive to manage its costs between rate cases
7 is one of the key advantages of the regulatory model. This is why most regulators have
8 favored adjusting rates between rate cases *only* when such adjustments avoid serious
9 financial hardship for utilities. Specifically, the NRRI explains:

10 If a commission wants to guarantee that the utility will recover its
11 authorized earnings, it would favor a rate design that allows the
12 utility to recover all of its fixed costs in a monthly service charge
13 or customer charge. Since generally commissions do not, they
14 implicitly recognize the positive incentive effect from allowing a
15 utility’s actual rate of return to deviate from the authorized level.
16 Commissions also know that if a utility is continuously earning
17 below its authorized rate of return, the utility has the right to file a
18 general rate increase.⁹

19 In this case, OG&E has not demonstrated it will experience “severe financial
20 consequences” as a result of its environmental compliance expenditures. The
21 environmental compliance expenditures are not volatile or unpredictable. OG&E has
22 ample opportunity to seek full cost recovery through traditional base rate recovery
23 methods once the facilities are placed in service. Rider treatment is not justified by the
24 Company simply stating that a particular cost category has increased significantly. For
25 these reasons, a rider is not deserved or appropriate at this time.

VI. CONCLUSION

1 **Q: DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

2 **A:** Yes, it does.

3

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⁹ Costello, Ken, NRRI, "How Should Regulators View Cost Trackers?" September 2009, at page 11.