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	)	CAUSE NO. PUD 201700496
RATES, CHARGES, AND TARIFFS FOR RETAIL	)	
ELECTRIC SERVICE IN OKLAHOMA	)	

Direct Testimony

of

Jason Bailey

on behalf of

Oklahoma Gas and Electric Company

January 16, 2018

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

A. My name is Jason Bailey. 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 the Director of Revenue Requirements.

Q. **Please summarize your educational background and professional qualifications.**

A. I received a Bachelor of Science in Chemical Engineering and a Master of Business Administration (Finance), both from the University of Oklahoma. I have been employed by either OGE Energy Corp. or OG&E since 2002. I have held various positions with increasing responsibility, most recently including Director of Risk Coordination, Director of Corporate Finance, and currently as the Director of Revenue Requirements.

Q. **What are your responsibilities as the Director of Revenue Requirements?**

A. As the Director of Revenue Requirements my responsibilities include directing the work of our Regulatory Accounting group, whose responsibilities include preparing accounting MFRs and testimony for various regulatory proceedings in both Oklahoma and Arkansas. I also direct a team of Regulatory Coordinators, whose responsibilities include managing the execution of various regulatory proceedings.

Q. **Have you testified previously before this Commission?**

A. Yes. I have previously testified on behalf of OG&E in Cause No. PUD 201400307 on the Economic Development Incentive Credit where the Commission accepted my credentials.

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

A. The purpose of my testimony is to sponsor the *pro forma* adjustments to the test year rate base in this Cause, and explain why these adjustments are appropriate. The Company utilized a historical test year ending September 2017 with *pro forma* adjustments through March 2018.

Q. **What is the importance of the rate base *pro forma* adjustments in this proceeding?**

A. The *pro forma* adjusted level of rate base is necessary to allow the Company to earn a rate of return on an adequate level of rate base.

Q. **Why are rate base *pro forma* adjustments to a test year necessary?**

A. The Company makes adjustments to the test year books to design rates which reflect the appropriate level of rate base the utility expects to experience prospectively. The Company utilizes a historic test year with *pro forma* adjustments reflecting reasonably known and measurable changes. Some of these adjustments include the removal of expenditures that are recovered elsewhere or the addition of expenditures that did not occur during the test year but will occur during the *pro forma* period.

PRO FORMA ADJUSTMENTS TO RATE BASE

Q. **What section of the Minimum Filing Requirements contains the adjustments made to rate base?**

A. Section B contains schedules and the supporting workpapers which present the elements of the rate base for the test year and adjustments to the test year rate base. Chart 1 shows the rate base adjustments and gives a description of each one. The rate base essentially represents the investment in facilities, equipment and other equipment used to provide service. The largest component of the rate base is plant in service. The *pro forma* adjusted rate base is multiplied by a proposed rate of return to arrive at the return requirement for capital investment. This return requirement represents a portion of the overall revenue requirement.

Chart 1 – *Pro Forma* Adjustments to Rate Base

***Pro Forma* Adjustment**	**Rate Base Description**
WP B 3-1	Arkansas AFUDC Adjustment
WP B 3-2	Holding Company Assets
WP B 3-3	Adjusts Test Year End CWIP balance for projects with completion after March 2018
WP B 3-4	Fuel Inventories
WP B 3-5	Gas in Storage
WP B 3-6	Adjusts CWIP for projects transferred to Plant in Service completed by March 2018
WP B 3-7	Adjusts Test Year Plant in Service for New Projects started after Test Year End and completed by March 2018
WP B 3-8	Materials and Supplies
WP B 3-9	Cash Working Capital
WP B 3-10	Prepayments
WP B 3-11	Plant Held for Future Use
WP B 3-12	Transmission Investments Recovered from Other Load Serving Entities
WP B 3-13	Adjust Accumulated Depreciation through March 2018
WP B 3-14	Accumulated Deferred Income Tax through March 2018
WP B 3-15	Regulatory Assets & Liabilities
WP B 3-16	Accumulated Depreciation Differential between FERC and Oklahoma Approved rates

Q. **Please explain WP B 3-1, *pro forma* adjustment to Arkansas AFUDC.**

A. There is a difference between how the Arkansas Public Service Commission and the Oklahoma Corporation Commission calculated AFUDC. In order to accurately reflect the AFUDC calculated and booked for the Oklahoma jurisdiction, an adjustment has to be made to plant in service. This adjustment increases plant in service by $3,670,937 and increases accumulated depreciation by $233,292 resulting in an increase in Net Plant of $3,437,645.

Q. **Please explain WP B 3-2, *pro forma* adjustment to Holding Company Assets.**

A. OG&E includes Holding Company Assets ("OGE Energy Corp.") as a part of plant in service. A percentage of these assets are devoted to non-utility activity and should therefore be excluded from the cost of service. This results in a decrease to plant in service of $14,260,201 and decrease to accumulated depreciation of $13,755,428 resulting in a decrease in Net Plant of $504,773.

Q. **Please explain WP B 3-3, *pro forma* adjustment to remove certain project construction costs.**

A. This adjustment removes costs for construction projects that will not be completed by the end of the six month post-test year or are reimbursable by a third party. This adjustment is a reduction of $414,408,983 to construction work in progress ("CWIP").

Q. **Please explain WP B 3-4, *pro forma* adjustment to Coal and Oil Inventory.**

A. OG&E recommends a 13 month average of the account balances for coal and oil inventory. This adjustment increases coal inventory by $3,920,408 and increases oil inventory by $442,570. The total adjustment increases rate base by $4,362,978.

Q. **Please explain WP B 3-5, *pro forma* adjustment to Gas in Storage Inventory.**

A. OG&E recommends a 13 month average of the natural gas inventory account balance. This adjustment increases natural gas inventory and rate base by $2,387,726.

Q. **Please explain WP B 3-6 and WP B 3-7, *pro forma* adjustments to increase plant in service.**

A. The Commission accepts out-of-period adjustments that are known and measurable beyond the end of the test year. The Company analyzed certain projects that were budgeted for the *pro forma* test year period and determined which projects would likely be in service by March 31, 2018, which is within six months of the test year. Adjustment

B 3-6 adjusts CWIP for projects that were not completed by the end of the test year but will be completed by the end of the *pro forma* year ending March 31, 2018, and transferred to plant. Adjustment B 3-7 adjusts plant in service for new projects that started after the test year and will be completed by the end of the *pro forma* year. WP B 3-6 and B 3-7 increase plant in service by $557,088,772 and $60,448,988 respectively. WP B 3-6 also removed the remaining balance of CWIP from the test year. This reduction amounted to $479,499,588. The Company will update this *pro forma* to reflect actual costs for plant completed and in service as of March 31, 2018 during this proceeding. The total adjustment increases rate base by $138,038,172.

Q. **Please explain WP B 3-8, *pro forma* adjustment to materials and supplies.**

A. This adjustment is made to account for the fluctuating cost of materials and supplies. The Company proposes adjusting materials and supplies to a 13 month average, which represents an appropriate level on an ongoing basis. This adjustment results in an increase to rate base of $937,348.

Q. **Before you explain WP B 3-9, please define cash working capital.**

A. Cash working capital is a component of OG&E's rate base. It is the average amount of capital provided by investors, not including plant in service and other measurable rate base items, which represent the amount of cash needed between the time expenditures are required for services and the time collections are received. The majority of the rate base components are specific values found on the Company's books as reflected on Schedule B-2. In order to arrive at a reasonable level for cash working capital, the Company utilized the lead-lag study from Cause No. PUD 201500273. The study determines the average amount of capital invested by the shareowners relative to the specific investments in other rate base components.

Q. **Please explain WP B 3-9, *pro forma* adjustment to cash working capital.**

A. OG&E utilized the lead lag study approach to calculate cash working capital. The results of this study are summarized in Schedule E-1, and the work papers behind the study are included as a part of the WP E's from the MFR Supplemental Package. This resulted in a negative cash working capital *pro forma* adjustment of $41,472,542. After this *pro forma* adjustment, the ending balance of cash working capital is negative $59,408,207. Please note that OG&E has not included depreciation, deferred tax expense, investment tax credits, or common equity return in the calculation of cash working capital.

Q. **Please explain WP B 3-10, *pro forma* adjustment to prepayments.**

A. This adjustment is made to account for the fluctuating balance of prepayments recorded on the balance sheet. Prepayments represent expenses paid in advance of actual services being performed. The Company is required to recognize an asset on the balance sheet for those expenses paid in advance until the suppliers/contractors have actually performed the service required. The Company proposes adjusting prepayments to a 13 month average, which represents an appropriate level on an ongoing basis. This adjustment results in an increase to rate base of $2,305,106.

Q. **Please explain WP B 3-11, *pro forma* adjustment to plant held for future use.**

A. Adjustment WP B 3-11 removes plant held for future use with an acquisition date older than 10 years from the test year and results in a decrease to rate base of $1,400,243. This adjustment is consistent with the adjustments made in the prior three rate cases, Cause Nos. PUD 200800398, PUD 201100087, and PUD 201500273.

Q. **Please explain WP B 3-12, *pro forma* adjustment to remove transmission related plant in service paid for by third parties.**

A. This adjustment removes a percentage of certain OG&E transmission related items from the rate base. This adjustment reflects the fact that the revenue requirement associated with regionally allocated transmission plant will be assigned to other load serving entities ("LSEs") around the SPP and should not be recovered from OG&E customers. OG&E has adjusted transmission related plant in service, accumulated depreciation, ADIT, and other various rate base items to reflect this recovery. The percentage allocated to other LSE's was derived from the FERC Transmission Formula Rate True-Up Adjustment for the most current filing, which is 2016 rate year. The net impact to rate base is a decrease of $799,495,436. A similar adjustment for O&M expense is made on the income statement and will be explained in OG&E Witness Thenmadathil's direct testimony.

Q. Please explain WP B 3-13, *pro forma* adjustment to update accumulated depreciation through the *pro forma* period.

A. This adjustment estimates an increase to accumulated depreciation through March 31, 2018 to account for increases to the depreciation reserve occurring as a result of an additional six months of depreciation expense associated with the *pro forma* period. This adjustment also includes updates to net removal and retirements through March 31, 2018. The net impact to the rate base is a decrease of $40,538,639.

Q. Please explain WP B 3-14, *pro forma* adjustment to update accumulated deferred income taxes ("ADIT") to the *pro forma* period.

A. The Company's ADIT balance has been projected to the end of the *pro forma* period. This *pro forma* adjustment includes the impact on ADIT for the remeasurement due to the reduction in the federal corporate income tax rate from 35% to 21%. The *pro forma* adjustment to ADIT is an increase to rate base of $1,042,221,259. This results in an adjusted estimated balance of ADIT as of March 31, 2018 of $828,363,952.

Q. How will OG&E pass the benefit of a lower corporate income tax rate and the reduction in accumulated deferred income tax liabilities to customers?

A. The Company has established a regulatory liability for the impact of the reduction in the federal corporate income tax rate. This regulatory liability results in a reduction to rate base of $1,035,552,055. The regulatory liability will be amortized, or returned to customers. The methodology utilized to calculate the liability amortization is addressed by OG&E Witness Rowlett in his direct testimony.

Q. **What is the net impact of *pro forma* adjustment B 3-14 after adjusting the ADIT at March 31, 2018, and for Deferred Tax Regulatory Liability?**

A. After adjusting the ADIT liability through the *pro forma* test year by $1,042,221,259, and creating the Deferred Tax Regulatory Liability for $1,035,552,055 the net impact of the adjustment is an increase in rate base by $6,669,204.

Q. **Please explain WP B 3-15, *pro forma* adjustment to regulatory assets and regulatory liabilities.**

A. WP B 3-15 is comprised of adjustments to both regulatory assets and regulatory liabilities. These adjustments include removals for rider related amounts, removal of expiring assets and liabilities, and updates to the pension regulatory liability through the *pro forma* period.

Q. **Please explain the first part of WP 3-15, which updates regulatory assets.**

A. This adjustment removes $43,262,227 associated with the storm regulatory asset from rate base, since this asset is recovered through a rider. This adjustment also removes $550,118 of regulatory assets that will be fully amortized before new rates are implemented. The total adjustment to regulatory assets results in a decrease to rate base of $43,812,345.

Q. **Please explain the second part of WP 3-15, which updates regulatory liabilities.**

A. The first adjustment increases rate base by removing $2,838,252 from the portion of the pension regulatory liability that was authorized to be credited back to customers in the previous rate case. This amount will be fully amortized (or fully credited to customers) when new rates are implemented. For the second adjustment, the remaining portion of the pension regulatory liability is reduced by $5,777,448, which increases the rate base. This updates the pension liability to March 31, 2018, or the end of the six month *pro forma* period. As part of this update, $3,000,000 has been reclassified from a contributory life insurance liability and moved into net pension benefit obligation. This reclassification resulted in a net zero impact to rate base. The total adjustments to regulatory liabilities results in a net increase to rate base of $5,615,700 ($2,838,252 + $5,777,448 - $3,000,000 = $5,615,700).

Q. **Do you recommend updating regulatory liabilities and the net pension benefit obligation to an actual amount as of March 31, 2018?**

A. Yes. Actual balances for both accounts will be available at that time, therefore an update to this adjustment will be necessary.

Q. **Please explain how the pension regulatory liability is calculated.**

A. To the extent pension and post-retirement benefits expense varies each year from the level authorized in the last rate case, a regulatory asset or liability is recorded. This is referred to as the Pension Tracker, which was first authorized in Cause No. PUD 200500151, with a later revision to incorporate retiree medical costs approved in Cause No. PUD 201100027. The pension regulatory asset/liability balance increases or decreases between rate cases. In the current case, a regulatory liability has accrued and will be credited to customers. Please refer to the *pro forma* adjustment H-2-29 for further breakdown of this regulatory liability. OG&E Witness Thenmadathil will discuss how this liability is being amortized and credited to customers.

Q. **What is the overall *pro forma* adjustment for WP B 3-15 for regulatory assets and liabilities?**

A. The adjustments to decrease regulatory assets by $43,812,345 and decreases to regulatory liabilities and net pension benefit obligations in the amount of $5,615,700, results in a net *pro forma* adjustment that decreases rate base by $38,196,645.

Q. **Please explain WP B 3-16, *pro forma* adjustment to accumulated depreciation rate differential.**

A. This adjustment is made to adjust accumulated depreciation for the differential between the FERC rates and Oklahoma approved rates. Depreciation reported to FERC is a blended rate comprised of a jurisdictionalized combination of the currently approved

Oklahoma and Arkansas rates. As a result, accumulated depreciation is decreased by $3,051,280, which is an increase to Net Plant by the same amount.

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

A. Yes.