

**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 201500273

**FILED**  
MAR 21 2016

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CORPORATION COMMISSION  
OF OKLAHOMA

**RESPONSIVE TESTIMONY**

OF

**EDWIN C. FARRAR**

ON BEHALF OF

**E. SCOTT PRUITT,**

**OKLAHOMA ATTORNEY GENERAL**

**March 21, 2016**

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**INTRODUCTION**

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**Q: PLEASE STATE YOUR NAME.**

A: My name is Edwin Farrar.

**Q: BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR BUSINESS ADDRESS?**

A: I am employed by the Office of the Attorney General of Oklahoma (“Attorney General”). My business address is 313 NE 21<sup>st</sup> Street, Room 3073, Oklahoma City, Oklahoma 73105.

**Q: WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?**

A: I graduated from Cameron University with a Bachelor of Science degree in Business Administration. I am also a Certified Public Accountant in the State of Oklahoma. I am a member of the American Institute of Certified Public Accountants and the Oklahoma Society of Certified Public Accountants. I was employed by the Public Utility Division of the Oklahoma Corporation Commission (“Commission”) from April 1985 through December 31, 2006 in various analyst and audit positions. From January 2007 until May 2011, I worked as an independent consultant on utility rate cases. I began employment with the Office of the Attorney General in May of 2011 as an auditor in the Public Utility Unit.

1 Q: **HAVE YOU TESTIFIED BEFORE THIS COMMISSION BEFORE AND HAVE**  
2 **YOUR CREDENTIALS BEEN ACCEPTED?**

3 A: Yes. I have previously testified before this Commission, and my credentials have been  
4 accepted.

5 **PURPOSE**

6 Q: **WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CAUSE?**

7 A: I am providing testimony to introduce the Attorney General's witnesses in this matter, to  
8 recommend certain adjustments with respect to rate base, to the operating income  
9 statement of Oklahoma Gas and Electric Company ("OG&E" or "the Company"), and to  
10 certain operating expenses. With respect to my proposed adjustments, I recommend rate  
11 base be updated for known and measurable changes that occur within six months after the  
12 end of the test year, as required by statute. In this case, that six-month post-test year  
13 window ends December 31, 2015. I recommend that payroll-related expenses be adjusted  
14 to levels at December 31, 2015. I also recommend that the Commission adopt the  
15 adjustments it has made in previous rate cases to incentive compensation, which is of  
16 limited benefit to ratepayers. I further recommend that the Commission exclude the cost  
17 of non-qualified pension plans from the revenue requirement and reject OG&E's  
18 adjustment to ad valorem tax expense.

**ATTORNEY GENERAL'S WITNESSES**

1  
2 **Q: WHO ARE THE ATTORNEY GENERAL'S WITNESSES IN THIS CASE?**

3 A: In addition to my testimony, the Attorney General is filing testimonies of certain  
4 consultants of GDS Associates, Inc. ("GDS"), who were retained by the Attorney  
5 General to provide expert analysis of OG&E's Application. GDS is a consulting firm  
6 with areas of expertise including generation capacity, power supply and transmission  
7 planning, compliance, rate consulting, distribution services, least cost planning, and  
8 litigation support. GDS witnesses and the subjects of their testimonies include:

- 9 I. Paul J. Wielgus, Managing Director of GDS Associates, Inc., who will testify as  
10 to affiliate costs and purchased power contract options.
- 11 II. E. Cary Cook, Senior Project Manager of GDS Associates, Inc., who will testify  
12 as to proposed depreciation rates and expense associated with OG&E's electric  
13 plant facilities.
- 14 III. J. Bertram Solomon, Executive Consultant with GDS Associates, Inc., who will  
15 testify as to rate of return, capital structure, and cost of capital.
- 16 IV. James W. Daniel, Vice President of GDS Associates, Inc., who will testify as to  
17 rate structure, and OG&E's request for recovery of consumables in the fuel  
18 adjustment clause.
- 19 V. Kevin J. Mara, Vice-President of GDS, Associates, Inc., who will testify as to  
20 OG&E's vegetation management plan.

**RATE BASE**

**Q: PLEASE DISCUSS THE RATE BASE ADJUSTMENTS YOU ARE RECOMMENDING FOR OG&E.**

A: OG&E did not update rate base for known and measurable changes occurring within six months after the end of the test year as required by statute,<sup>1</sup> because its Application was filed before that date. Instead, the Company only included some post-test year adjustments and estimates. I recommend that adjustments be made to OG&E's filed exhibits to recognize its utility investments as of December 31, 2015.

**Q: WHAT IS THE AMOUNT OF THESE ADJUSTMENTS?**

A: The adjustments to update the major components of the jurisdictional rate base to December 31, 2015, showing each adjustment's impact on rate base, are as follows:

Plant in Service	\$12,473,690
Accumulated Depreciation	\$28,840,304
Prepayments	\$79,453
Material, Supplies and Fuel Inventories	(\$799,431)
Asset Retirement Obligations	(\$3,490,626)
Customer Deposits and Advances	(\$1,148,809)
Net Pension Benefit Asset	(\$6,447,061)
Accumulated Deferred Income Taxes	<u>\$734,262</u>
Net Change in Rate Base	<u>\$30,241,782</u>

These adjustments are summarized on Exhibit ECF-1, pages 2 through 9.

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<sup>1</sup> See OKLA. STAT. tit.17, § 284:

In its review and examination of an application by a utility to change its rates and charges pursuant to Sections 137, 152 or 158.27 of Title 17 of the Oklahoma Statutes, and in any order resulting therefrom, the Corporation Commission shall give effect to known and measurable changes occurring or reasonably certain to occur within six (6) months of the end of the test period upon which the rate review is based.

1 **Q: DO YOU RECOMMEND ANY ADDITIONAL ADJUSTMENTS TO RATE**  
2 **BASE?**

3 A: Yes. I also recommend that Plant Held for Future Use be excluded from rate base, and I  
4 recommend that the gains from the sale of utility assets from the last rate case be included  
5 as a reduction to rate base.

6 **Q: WHY SHOULD THE NET GAINS ON THE SALE OF UTILITY ASSETS BE**  
7 **INCLUDED AS A REDUCTION TO RATE BASE?**

8 A: When assets are no longer used to serve ratepayers, they are retired from service. That  
9 retirement process may include a cost to remove the asset from service, and sale or  
10 salvage proceeds. The asset may be retired before its anticipated useful life is complete,  
11 in which case the asset would have a higher basis, and the sale may result in a net loss. A  
12 gain can result if the useful life is longer than was estimated when depreciation rates were  
13 set, or retirement costs are overestimated, or sale proceeds are underestimated. In the case  
14 of a net loss, the utility may use that net loss to reduce accumulated depreciation and  
15 increase future depreciation rates, or it may request a special recovery for the  
16 decommissioning of the asset. Both mechanisms serve to keep shareholders fully  
17 compensated for their investment. However, some utilities, like OG&E, will follow a  
18 different procedure when a gain is realized on the retirement of an asset. In that case, the  
19 utility may take the gain directly to shareholders instead of using it to offset the asset  
20 retirement losses it is asking ratepayers to bear. That is what OG&E did with its sale of  
21 utility assets in the test year. For that reason, I recommend that the net gains that have

1           been flowed directly to shareholders be used to reduce rate base, and be amortized over a  
2           reasonable period to offset the losses that are normally included in rate base and the  
3           related increase in depreciation or decommissioning expenses.

4   **Q:   WHAT IS THE AMOUNT OF THE ADJUSTMENT TO INCLUDE THE NET**  
5           **GAINS ON THE SALE OF UTILITY ASSETS AS A REDUCTION TO RATE**  
6           **BASE?**

7   A:   The adjustment to include the gains from the sale of utility assets reduces the  
8           jurisdictional rate base by \$1,136,352, as shown on Exhibit ECF-1, page 10 of 18. I will  
9           discuss the amortization of this item later in my testimony.

10 **Q:   WHY SHOULD PLANT HELD FOR FUTURE USE BE EXCLUDED FROM**  
11           **RATE BASE?**

12 A:   Plant Held for Future Use is not used to provide service for current utility customers, so it  
13           does not meet the standard that “costs should be borne by the cost causer.” If this cost  
14           were included in rate base, then current customers would be bearing the carrying cost for  
15           assets that are of no value to them. For that reason, Plant Held for Future Use should be  
16           excluded from rate base.

17 **Q:   WHAT IS THE AMOUNT OF THE ADJUSTMENT TO EXCLUDE PLANT**  
18           **HELD FOR FUTURE USE FROM RATE BASE?**

19 A:   The adjustment to exclude Plant Held for Future Use reduces the jurisdictional rate base  
20           by \$1,079,239, as shown on Exhibit ECF-1, page 11 of 18.

**ENVIRONMENTAL REGULATORY ASSETS**

1  
2 **Q: PLEASE DISCUSS THE REGULATORY ASSETS REQUESTED BY OG&E FOR**  
3 **ITS ENVIRONMENTAL COMPLIANCE PLAN.**

4 A: OG&E is requesting a regulatory asset for environmental upgrades to two of its Seminole  
5 generating units and for environmental consumables, if the Commission does not allow  
6 the recovery of those costs through the fuel adjustment clause.<sup>2</sup> The environmental  
7 upgrade for Seminole Unit 1 is expected to be completed by May of 2016 and for  
8 Seminole Unit 3 by March of 2017. The Attorney General will recommend in the cost of  
9 service/rate design testimony of James W. Daniel, to be filed on March 31, 2016, that the  
10 environmental consumables *not* be recovered in the fuel adjustment clause. The Attorney  
11 General instead is recommending that the environmental consumables be recovered in  
12 base rates.

13 **Q: DOES THE AUTHORIZATION OF REGULATORY ASSETS IN RATEMAKING**  
14 **REPRESENT GOOD REGULATORY POLICY?**

15 A: Under certain circumstances, the authorization for a utility to record a regulatory asset  
16 can be a sound regulatory policy. Those circumstances include when the cost is so high  
17 that it will impair the ability for a utility to earn its authorized return, when the amounts  
18 to be recovered are uncertain and the cost is not controllable by the utility, and when the  
19 cost is absolutely necessary for the operation of the utility. The Attorney General  
20 recommends excluding two items for which the Company is seeking a regulatory asset in

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<sup>2</sup> See Dir. Test. Rowlett 18: 1-25, and Resp. to AG 8-24.

1 this case because they will not be completed until after the end of the statutory update  
2 period, and because it is not possible to identify any increases in revenues or decreases in  
3 expenses that would offset the cost of these items. If a regulatory asset is allowed, it is  
4 important for the Commission to ensure that all issues impacting the utility's earnings are  
5 reviewed before recovery of the regulatory asset, and before any related deferred  
6 expenses are allowed in rates in a future rate case. At a minimum, the Commission  
7 should verify that the Company was not able to earn its authorized return during the  
8 period when costs were recorded for the regulatory asset.

9 **Q: CAN THE COMPANY EARN ITS AUTHORIZED RETURN IF THE**  
10 **REGULATORY ASSET IS NOT AUTHORIZED IN THIS CAUSE?**

11 A: Yes. We know that there are factors that can offset this cost for the Company. For  
12 example, the Company's requested jurisdictional depreciation expense is \$285 million  
13 per year. The Company's net plant investment will be reduced by that amount every  
14 year. That reduction offsets plant additions, which in the case of the Seminole  
15 environmental upgrades are much smaller, totaling only \$42 million in the 21 months  
16 following the test year.<sup>3</sup> While these costs are significant in most contexts, in this case it  
17 is reasonable to assume that these costs can and will be offset by other cost reductions or  
18 increased revenue.

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<sup>3</sup> See Resp. to AG 8-24.

1 **Q: WHAT IS YOUR RECOMMENDATION REGARDING OG&E'S REQUEST**  
2 **FOR A REGULATORY ASSET FOR THESE ENVIRONMENTAL COSTS?**

3 A: I recommend that the request for the regulatory assets be denied. However, if the  
4 Commission does approve the recording of a regulatory asset, I recommend that the  
5 recovery in a future rate case be conditional on an earnings review for the period in  
6 question, and that the recovery be disallowed if the Company is determined to have  
7 earned its authorized return.

8 **OPERATING REVENUE**

9 **Q: WHAT ADJUSTMENTS ARE YOU RECOMMENDING TO OG&E'S**  
10 **OPERATING REVENUE?**

11 A: I am recommending an adjustment based on OG&E's customer count updated to  
12 December 31, 2015, which I calculated using the Company's supplemental response to  
13 discovery response AG 2-10. This discovery response included OG&E's calculation of  
14 the impact of changes in customer levels for each rate class to December 31, 2015.

15 **Q: WHAT IS THE AMOUNT OF YOUR PROPOSED ADJUSTMENT TO OG&E'S**  
16 **PRO FORMA RETAIL ELECTRIC REVENUE TO ACCOUNT FOR CHANGES**  
17 **IN CUSTOMER LEVELS AFTER THE END OF THE TEST YEAR?**

18 A: I recommend that OG&E's pro forma jurisdictional electric revenue be increased by  
19 \$5,375,062 to reflect the changes in customer levels through December 31, 2015, as  
20 summarized on Exhibit ECF-1, page 12 of 18.

**OPERATING EXPENSES**

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**Q: WHAT ADJUSTMENTS ARE YOU RECOMMENDING TO OPERATING EXPENSES?**

A: I recommend several adjustments to operating expenses, including payroll, incentive compensation, non-qualified retirement plans, and gains realized on the sale of utility assets.

**Q: DO YOU AGREE WITH OG&E'S PROPOSAL TO INCLUDE ENVIROMENTAL CONSUMABLES IN THE FUEL ADJUSTMENT CLAUSE?**

A: No. The Attorney General's witness James W. Daniel is recommending that the environmental consumables, also known as Air Quality Control System ("AQCS") consumables, be recovered through base rates instead of through the Company's Fuel Adjustment Clause ("FAC") as requested by the Company.

**Q: DO YOU SUPPORT MR. DANIEL'S RECOMMENDATION FOR BASE RATE RECOVERY OF THE AQCS CONSUMABLES?**

A: Yes. I support Mr. Daniel's recommendation because the statute authorizing the FAC specifically addresses the cost of fuel and purchased power, not materials used for the treatment of exhaust gasses.<sup>4</sup>

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<sup>4</sup> OKLA. STAT. tit. 17, §§ 251 *et. seq.*

1 **Q: DOES THE RECOMMENDATION TO INCLUDE ENVIRONMENTAL**  
2 **COMSUMABLES IN BASE RATES REQUIRE AN ADJUSTMENT TO THE**  
3 **JURISDICTIONAL TOTAL REVENUE REQUIREMENT?**

4 A: No. The Company included environmental consumables in the \$57,051,755 FAC-related  
5 reduction to OG&E's requested rate increase.<sup>5</sup>

6 **Q: PLEASE EXPLAIN OG&E'S ADJUSTMENT TO PAYROLL-RELATED**  
7 **EXPENSES.**

8 A: OG&E adjusted its payroll expense by annualizing the projected salaries of those  
9 employed by the Company on December 31, 2015. The Company's adjustment increased  
10 the test year payroll expense by \$5,650,503.<sup>6</sup>

11 **Q: PLEASE DISCUSS THE PROBLEMS WITH REFLECTING PROSPECTIVE**  
12 **PAY INCREASES IN THIS TYPE OF ADJUSTMENT.**

13 A: Utilities often include future pay increases in their pro forma payroll costs, often well  
14 past the end of the test year. The utilities' projections are almost always based on  
15 nominal pay raises instead of average pay raises. The difference is important because not  
16 all employees are eligible to receive a raise, and under a merit system, not all employees  
17 receive the maximum or nominal raise amount. The only way to ensure that payroll did  
18 increase at the rate stated by the Company is to annualize payroll costs at a date after the  
19 raise has been implemented. This was not possible for OG&E because its application

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<sup>5</sup> See OG&E Minimum Filing Requirements: Schedule B-1. Line 8, and WP M's, Tab: M-1c FAC Changes.

<sup>6</sup> See WP H\_2-23 Payroll.

1 was filed on December 17, 2015. OG&E's proposed payroll expense is based on an  
2 estimate of the impact of future events instead of a measurement of the actual level of  
3 costs the Company experienced. Estimates are generally less accurate than actual  
4 measurements in determining the amount of an expense to include in rates.

5 **Q: WHAT DATE SHOULD BE USED TO MEASURE THE INCREASE IN**  
6 **PAYROLL THAT SHOULD BE INCLUDED IN BASE RATES?**

7 A: Payroll should be annualized at December 31, 2015, which is six months after the end of  
8 the test year. If a later date is used, there will be bias in the rate-setting process to  
9 recognize increases in the revenue requirement, but not offsetting increases to sales and  
10 decreases to other expenses that might offset the increase in payroll costs.

11 **Q: PLEASE DESCRIBE THE PAYROLL ANNUALIZATION YOU RECOMMEND.**

12 A: I recommend using OG&E's annualized pay at December 31, 2015, to reflect actual  
13 payroll costs at the end of the six-month update period. I based my recommendation on  
14 the Company's response to discovery request AG 2-11.

15 **Q: WHAT IS THE ADJUSTMENT TO PAYROLL EXPENSE THAT YOU**  
16 **RECOMMEND?**

17 A: I recommend that OG&E's requested jurisdictional payroll cost be reduced by \$486,681,  
18 to reflect the annualized payroll cost at December 31, 2015, which is six months after the  
19 end of the test year. This adjustment is found on Exhibit ECF-1, page 13.

1 **Q: DOES THIS ADJUSTMENT AFFECT PAYROLL TAX EXPENSE?**

2 A: Yes, it does. My recommended payroll adjustment impacts payroll taxes. I recommend  
3 that OG&E's jurisdictional Payroll Tax Expense be reduced by \$34,165 to reflect the  
4 impact of my payroll adjustment.<sup>7</sup>

5 **INCENTIVE PLANS**

6 **Q: PLEASE DISCUSS OG&E'S INCENTIVE PLANS.**

7 A: OG&E offers its employees an annual or short-term incentive plan, as well as long-term  
8 incentive plans. The annual incentive plan covers all employees, while the long-term  
9 incentive plans only cover management level employees. This is similar to the annual  
10 incentive plans of other utilities, which typically include a mix of safety and operational  
11 goals, and the operational goals usually include company earnings.<sup>8</sup> OG&E's long-term  
12 incentive plan is focused on earnings, which is also typical of other utilities.

13 **Q: WHAT ARE THE MAJOR CATEGORIES FOR OG&E'S ANNUAL INCENTIVE**  
14 **PLAN?**

15 A: My review of OG&E's incentive compensation plan indicates that it is heavily weighted  
16 to financial and operational objectives, with smaller components related to safety and  
17 customer satisfaction. From a regulatory perspective, the primary concerns of a public  
18 utility should be safety, reliability, customer satisfaction, and the cost of the utility's  
19 service. The latest J.D. Power and Associates survey of electric utilities ranked OG&E

<sup>7</sup> (\$486,681) \* 7.02% = (\$34,165).

<sup>8</sup> See Resp. to AG 2-16 for OG&E's annual incentive plan.

1 highest in residential customer satisfaction for midsize utilities in the south region.<sup>9</sup>

2 However, OG&E ranked below average in business customer satisfaction.<sup>10</sup>

3 **Q: WHAT WERE THE RESULTS OF OG&E'S ANNUAL INCENTIVE PLAN FOR**  
4 **THE TEST YEAR?**

5 A: The Company awarded significant amounts of annual incentives for financial, operational  
6 and customer satisfaction goals, but employees failed to meet the minimum standards to  
7 receive the safety incentive award.

8 **Q: WHAT RATEMAKING TREATMENT HAS THE COMMISSION GIVEN TO**  
9 **ANNUAL INCENTIVE PLANS IN THE PAST?**

10 A: The Commission has split the cost of annual incentive plans between the utility's  
11 shareholders and ratepayers. One half of annual incentives have been included in rates.<sup>11</sup>

12 **Q: WHY SHOULDN'T THE COMMISSION INCLUDE ALL OF THE INCENTIVE**  
13 **COMPENSATION COSTS IN RATES IF THAT IS THE LEVEL OF**  
14 **COMPENSATION THE COMPANY BELIEVES IS FAIR FOR EMPLOYEES?**

15 A: It is not appropriate for all costs to be included in rates. For example, utilities are  
16 required to absorb the cost of lobbying activities and promotional advertising that may be  
17 against the public interest. Similarly, it would not be appropriate for ratepayers to bear  
18 the cost of financial incentives that may cause utility employees to seek rate increases. It

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<sup>9</sup> Press Release, J.D. Power, July 15, 2015, *available at* [jdpower.com](http://jdpower.com).

<sup>10</sup> Press Release, J.D. Power, January 13, 2016.

<sup>11</sup> See Order No. 564437 at 19 – 21, *Appl. of Pub. Serv. Co. of Okla. for an Adjustment in its Rates and Charges for Elec. Serv. in the St. of Okla.*, Cause No. PUD 200800144 (Findings of Fact (¶E.21)).

1 has been said that a well-designed financial incentive should more than pay for itself with  
2 added revenue or cost savings, and if it doesn't, it should be discontinued. Apparently,  
3 financial incentive plans have been working for shareholders because utilities have  
4 maintained them, even though most utility commissions exclude the plans' expenses from  
5 utilities' revenue requirement, as has this Commission for OG&E.<sup>12</sup>

6 **Q: WHAT IS YOUR RECOMMENDATION REGARDING OG&E'S ANNUAL**  
7 **INCENTIVE COMPENSATION PLAN?**

8 A: I recommend that the Commission continue to exclude fifty percent (50%) of OG&E's  
9 annual incentive plan expenses from rates.

10 **Q: WHAT IS THE IMPACT OF THE ADJUSTMENT TO EXCLUDE 50% OF THE**  
11 **COST OF THE ANNUAL INCENTIVE PLANS FROM RATES?**

12 A: The adjustment to exclude 50% of the annual incentive plan costs from the revenue  
13 requirement for OG&E reduces pro forma expenses by \$7,104,635, and it reduces payroll  
14 tax expense by an additional \$498,745 for the Oklahoma retail jurisdiction, as reflected  
15 on Exhibit ECF-1, page 14.

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<sup>12</sup> See, e.g., Order No. 516261 at 77 & 99, *In re Appl. of Okla. Gas and Elec. Co. for an Order of the Comm'n Authorizing Applicant to Modify its Rates, Charges, and Tariffs for Retail Elec. Serv. in Okla.*, Cause No. PUD 200500151 (PUD's recommendation and Findings of Fact). This was OG&E's most recent fully litigated rate case.

1 Q: WHAT TREATMENT HAS THE COMMISSION GIVEN TO LONG-TERM  
2 INCENTIVE PLANS?

3 A: The Commission has excluded the cost of long-term incentive plans from utilities'  
4 revenue requirement,<sup>13</sup> as most commissions do. That exclusion is because these plans  
5 are almost always entirely financial in nature, designed to increase utilities' earnings,  
6 regardless of how that is achieved.

7 Q: WHAT IS YOUR RECOMMENDATION REGARDING THE COMPANY'S  
8 LONG-TERM INCENTIVE PLANS?

9 A: I recommend that the Commission follow its policy to exclude the cost of the long-term  
10 incentive plans from rates. Incenting employees to pursue high earnings is not necessary  
11 for the provision of utility service and may even be detrimental to the interests of  
12 ratepayers.

13 Q: WHAT IS THE AMOUNT OF THE ADJUSTMENT TO EXCLUDE THE COST  
14 OF LONG-TERM INCENTIVES FROM RATES?

15 A: The adjustment to exclude the cost of the long-term incentive plans from rates reduces  
16 the jurisdictional revenue requirement by \$5,505,684, as found on Exhibit ECF-1, page  
17 15.

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<sup>13</sup> See Order No. 564437 at 19 – 21, *Appl. of Pub. Serv. Co. of Okla. for an Adjustment in its Rates and Charges for Elec. Serv. in the St. of Okla.*, Cause No. PUD 200800144 (Findings of Fact).

**NON-QUALIFIED PENSION COSTS**

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**Q: DID THE COMPANY INCLUDE EXPENSES FOR A NON-QUALIFIED PENSION PLAN IN THE REVENUE REQUIREMENT?**

A: Yes, it did.

**Q: WHAT IS A NON-QUALIFIED PENSION PLAN?**

A: A non-qualified pension plan covers the portion of the executives' retirement costs for salaries above the IRS limits, which are currently \$265,000 per year. This means that fund contributions are not tax deductible, and as a result, companies rarely fund these plans.

**Q: DO YOU RECOMMEND THAT THIS COST BE INCLUDED IN THE REVENUE REQUIREMENT?**

A: No. This type of indirect compensation for highly paid executives is unnecessary and expensive because of its added cost. I recommend that the Commission exclude the non-qualified pension cost from expenses.

**Q: WHAT IS THE AMOUNT OF THE ADJUSTMENT TO EXCLUDE NON-QUALIFIED PENSION COSTS FROM THE REVENUE REQUIREMENT?**

A: This adjustment reduces the Oklahoma retail revenue requirement by \$1,713,195 for OG&E, as found on Exhibit ECF-1, page 16.



1 levels of plant investment. OG&E requested that \$74,607,317 in ad valorem taxes be  
2 included in the total Company revenue requirement.

3 **Q: DO YOU AGREE WITH OG&E'S PROPOSED LEVEL OF AD VALOREM**  
4 **TAXES?**

5 A: No. The Company based its adjustment to increase ad valorem taxes on past increases to  
6 this expense. Essentially, the Company is saying that Oklahoma ad valorem taxes  
7 increased at an average rate of 5.1% over the last three years, so the test year cost will  
8 increase at the same rate.<sup>15</sup> An examination of the Company's costs for the calendar year  
9 2015 shows that FERC Account 408.1, Taxes Other than Income Tax, increased by less  
10 than 0.24% over the test year.<sup>16</sup> The Company has proposed an increase to payroll tax  
11 expense of \$392,720, which is greater than the test year to calendar year 2015 increase in  
12 the whole account of \$215,432. The Company's adjustment clearly isn't justified. For  
13 that reason, I recommend that the Company's adjustment be reversed.

14 **Q: WHAT IS THE AMOUNT OF THE ADJUSTMENT YOU PROPOSE TO AD**  
15 **VALOREM TAXES?**

16 A: This adjustment reduces jurisdictional ad valorem taxes by \$4,166,889. This adjustment  
17 is found on Exhibit ECF-1, page 18.

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<sup>15</sup> The increase rate the Company calculated for Arkansas is 7.3%. The rate of increase is properly calculated as:  $(2015 \text{ amount}/2012 \text{ amount})^{(1/3)} - 1$ , which results in an actual average annual increase rate for Oklahoma of 4.9% and for Arkansas of 6.8%.

<sup>16</sup> See Resp. to AG-10, AG 1-10\_Suppl. The test-year-end June 30, 2015 amount for Taxes Other Than Income Taxes was \$89,693,060, and the calendar year 2015 amount was \$89,908,492.

1 **SUMMARY OF RECOMMENDATIONS**

2 **Q: WHAT IS THE IMPACT OF THE ATTORNEY GENERAL'S**  
3 **RECOMMENDATIONS IN THIS CAUSE?**

4 **A:** Based on the above recommendations and those of other witnesses, the Attorney General  
5 recommends a reduction to the increase requested by OG&E of \$103,252,340, as shown  
6 on Exhibit ECF-1, page 1. The jurisdictional impacts of the adjustments presented on  
7 Exhibit ECF-1 are approximate based on general allocation factors. The precise  
8 jurisdictional impact of the final adjustments adopted by the Commission should be  
9 determined with the application of a comprehensive revenue requirement model. These  
10 recommendations are subject to change based on information that may be presented in  
11 this cause after the filing date of this testimony.

12 **OTHER ISSUES**

13 **Q: DOES YOUR TESTIMONY ADDRESS ALL ISSUES IN THIS RATE CASE?**

14 **A:** No, it does not. I will review issues raised by other parties to this Cause and reserve the  
15 right to address those issues in rebuttal testimony.

16 **CONCLUSION**

17 **Q: DOES THIS CONCLUDE YOUR TESTIMONY?**

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

**OKLAHOMA GAS AND ELECTRIC COMPANY**  
**ATTORNEY GENERAL ISSUE IMPACT**  
**TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

Line No.	<u>Witness</u>	<u>Jurisdictional Rate Base</u>	<u>Pre-Tax Rate of Return</u>	<u>Net Rate Increase</u>
1	Requested increase	\$ 4,152,329,406		\$ 92,494,692
2	Plant in Service	\$ 12,473,690	11.5486%	1,440,537
3	Accumulated Depreciation	28,840,304	11.5486%	3,330,651
4	Accumulated Deferred Income Taxes	734,262	11.5486%	84,797
5	Prepayments	79,453	11.5486%	9,176
6	Materials and Supplies Inventory	(799,431)	11.5486%	(92,323)
7	Asset Retirement Obligations	(3,490,626)	11.5486%	(403,118)
8	Customer Deposits and Advances	(1,148,809)	11.5486%	(132,671)
9	Net Pension Benefit Asset	(6,447,061)	11.5486%	(744,545)
10	Gain on Sale of Assets	(1,136,352)	11.5486%	(131,233)
11	Plant Held for Future Use	(1,079,239)	11.5486%	(124,637)
12	Total adjustments to rate base	\$ 28,026,191		\$ 3,236,634
13	Adjusted Rate Base	\$ 4,180,355,597		
14	Capital Structure at 50% Equity	\$ 4,180,355,597	-0.3681%	(15,387,889)
15	Return on Equity at 9.2500%	\$ 4,180,355,597	-0.8166%	(34,136,784)
16	Adjust Revenue for Customer Growth	Farrar		(5,375,062)
17	Payroll annualized at 12/31/2015	Farrar		(486,681)
18	Payroll taxes annualized at 12/31/2015	Farrar		(34,165)
19	Remove 50% of annual incentives	Farrar		(7,104,635)
20	Remove payroll taxes on incentives	Farrar		(498,745)
21	Remove long term incentives	Farrar		(5,505,684)
22	Remove non-qualified retirement plan	Farrar		(1,713,195)
23	Amortize gains on sale of utility assets	Farrar		(573,978)
24	Reduce Trim Cycle to \$18,725,165	Mara		(4,354,171)
25	Reduce Non-Cyle 40%	Mara		(657,027)
26	Restore corporate cost allocation to affiliates	Wielgus		(5,579,128)
27	Depreciation expense - Dismantlement	Cook		(15,555,000)
28	Depreciation expense - Wind	Cook		(5,287,416)
29	Depreciation expense Holding Company	Cook		(72,525)
30	Ad valorem taxes	Farrar		(4,166,889)
31	Adjustment Impact			<u>\$ (103,252,340)</u>
32	Adjusted increase			<u>\$ (10,757,648)</u>

OKLAHOMA GAS AND ELECTRIC COMPANY  
PLANT IN SERVICE  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	OG&E updated Plant in Service 6/30/2011	\$ 9,631,284,933	89.84%	\$ 8,653,066,331
2	Less OG&E proposed Plant in Service	<u>9,617,401,108</u>	89.84%	<u>8,640,592,641</u>
3	Adjustment to Plant in Service*	<u>\$ 13,883,825</u>		<u>\$ 12,473,690</u>

\*To adjust Plant in Service to the balance at December 31, 2015.

OKLAHOMA GAS AND ELECTRIC COMPANY  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273  
TYE JUNE 30, 2015; CAUSE NO. PUD 201500273

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	Accumulated Depreciation 6/30/2011	\$ (3,640,581,266)	90.02%	(3,277,279,877)
2	Less OG&E proposed Accumulated Depreciation	<u>(3,672,618,649)</u>	90.02%	<u>(3,306,120,181)</u>
3	Adjustment to Accumulated Depreciation*	<u>\$ 32,037,383</u>		<u>\$ 28,840,304</u>

\*To adjust Accumulated Depreciation to the balance at December 31, 2015.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
ACCUMULATED DEFERRED INCOME TAXES  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	Accumulated Deferred Income Tax ("ADIT") at 12/31/2015	\$ (1,480,273,771)	90.00%	\$ (1,332,246,394)
2	Less Depreciation-Related ADIT Requested by OG&E	<u>(1,481,089,618)</u>	90.00%	<u>(1,332,980,656)</u>
3	Adjustment to ADIT*	<u>\$ 815,847</u>		<u>\$ 734,262</u>

\*To adjust depreciation-related Accumulated Deferred Income Tax to the balance at December 31, 2015.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
PREPAYMENTS  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<b>Line No.</b>		<b>Total Company</b>	<b>Allocation Factor</b>	<b>Oklahoma Retail</b>
1	December 2014	\$ 4,914,832		
2	January 2015	5,952,288		
3	February 2015	5,433,315		
4	March 2015	4,341,694		
5	April 2015	4,543,375		
6	May 2015	3,760,216		
7	June 2015	3,726,116		
8	July 2015	2,177,339		
9	Aug 2015	1,455,910		
10	Sept 2015	1,881,622		
11	October 2015	2,578,243		
12	November 2015	4,765,129		
13	December 2015	<u>4,914,286</u>		
14	Thirteen (13) Month Average at December 31, 2015	\$ 3,880,336	90.98%	\$ 3,530,329
15	Test Year End 13 Month Average	<u>3,793,005</u>	90.98%	<u>3,450,876</u>
16	Adjustment to Prepayments*	<u>\$ 87,331</u>		<u>\$ 79,453</u>

\*To adjust Prepayments to the thirteen month average balance at December 31, 2015.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
MATERIALS AND SUPPLIES INVENTORY  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<b>Line No.</b>		<b>Total Company</b>	<b>Allocation Factor</b>	<b>Oklahoma Retail</b>
1	December 2014	\$ 77,897,336		
2	January 2015	77,821,394		
3	February 2015	77,757,629		
4	March 2015	77,755,862		
5	April 2015	75,014,523		
6	May 2015	75,872,251		
7	June 2015	76,759,006		
8	July 2015	76,288,351		
9	Aug 2015	75,548,285		
10	Sept 2015	75,770,062		
11	October 2015	73,314,773		
12	November 2015	74,293,021		
13	December 2015	<u>78,826,932</u>		
14	Thirteen (13) Month Average at December 31, 2015	\$ 76,378,417	91.66%	\$ 70,008,457
15	Test Year End 13-Month Average	<u>77,250,587</u>	91.66%	<u>70,807,888</u>
16	Adjustment to Materials and Supplies Inventory*	<u>\$ (872,170)</u>		<u>\$ (799,431)</u>

\*To adjust Materials and Supplies Inventory to the 13 month average balance at December 31, 2015.

OKLAHOMA GAS AND ELECTRIC COMPANY  
ASSET RETIREMENT OBLIGATIONS  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	Asset Retirement Obligations at December 31, 2015	\$ (63,292,180)	90.92%	(57,545,250)
2	Amount requested by OG&E	<u>(59,452,952)</u>	90.92%	<u>(54,054,624)</u>
3	Adjustment to Asset Retirement Obligations*	<u>\$ (3,839,228)</u>		<u>\$ (3,490,626)</u>

\*To adjust the Asset Retirement Obligations balance to December 31, 2015.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
CUSTOMER DEPOSITS AND ADVANCES FOR CONSTRUCTION  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	Customer Deposits and Advances for Construction at 12/31/2015	\$ (77,179,247)	92.19%	\$ (71,151,548)
2	Customer Deposits and Advances for Construction at 6/30/2015	<u>(75,933,115)</u>	92.19%	<u>(70,002,739)</u>
3	Adjustment to Customer Deposits and Advances for Construction*	<u>\$ (1,246,132)</u>		<u>\$ (1,148,809)</u>

\*To adjust the balance of Customer Deposits and Advances for Construction to December 31, 2015.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
NET PENSION BENEFIT ASSET  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	Statement of Financial Accounting Standards ("SFAS") 158, Account 182.3, at December 31, 2015	\$ 242,232,668		
2	Accrued Pension and Benefit Obligation at 12/31/15	(179,925,299)		
3	Pension Asset Deferred Income Taxes	(55,737,561)		
4	Pension Liability Deferred Income Taxes	<u>41,421,653</u>		
5	Net Pension Benefit Asset at December 31, 2015	\$ 47,991,461	92.33%	\$ 44,308,541
6	SFAS 158, Account 182.3, at June 30, 2015	\$ 254,186,790		
7	Accrued Pension and Benefit Obligation at 6/30/15	(174,015,692)		
8	Pension Asset Deferred Income Taxes	(66,562,736)		
9	Pension Liability Deferred Income Taxes	<u>41,366,040</u>		
10	Net Pension Benefit Asset at June 30, 2015	\$ 54,974,401	92.33%	\$ 50,755,602
11	Adjustment to Net Pension Benefit Asset*	<u>\$ (6,982,940)</u>		<u>\$ (6,447,061)</u>

\*To adjust the Net Pension Benefit Asset to the balance at Decemeber 31, 2015.

OKLAHOMA GAS AND ELECTRIC COMPANY  
GAIN ON SALE OF UTILITY ASSETS  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	Net Gains from Utility Assets Sold Since Last Rate Case*	\$ <u>(1,262,322)</u>	90.02%	\$ <u>(1,136,352)</u>

\*To recognize the net gains from the sale of utility assets in rate base.

OKLAHOMA GAS AND ELECTRIC COMPANY  
PLANT HELD FOR FUTURE USE  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273

<u>Line</u> <u>No.</u>		<u>Total</u> <u>Company</u>	<u>Allocation</u> <u>Factor</u>	<u>Oklahoma</u> <u>Retail</u>
1	Plant Held for Future Use ("PHFU")	\$ 1,497,777	72.06%	1,079,239
2	Adjustment to Remove PHFU*	<u>(1,497,777)</u>		<u>(1,079,239)</u>

\*To remove Plant Held for Future Use that is not providing service to rate payers.

OKLAHOMA GAS AND ELECTRIC COMPANY  
REVENUE  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273

<u>Line No.</u>		<u>Oklahoma Retail</u>
1	Revenue Increase for Customer Growth to December 31, 2015	\$ 17,886,497
2	Customer Growth Revenue Adjustment Proposed by OG&E	<u>12,511,435</u>
3	Adjustment to OG&E Jurisdictional Revenue*	<u>\$ 5,375,062</u>

\*To adjust revenue to reflect customer levels at December 31, 2015.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
PAYROLL  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	Adjustment Based on Payroll at 12/31/2015	\$ 5,122,076	92.10%	4,717,432
2	OG&E Original Adjustment to Payroll	<u>5,650,503</u>	92.10%	<u>5,204,113</u>
3	Adjustment to Requested Payroll Expenses*	<u>\$ (528,427)</u>		<u>\$ (486,681)</u>
4	Payroll Tax Effective Rate	<u>7.02%</u>		<u>7.02%</u>
5	Adjustment to Payroll Taxes*	<u>\$ (37,096)</u>		<u>\$ (34,165)</u>

\*To adjust payroll and payroll tax expenses for the annualized pay rates at June 30, 2015.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
ANNUAL INCENTIVE PLAN  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<b>Line No.</b>		<b><u>Utility</u></b>	<b><u>Holding Company</u></b>	<b><u>Total Company</u></b>
1	Pro Forma Annual Incentive Plan Cost	\$ 10,870,270	\$ 4,557,820	\$ 15,428,090
2	Adjustment to Remove One Half of Annual Incentives	<u>(5,435,135)</u>	<u>(2,278,910)</u>	<u>\$ (7,714,045)</u>
3	Jurisdictional Operation and Maintenance ("O&M") Expense Allocation Factor	<u>92.10%</u>	<u>92.10%</u>	<u>92.10%</u>
4	Adjustment to Oklahoma Retail O&M Expense*	<u>(5,005,759)</u>	<u>(2,098,876)</u>	<u>(7,104,635)</u>
5	Payroll Tax Effective Rate			<u>7.02%</u>
6	Total Company Adjustment to Payroll Taxes			\$ (541,526)
7	Adjustment to Oklahoma Retail Payroll Taxes*			<u>\$ (498,745)</u>

\*To adjust incentives to allow 50% of requested expense levels.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
LONG TERM INCENTIVE PLANS  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<b>Line No.</b>		<b><u>Utility</u></b>	<b><u>Holding Company</u></b>	<b><u>Total Company</u></b>
1	Long Term Incentive Plan Expenses ("LTI") in the Total Company Revenue Requirement	\$ 2,071,315	\$ 3,906,626	\$ 5,977,942
2	Adjustment to Exclude LTI	\$ (2,071,315)	\$ (3,906,626)	\$ (5,977,942)
3	Allocation Factor	<u>92.10%</u>	<u>92.10%</u>	<u>92.10%</u>
4	Oklahoma Jurisdictional Adjustment to Remove LTI*	<u>\$ (1,907,681)</u>	<u>\$ (3,598,003)</u>	<u>\$ (5,505,684)</u>

\*To remove the cost of long-term incentives from the revenue requirement.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
NON-QUALIFIED RETIREMENT PLAN  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<u>Line No.</u>		<u>Utility</u>	<u>Holding Company</u>	<u>Total</u>
1	Retirement Restoration Plan Expense Requested	\$ 217,248	\$ 1,642,899	\$ 1,860,147
2	Adjustment to exclude Non-Qualified Pensions*	\$ (217,248)	\$ (1,642,899)	\$ (1,860,147)
3	Oklahoma Retail Allocation Factor	<u>92.10%</u>	<u>92.10%</u>	<u>92.10%</u>
4	Adjustment to Exclude Non-Qualified Pensions from Oklahoma Retail Expenses*	<u>\$ (200,085)</u>	<u>\$ (1,513,110)</u>	<u>\$ (1,713,195)</u>

\*To remove the cost of the non-qualified retirement plan from the revenue requirement.

**OKLAHOMA GAS AND ELECTRIC COMPANY  
AMORTIZATION OF GAIN ON SALE OF UTILITY ASSETS  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273**

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	Utility Assets Sold Since Last Rate Case	\$ 1,262,322	90.94%	\$ 1,147,956
2	Amortization Period (in years)	<u>2</u>		<u>2</u>
3	Annual Amortization Amount	\$ 631,161		\$ 573,978
4	Adjustment for Amortization of Net Asset Gains*	<u>\$ (631,161)</u>		<u>\$ (573,978)</u>

\*To recognize that ratepayers should be credited for the value of overdepreciated assets and for gains realized in addition to the fair return on those assets provided by ratepayers.

OKLAHOMA GAS AND ELECTRIC COMPANY  
AD VALOREM TAX  
TEST YEAR END JUNE 30, 2015; CAUSE NO. PUD 201500273

<u>Line No.</u>		<u>Total Company</u>	<u>Allocation Factor</u>	<u>Oklahoma Retail</u>
1	OG&E Proposed Adjustment for 2015 Property Tax Increases	\$ 4,624,225	90.11%	\$ 4,166,889
2	Adjustment to Property Tax Expense*	<u>\$ (4,624,225)</u>		<u>\$ (4,166,889)</u>

\*To remove the estimated increases to ad valorem taxes.

*Cause No. PUD 201500273  
Responsive Testimony of Edwin C. Farrar  
on Behalf of E. Scott Pruitt, Oklahoma Attorney General*

**CERTIFICATE OF SERVICE**

On this 21<sup>st</sup> day of March, 2016, a true and correct copy of the above and foregoing  
*Responsive Testimony of Edwin C. Farrar on Behalf of E. Scott Pruitt, Oklahoma Attorney General,*  
was sent via electronic mail to the following interested parties:

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*Cause No. PUD 201500273  
Responsive Testimony of Edwin C. Farrar  
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