

FILED
JAN 16 2018

BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

**COURT CLERK'S OFFICE - OKC
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

Direct Testimony

of

Donald R. Rowlett

on behalf of

Oklahoma Gas and Electric Company

January 16, 2018

Donald R. Rowlett
Direct Testimony

1 Q. **Please state your name, position, by whom you are employed, and your business**
2 **address.**

3 A. My name is Donald R. Rowlett. I am the Managing Director of Regulatory Affairs for
4 Oklahoma Gas and Electric Company ("OG&E"). My business address is 321 N. Harvey
5 Avenue, Oklahoma City, Oklahoma 73102.
6

7 Q. **Please state your educational qualifications and employment history.**

8 A. I earned a Bachelor of Science degree in Business with an accounting emphasis (1980)
9 and a Master's in Business Administration (1992), from Oklahoma City University. I
10 have also completed all work, except for the dissertation, on a Ph.D. from Oklahoma
11 State University in Business Administration. I joined OG&E in 1989. I currently serve
12 as Managing Director of Regulatory Affairs where I am responsible for overseeing the
13 Company's economic regulatory activities with the Oklahoma Corporation Commission,
14 the Arkansas Public Service Commission and the Federal Energy Regulatory
15 Commission. I have served in various financial roles in the Company including ten years
16 as Vice President, Controller and Chief Accountant. As the Company's Controller I was
17 responsible for financial and operations accounting, federal, state and local income and
18 property taxes and budgeting. I have also made investor presentations and participated in
19 numerous public equity and debt offerings. Prior to joining OG&E, I was employed by
20 Arthur Andersen & Co. as a financial consultant and audit manager. During my
21 employment, I performed audits of financial statements in a variety of industries.
22 Additionally, I prepared filings with the Securities and Exchange Commission ("SEC")
23 and provided clients with guidance on the financial reporting requirements of the SEC
24 and Generally Accepted Accounting Principles ("GAAP").

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

2 A. Yes. In addition to testifying before the Commission, I have testified on behalf of the
3 Company before the Arkansas Public Service Commission and the Environmental and
4 Public Works Committee in the United States Senate. I have also filed testimony before
5 the Federal Energy Regulatory Commission.
6

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

8 A. The purpose of my testimony is to discuss the relief requested and explain why OG&E is
9 seeking to essentially keep its rates flat at this time. OG&E would have requested a
10 revenue requirement increase of approximately \$72 million. However, the recent Tax
11 Cuts and Jobs Act of 2017 (“TCJA of 2017”) has allowed the Company to reduce its
12 requested relief and essentially hold its request to a relatively small increase. . In
13 addition, I discuss some of the key issues in the Company’s application, including the
14 recent TCJA of 2017. Finally, I will introduce each of the Company witnesses in this
15 proceeding.
16

17 Q. **Please state the relief sought from the Commission through this application.**

18 A. OG&E is requesting a general rate change¹ pursuant to the Commission Rules, including
19 Chapter 70 Minimum Standard Filing Requirements. The accounting exhibits, schedules,
20 testimony and evidence that support the general rate change are included in the
21 Application Package² filed in this cause.

¹ 165:70-1-2. Definitions. “**General Rate Change**” means a change in rates and charges which exceeds three percent (3%) based on the previous twelve (12) months revenue generated by the existing rates for an association or electric cooperative subject to the Commission's jurisdiction pursuant to 17 O.S. Section 158.27 et seq; or a change in rates resulting in more than a one percent (1%) increase in a utility’s jurisdictional annual gross operating revenues unless otherwise allowed by law. A change mandated by regulation or legislation, a change in the terms and conditions of service, a request for a special contract, or a request for a new and/or optional service does not constitute a general rate change.

² 165:70-1-2. Definitions. “**Application package**” means the required schedules and testimony filed by a Class A or B utility to initiate a general rate change. See 165:70-3-1 and 165:70-5-4.

1 Q. **Did OG&E provide the Commission advance notice of the Company's Application?**

2 A. Yes. A utility is required to provide the Commission a 45 day notice of its intent to file
3 an Application for a general rate change³. The notice is required to be in writing and
4 filed with the Commission's Court Clerk. On November 9, 2017, OG&E filed a Notice
5 of Intent that the Company would be filing an application on or about December 29, 2017
6 requesting a modification to its rates and charges for its Oklahoma jurisdiction customers.
7 Subsequent to the passing of the TCJA of 2017, OG&E notified the Administrative Law
8 Judge and Intervening parties that the Company would be filing its Application on
9 January 16, 2018.

10
11 Q. **What test year was utilized in developing the Application Package?**

12 A. The Company's exhibits are based on the financial results of the test year⁴ ended
13 September 30, 2017. The Application Package contains *pro forma* adjustments to rate
14 base⁵ and *pro forma* adjustments to operating income.⁶ *Pro forma* adjustments reflect
15 reasonably known and measurable changes that occur during and after the test year.

16
17 **DISCUSSION OF RELIEF REQUESTED**

18 Q. **Please generally describe OG&E's request for a general rate change in this filing.**

19 A. OG&E is requesting an overall increase in rates of \$1.86 million annually which reflects
20 a 0.1% increase over the rates last set in May of 2017. The Company expects the new
21 rates to go into effect no later than July of 2018. The Company's estimated increase to
22 rates, before the changes associated with the new federal tax cuts, was approximately \$72
23 million.

³ 165:70-3-7(a)

⁴ 165:70-1-2. Definitions. "**Test Year**" means the twelve (12) month period used in determining rate base, operating income and rate of return.

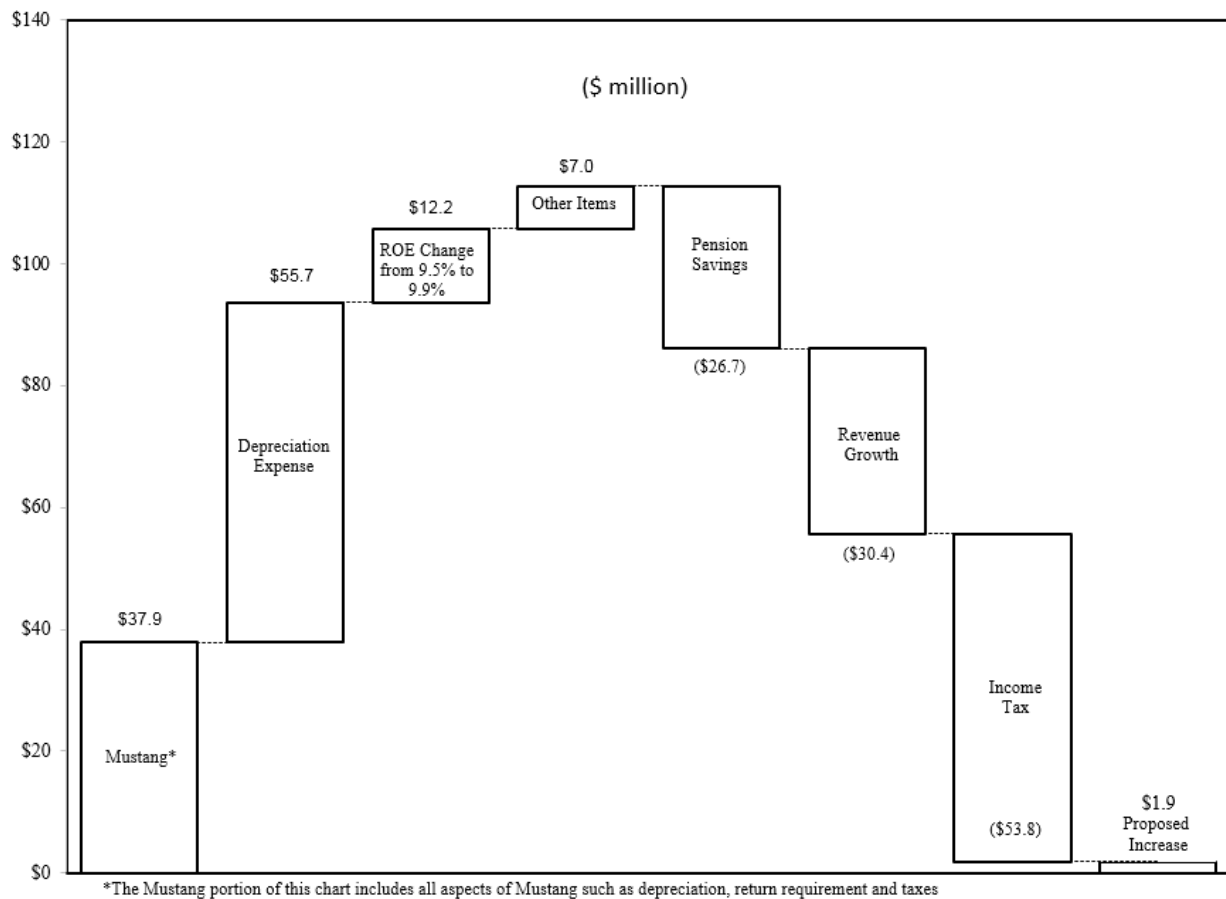
⁵ Application Package, Volume II, Section B, Schedule B-4.

⁶ Application Package, Volume II, Section H, Schedule H-3.

1 Q. Why is OG&E asking for a rate increase?

2 A. The primary reason OG&E is seeking a rate increase is to recover the costs associated
3 with the Mustang Modernization project. This project involved adding seven (7) new
4 quick-start combustion turbines (“CTs”) at the existing Mustang Power Plant site. The
5 increase also includes an increase on the Company’s allowed return on equity, and
6 depreciation expense based on an updated depreciation study, including recovery of the
7 cost of decommissioning retired generation plant. These increases are almost completely
8 offset by the reduction of the Federal income tax rate and amortization of the pension
9 tracker regulatory liability.

Chart 1: Visual Depiction of Rate Increase Drivers



1 Q. **What impact will the proposed rate increase have on monthly residential electric**
2 **bills?**

3 A. All things considered, the average residential customer will not see an increase in their
4 bills when compared to current rates. OG&E is not proposing to change residential
5 electric rates as a result of this application.

6 Q. **Will the increase in rates as proposed by the Company result in all customer classes**
7 **paying their full cost of service?**

8 A. No. OG&E has proposed that the revenue allocation among customer classes generally
9 follow the allocation approved by the Commission in PUD 201500273, Order 662059.
10 Witnesses Scott and Wai more fully describe the Company's revenue allocation and rate
11 design.

12
13 Q. **Does OG&E support moving towards each customer class paying its full cost of**
14 **service?**

15 A. Yes. OG&E believes that moving towards setting each customer class' rates to recover
16 100% of its cost of service is appropriate. Witness Scott discusses the difference between
17 full cost of service allocation for each class and the allocation proposed by the Company
18 in this cause. The Company encourages the Commission to begin moving each customer
19 class rate toward its total cost and therefore reduce subsidies that may exist in current
20 rates. OG&E looks forward to working with the Commission staff, AG's office and other
21 interveners in this case to develop a plan to move OG&E's rate design towards this goal.

22
23 Q. **How will OG&E's rates compare to the national average after the proposed**
24 **changes?**

25 A. OG&E's rates are currently well below the national average and will continue to be so
26 even with the proposed change. Currently, OG&E's overall retail rates are 24% below
27 that national average and residential rates specifically are 19% percent below the national
28 average.⁷ OG&E's overall retail rates advantage remains approximately the same.

⁷ Edison Electric Institute Typical Bills and Average Rates Report, Summer 2017.

1 Q. **Is there a connection between the Company's need for additional revenues and**
2 **customer satisfaction?**

3 A. Yes. The challenges in maintaining reliability are becoming tougher as OG&E faces
4 increasingly stringent reliability standards, a growing power delivery system, increased
5 vegetation management costs including unanticipated natural events, and increasing
6 cyber security costs. OG&E's customers expect the Company to rise to meet these
7 challenges.

8 9 **DISCUSSION OF KEY ISSUES**

10 Mustang Modernization

11 Q. **Why is OG&E modernizing the Mustang Facility?**

12 A. OG&E is advancing its generation fleet by replacing the 1950s era steam units of the
13 former Mustang Power Plant with new, modern, quick-start natural gas-fired units. The
14 Company has replaced the capacity of the steam units at the Mustang plant with seven (7)
15 natural gas-fired, quick-starting combustion turbines ("CTs") at the existing plant site.
16 All of Mustang's steam units are well beyond the average life for this type of unit, and
17 have been retired. The units served OG&E customers well for more than 60 years but it
18 was clear they were at the end of their practical lives. The new quick start units are
19 important for grid reliability, and offer significantly improved ability to respond to the
20 variability of intermittent resources such as wind and solar. The new units have a
21 nameplate capacity of 462 MWs and will be capable of starting and putting electricity
22 onto the system in just 10 minutes, compared to 10 to 20 hours for the existing units.
23 OG&E witnesses Burch, Webster, and Howell testify in detail about both the need to
24 retire the old Mustang units and the selection of the new CT technology. In addition,
25 OG&E witnesses McAuley and Nickell testify regarding the reliability benefits of the
26 CTs to not just the OG&E system, but also the SPP Integrated Market.

27
28 Q. **How did OG&E approach its decision to construct CTs at the Mustang site?**

29 A. As detailed in the Company's August 2014 Integrated Resource Plan ("IRP"), retiring the
30 old Mustang Units reduces OG&E's generating capacity by 480 MW. OG&E must have
31 enough generation capacity to meet its load plus a reserve amount as determined by the

1 Southwest Power Pool, Inc. ("SPP"). With the retirement of the old Mustang Units,
2 OG&E's IRP shows that OG&E will need additional capacity beginning in the summer
3 of 2018.
4

5 **Q. Once the need for additional capacity was established, how did OG&E narrow its**
6 **choice to install CTs at the Mustang site?**

7 A. OG&E had to choose the type of generation technology it needed to install and where it
8 needed to locate the capacity. Quick-starting CTs were highly desirable for several
9 reasons. This quick start ability allows the units to supply power during peak demand,
10 serve unscheduled demand, and supply ancillary services to the grid (such as operating
11 reserves and VAR support) while delivering better reliability, improved efficiency, better
12 load responses, improved operational flexibility and lower emission rates. Quick start
13 CTs can respond quickly to market signals in the SPP Integrated Marketplace ("IM"), are
14 capable of multiple starts per day and can come off-line quickly when not needed. Most
15 importantly, with the growth of highly variable renewable generating resources in the
16 SPP and OG&E's service territory, such quick-starting CTs are able to respond quickly to
17 changing conditions inherent with such variable generation resources like wind and solar.

18 Prior to the construction of the new Mustang CTs, quick start CTs only
19 constituted a very small percentage of OG&E's current generation fleet. With wind
20 generation reaching as high as 54% of the total generation in the SPP, quick start CTs can
21 step in and replace that intermittent wind generation if the wind stops blowing. Adding
22 462 MW of flexible, quick start CTs in a market containing such high levels of wind and
23 solar improves reliability.
24

25 **Q. Were there any SPP studies that validated OG&E's decisions to install CTs at the**
26 **Mustang site?**

27 A. Yes. A recent SPP voltage stability study showed that even at wind generation levels
28 much lower than those levels currently experienced, the Oklahoma City area (the
29 Company's largest load center) could experience system overloads and voltage collapse
30 under certain circumstances (like the loss of a key transmission line). As testified by
31 Witness Lanny Nickell, Vice President of Engineering at the SPP, quick start CTs at the

1 Mustang site are critical to mitigate those overloads and limit exposure to any voltage
2 collapse situations, especially in an environment of fluctuating wind generation. In his
3 testimony, Mr. Nickell concludes that “the availability of generation at Mustang is critical
4 to reliable system operations in the Oklahoma City area. The generation OG&E has
5 chosen, fast-start CTs, provides a valuable reliability tool to more quickly respond to
6 system loading and voltages in the largest load center of Oklahoma.”
7

8 **Q. Why did OG&E focus on installing its new generation only at the Mustang site?**

9 A. As testified by OG&E Witness McAuley, CTs at the Mustang site can manage increases
10 or decreases in voltage to stabilize the transmission system. The site’s connection to both
11 the 138kV and 69kV transmission systems on the west side of Oklahoma City provides
12 specific operational and reliability benefits including reduced line losses, reduced line
13 congestion and cost, voltage control support, and support for the Company’s system
14 restoration plan. The Mustang location already has the necessary infrastructure in place
15 to support a generating facility, including a secure property, roads, facilities to support
16 operations and maintenance, water supply and rights, fuel supply facilities, and most
17 importantly, existing switchyard interconnections to both the 138kV and 69kV
18 transmission systems. As discussed by OG&E Witness Burch, utilizing this existing
19 infrastructure at the Mustang site is estimated to save OG&E customers \$45 million
20 compared to replicating that same infrastructure at a new greenfield facility.
21

22 **Q. Does OG&E have any new information in this proceeding that validates the**
23 **Company’s decision to construct the new Mustang CTs?**

24 A. Yes. OG&E decided to seek outside validation of (i) its decision to retire the old
25 Mustang units and (ii) its belief that that CTs are needed for transmission system
26 reliability, especially CTs located at the Mustang site. OG&E engaged Black & Veatch to
27 conduct an independent review of OG&E’s decision to retire the old Mustang units. To
28 address the question of whether CTs at Mustang are needed for transmission system
29 reliability, OG&E requested that Lanny Nickell, Vice President of Engineering at SPP,
30 provide an independent assessment of the need for CTs at Mustang. As discussed above,
31 Mr. Nickell testifies that CTs are indeed essential and that SPP believes that the Mustang

1 location is a critical location for these CTs in order to maintain the reliability of the
2 system.

3
4 **Q. What was the conclusion of Black & Veatch in its review of OG&E's decision to**
5 **retire the old Mustang Units?**

6 A. Black & Veatch concluded that OG&E made the prudent decision to avoid spending
7 additional capital on the old Mustang units and instead, retire those units slightly early.
8 After its review of the facts, in September 2016, Black & Veatch issued a study entitled
9 "Evaluation Report: Mustang Power Plant Retirement Consideration" in which it
10 provided its independent assessment of OG&E decision to retire the old Mustang units.
11 Black & Veatch reviewed numerous documents and data related to the status and
12 operating condition of Mustang Units 1, 2, 3 and 4 and the numerous capital projects
13 needed in order to keep those units running for the full 65 years. OG&E has requested
14 the leader of the Black & Veatch's review, Witness Phillip Webster, to provide testimony
15 in this docket to explain his analysis and conclusions.

16
17 **Q. Does the Black & Veatch study and the Nickell testimony confirm OG&E's belief**
18 **that its Mustang Modernization Plan is just, reasonable and consistent with the**
19 **public interest?**

20 A. Yes. This new information confirms what OG&E believed back in 2014 when it made
21 the decision to retire the old units and install CTs at Mustang. Given all the facts
22 available to OG&E in 2014, the Company believes that it made the right decision. Not
23 only would continuing to invest in the old Mustang units have been imprudent, OG&E
24 needed new CTs and locating them at the Mustang site was the reasonable action.

25
26 **Q. Does the Company have an estimate of the cost of the Mustang Modernization plan?**

27 A. The Company currently estimates the cost of the Mustang plant to be \$355 million
28 excluding capitalized costs, which is approximately \$56 million below the original
29 estimate of \$411 million. Including capitalized AFUDC and Ad Valorem taxes the total
30 cost is estimated to be approximately \$390 million.

1 Q. **Has the Company estimated the Revenue Requirement associated with the Mustang**
2 **Modernization Plan?**

3 A. Yes. Utilizing a total cost of approximately \$390 million, OG&E estimates the
4 Oklahoma jurisdictional revenue requirement to be approximately \$37.9 million.
5

6 Q. **Has the Company determined the depreciation rates for the new Mustang CTs?**

7 A. Yes. The Company is proposing that depreciation rates (including decommissioning and
8 escalation) for the new Mustang CTs and may be found in the Direct Testimony of
9 OG&E witness Spanos or in the MFR Package WP I-3.
10

11 Q. **Has the Company asked for approval of the Mustang CTs in its Arkansas**
12 **jurisdiction?**

13 A. Yes. The Arkansas Public Service Commission found, in Docket No. 17-030-U, Order
14 No. 3 that the Mustang CTs were in the public interest and cost recovery will be allowed
15 in accordance with its Arkansas Formula Rate Plan. The investment in the Mustang CTs
16 will be included in the Company's Formula Rate Plan that will be filed later in 2018.
17

18 Return on Equity

19 Q. **What Return on Equity ("ROE") is OG&E seeking in this proceeding?**

20 A. OG&E witness Morin's recommendation is an ROE of 9.90% which is consistent with
21 the national average for vertically integrated electric utilities. The Company is currently
22 allowed an ROE below the national average in spite of delivering highly reliable service
23 to customers and residential rates 19% below the national average.
24

25 Q. **What will be OG&E's cost of capital based on the recommended ROE and capital**
26 **structure?**

27 A. OG&E's current capital structure includes 47% long-term debt with a weighted average
28 cost of 5.32% and 53% equity. At the recommended 9.90% ROE the overall rate of return
29 ("ROR") would be 7.76%.

1 Q. **Does OG&E have other witnesses that will be discussing ROE?**

2 A. Yes. Steve Merrill, the Company's Chief Financial Officer, discusses how ROE affects
3 OG&E's planning and cost of capital as well as its impact on our customers and the
4 community. Dr. Russell Evans, from Oklahoma City University, provides his perspective
5 on the broad economic principles that will be considered by the Commission in this case
6 and discusses the importance of the decision in this case to both OG&E's customers and
7 the entire state. He also measures the economic impact of a financially strong, locally
8 headquartered utility to the state.

9
10 Q. **Why is a reasonable ROE important?**

11 A. Investing in infrastructure is a long-term commitment that typically serves customers for
12 many decades. Stable and predictable authorized ROEs are important to investors who
13 are committing a significant amount of capital in these investments. In exchange for this
14 capital commitment, investors require adequate and stable returns over the life of these
15 investments.

16 A reasonable ROE is needed to obtain new financing and maintain a company's
17 financial integrity, which helps keep debt costs low, therefore, benefiting customers. An
18 authorized ROE affects a company's cash flows, credit metrics, and indicate regulatory
19 support in the jurisdiction it operates in. A reasonable ROE gives investors' confidence
20 in investing in that regulatory environment because it supports a utility's ability to attract
21 capital efficiently.

22 It is essential that the process of determining the allowed ROE provide stable,
23 predictable and adequate returns that are needed to attract the investment necessary to
24 provide quality, reliable service to customers. From the Company's perspective it allows
25 OG&E to successfully compete for capital. Investors have a choice whether to invest in
26 OG&E or other companies with similar risk profiles. OG&E is competing against other
27 utilities across the country; utilities with good credit ratings like OG&E. The importance
28 of a reasonable ROE is discussed in more detail by OG&E witness Merrill.

1 Q. **Does a reasonable ROE benefit customers?**

2 A. Yes, in several ways. First it helps keep an Oklahoma City headquartered company
3 strong and financially viable. OG&E, being headquartered in Oklahoma, has a strong
4 sense of community pride. We believe that our growth is closely aligned with the growth
5 of the communities we serve. That is why we are such active corporate citizens with our
6 volunteerism, philanthropy and other community involvement. In addition, corporate
7 headquarters provide jobs, directly and indirectly, that are not always present without the
8 headquarters itself. Also, customers know where their company is located and have more
9 accessibility than a company not located here. Witness Evans will discuss some of these
10 issues in his testimony.

11
12 Q. **Does the State of Oklahoma benefit when Oklahoma utilities have an opportunity to**
13 **earn reasonable ROEs?**

14 A. The investment community closely follows the business climate in Oklahoma including
15 regulatory actions. Their ultimate aim is to provide guidance to investors across the
16 nation and around the globe. By authorizing an ROE that is consistent with similarly
17 rated utilities and regulatory jurisdictions, the Commission sends a clear message that
18 investors will be treated fairly as compared to other similar investment opportunities.
19 Awarding a reasonable ROE sends a positive message while a lower ROE sends a
20 negative message. Prudent investors do not expect ROE's that are higher than
21 appropriate at the expense of customers since that would not be sustainable. At the same
22 time investors are not interested in providing capital for below market returns.

23
24 Q. **What happens if the Commission authorizes an ROE that is below market**
25 **expectations?**

26 A. The market will adjust the market value of OG&E's equity to reflect its expected
27 earnings as adjusted by the Commissions decisions. As further discussed by OG&E
28 witness Merrill, this will be reflected in a decrease in the price earnings ratio (PE) of
29 OG&E's stock making it a less attractive investment option.

1 Q. **Are there other ways customers benefit from a reasonable ROE?**

2 A. Yes, Witness Morin discusses the relationship between ROE and bond ratings and the
3 ultimate financial impact on customers.
4

5 Depreciation

6 Q. **Are there any changes to OG&E's depreciation rate schedules that you would like
7 to address?**

8 A. Yes. OG&E is recommending a change in depreciation expense to account for the
9 increased level of plant requested in this case as well as new depreciation rates. OG&E
10 believes that the depreciation rates set in the last rate case were too low and
11 underestimated the appropriate level of depreciation expense. The reason for these low
12 depreciation rates stem from unreasonably long service lives for certain accounts adopted
13 in the last rate case. OG&E Witness Spanos discusses the reasons why these service lives
14 are unreasonably long. The effect of those inappropriately low depreciation rates is to
15 increase customer costs in the long run. When depreciation rates are too low there
16 remains an unrecovered investment as exhausted utility assets are retired. Future
17 customers are then forced to pay rates that include the investment for new plant as well as
18 the unrecovered old investment. OG&E believes that now is the time to return to more
19 reasonable and realistic service lives so that customers will not incur higher long term
20 costs.

21 In addition to the depreciation study sponsored by OG&E witness Spanos, OG&E
22 is also providing a Fleet Decommissioning Study, which was conducted by Burns &
23 McDonnell and is supported by OG&E witness Jeffrey Kopp. Overall the change in
24 depreciation rate (including the impact on the addition of new capital), the inclusion of
25 the periodic cost of decommissioning, and the escalation of decommissioning costs to
26 reflect those that will ultimately be incurred increase Oklahoma jurisdictional
27 depreciation expenses by approximately \$67 million.

1 Q. **What is the change in depreciation expense without including the costs of**
2 **decommissioning?**

3 A. Based on the 2017 Depreciation Study, the proposed depreciation rates without
4 decommissioning would increase annual depreciation expense by approximately \$48
5 million when compared to current rates, on an annual basis.
6

7 Q. **Why is depreciation important?**

8 A. Depreciation is how the Company recovers its capital investment over the actual period
9 of time those capital assets will be serving customers. It is an important and essential
10 factor in informing investors the pace at which the Company's investors will be paid back
11 though the Company's periodic income. Depreciation decisions by the Commission
12 impact future costs to customers, and future cost recovery and cash flows to the
13 Company. Costs are allocated over the service lives of the assets so that customers' rates
14 reflect the costs of the assets over the time that those assets are used to serve those
15 customers.

16 Witness Spanos analogizes unreasonably long service lives to the extension of a
17 mortgage on a home — the longer lives ultimately increase the overall cost to customers;
18 reducing the monthly payment, but dramatically increasing the financing cost over time.
19 When service lives are overestimated and assets stay in rate base for too long a period,
20 the Company continues to earn a return on those assets and, just like paying more
21 mortgage interest, this increases the costs paid by customers over time. Based on the
22 longer service lives approved in the last rate case, the Company has calculated that
23 customers will pay significantly more than if the Commission had adopted the
24 Company's more realistic service lives for transmission and distribution assets.

25 Another analogy could be financing a car for an unreasonably long amount of
26 time. If you finance a car too long, you may continue to pay for the car when you also
27 have to begin paying for your next car. It is important to have your depreciation rates
28 reflect the actual life of the assets so customers do not have to pay for a return on assets
29 that are retired, obsolete or replaced. That is, longer depreciable lives increase the risk of
30 assets failing (or becoming functionally obsolete) prior to being recovered, thus creating

1 potential stranded cost issues with which both the Company and the Commission will
2 have to address at a later date.

3
4 **Q. Why did the Company perform the generation Fleet Decommissioning Study?**

5 A. In the last rate case, OG&E requested inclusion of decommissioning costs in its
6 depreciation rates. Decommissioning costs include the costs for dismantling,
7 demolishing, and remediating retired power plants. However, in that last rate case,
8 OG&E had not performed a detailed plant specific decommissioning study and the
9 Commission cited the lack of a detailed study as support for denying the Company's
10 request to include decommissioning costs in its depreciation expense recovery. The
11 Company then commissioned the engineering firm of Burns & McDonnell to perform a
12 Fleet Decommissioning Study to estimate the costs that the Company will incur when it
13 demolishes and dismantles those power plants and performs site restoration.

14
15 **Q. Why is it important to reflect decommissioning costs in this depreciation study?**

16 A. Retirement of OG&E's generating plants is inevitable and the decommissioning costs to
17 dismantle are reasonable costs to include in rates. By collecting these costs slowly over
18 time, OG&E can mitigate the impact on customers. Delaying the recovery of
19 decommissioning costs will only increase the burden for customers in the future when the
20 plants are no longer providing benefits.

21
22 **Q. What is the estimated annual cost of decommissioning, as demonstrated by the**
23 **Burns & McDonnell Fleet Decommissioning Study and reflected in OG&E witness**
24 **Spanos Depreciation Study?**

25 A. The estimated cost of decommissioning is approximately \$12 million.

26
27 **Q. What is escalation, as it relates to decommissioning?**

28 A. Escalation is the annual amount of the difference between the present value of the cost to
29 dismantle plant and the cost that will ultimately be incurred. Escalation accounts for
30 inflation each year of the cost of decommissioning.

1 Q. **What is the estimated cost of escalation?**

2 A. The estimated annual cost of escalation is approximately \$7 million.

3
4 Q. **OG&E Witness Spanos identifies proposed depreciation rates for new and future assets. Why is it important for the Commission to approve depreciation rates for these new and future assets?**

5
6
7 A. OG&E is asking for approval of depreciation rates to be applied to assets that have been
8 added are will be added since the Commission last approved depreciation rates. This
9 includes depreciation rates for the new Mustang CTs, the new Activated Carbon Injection
10 systems at Muskogee Units 4 and 5, as well as the scrubbers that are being installed at the
11 Sooner generating facility and the converted Muskogee coal units. When assets are
12 placed in service, they immediately begin depreciating in value. Therefore, OG&E must
13 have depreciation rates in place to properly begin recording depreciation expense.

14
15 Pension Liability Credit

16 Q. **Does OG&E have a mechanism to recognize the variability of pension expense?**

17 A. Yes. In Cause No. PUD 200500151, the Commission authorized OG&E to establish a
18 “pension tracker” which compares OG&E’s actual pension expense with the level
19 authorized by the Commission in rates. In other words, OG&E is directed to track the
20 actual level of pension expense and compare it with the level our customers pay on their
21 bills. Retiree medical expense is also treated the same way as pension expense, and
22 included in the “pension tracker”.

23 The difference between the pension expense level in rates and the actual expense
24 level is “tracked,” and the over/under recovery recorded on the balance sheet and set
25 aside to be either charged or credited to customers during a subsequent rate case. The
26 amount accumulated in the tracker to be amortized, to be returned to or collected from
27 customers, over a set amount of years determined by the Commission.

28
29 Q. **What is the current status of the Pension Tracker?**

30 A. The Pension Tracker is estimated to have a balance of approximately \$42 million at
31 March 31, 2018, the end of the *pro forma* period. This represents a regulatory liability on

1 OG&E's books. OG&E recommends amortizing this regulatory liability over 5-years.
2 Pension expenses have decreased over the last several years, in large part, due to a
3 declining number of participants in the defined benefit plan. The reduction resulted in an
4 over-recovery. The annual amortization would reduce OG&E's annual jurisdictional
5 revenue requirement by approximately \$8 million. Combined with the annual pension
6 expense reduction of approximately \$23 million and the elimination of the previous
7 pension liability amortization of approximately \$5 million, the overall reduction in
8 revenue requirement due to pension savings is approximately \$27 million. The Pension
9 Tracker is further discussed by OG&E witness Thenmadathil.

10
11 Income Tax Treatment

12 **Q. How has OG&E addressed the Tax and Jobs Act of 2017 ("TCJA" or the "Act")?**

13 **A.** OG&E has incorporated the changes in federal income tax rates and other provisions of
14 the Act in determining its revenue requirement as shown on Schedule A. The TCJA
15 creates three opportunities to reduce customer rates.

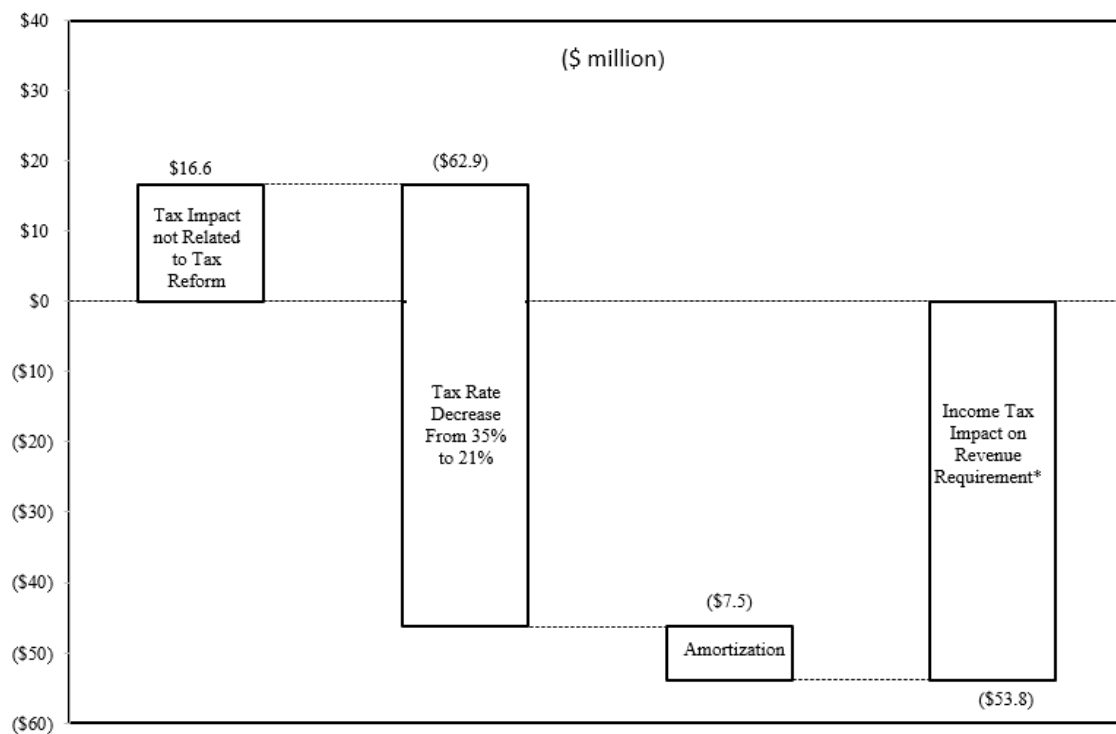
16 First, the federal corporate income tax rate has been reduced from 35% to 21%,
17 resulting in an approximate \$63 million reduction in OG&E's annual revenue
18 requirement. The new federal income tax rate is reflected in this application on the
19 schedules in Section J of the MFR package.

20 Second, OG&E's current rates for electric service reflect a 35% federal income
21 tax rate. Beginning January 1, 2018, OG&E's federal income tax rate dropped to 21%.
22 OG&E began recording a regulatory liability for the difference in the provision for
23 income taxes based on the 35% federal income tax rate and the amount that would have
24 been provided had rates been based on a 21% federal rate. In accordance with
25 Commission Order No. 671982 in Cause No. 201700569, the Company will accrue a
26 carrying charge on that liability at the 7.0667% weighted cost of capital. OG&E proposes
27 that the amount accumulated in the regulatory liability be returned to customers through
28 an income tax rider.

29 Third, OG&E has recorded accumulated deferred income taxes ("ADIT") for
30 temporary differences between book and tax income. These accumulated income taxes
31 are currently based on a 35% federal corporate income tax rate. With the passage of the

TCJA, the deferred income tax liability must be remeasured at the 21% income tax rate. OG&E has previously included the provision for deferred income taxes in determining its revenue requirement. The difference between the ADIT balance previously recorded and the remeasured amount should be recorded as a regulatory liability. OG&E's billed revenues will be lower in the future as a result of returning excess deferred income taxes to customers. The regulatory liability should be grossed up for the income tax benefit that OG&E will realize. This regulatory liability, when grossed up for income taxes, is approximately \$1 billion. The current year turnaround of the excess deferred income taxes results in a reduction to OG&E's revenue requirement of approximately \$7 million.

Chart 2: Income Tax Impact on Revenue Requirement



* Excludes income taxes and Investment Tax Credits related to Mustang combustion turbines

Q. How will this regulatory liability for excess deferred income taxes be returned to OG&E's customers?

A. OG&E will follow the normalization provisions of Section 203 (e)(2)(B) of the 1986 Tax Reform Act that prescribes the Company use the Average Rate Assumption Method ("ARAM"). OG&E's revenue requirement will be reduced in the year that the temporary differences that gave rise to the accumulated deferred income taxes turnaround. Revenues

1 will decrease by the difference between the rate used to accrue them (35%) and the tax
2 rate used to determine how much will be paid (21%).
3

4 **Q. Does the level of book/tax differences turning around stay constant?**

5 A. No. The level of temporary differences turning around will slowly increase over time. As
6 more vintage year additions reach the point where book depreciation expense exceeds tax
7 depreciation.
8

9 **Q. How does OG&E propose handle this increase in the turnaround of excess deferred**
10 **income taxes?**

11 A. OG&E proposes to record the difference between the level of turnaround of excess
12 deferred income taxes included in rates and actual level that occurs in subsequent years as
13 a regulatory liability. OG&E further proposes that the amount accumulated in the
14 regulatory liability be returned to customers monthly using the proposed Federal Tax
15 Change and Production Tax Credit ("FTCPTC") Rider, which is discussed more fully by
16 OG&E witness Cash.
17

18 **Q. Will the Company retain any benefits from the tax changes and are customers**
19 **harmed by your treatment?**

20 A. No. The Company's approach to incorporating the tax changes into our filing preserve for
21 our customers all the benefits of the federal tax rate reduction beginning on January 1,
22 2018, the effective date of the new law.
23

24 **Q. When will customers begin to recognize the benefits of the tax changes?**

25 A. The Company will begin tracking the benefits of lower tax rates effective January 1,
26 2018. Customers will begin to recognize the benefits of the lower tax rates when new
27 rates are implemented in this Cause.

1 Q. **What will be included in the FTCPTC rider?**

2 A. The Rider will include three factors, which are:

- 3 1. Federal Tax Change (“FTC”) factor,
- 4 2. Amortization of the Regulatory Liability (“ARL”) factor, and
- 5 3. Production Tax Credit (“PTC”) factor.

6 The mechanics and a copy of the proposed FTCPTC rider are attached and discussed in
7 detail in the direct testimony of OG&E witness Cash.

8
9 Q. **What is a PTC?**

10 A. A PTC is a tax credit which reduces the income taxes of qualified tax-paying owners of
11 renewable energy projects based on the electrical output (measured in kilowatt-hours, or
12 kWh) of grid-connected renewable energy facilities. The PTC is an incentive that
13 provides financial support for development of renewable energy facilities. Companies,
14 like OG&E, that generate electricity from wind, or other renewables are eligible for a
15 federal PTC for the first ten years of renewable energy facility's operation. Currently,
16 this PTC incentive is \$0.024 per kWh. The Oklahoma state PTC provides a \$0.0025 per
17 kWh incentive for facilities placed in service prior to January 1, 2007 and a \$0.005 per
18 kWh incentive for facilities placed in service after January 1, 2007. PTCs have been used
19 to reduce the income tax expense component of the Company's cost of service and the
20 PTC's have been used to reduce the cost recovered through individual project riders.

21
22 Q. **Were PTCs addressed in OG&E's last rate case?**

23 A. Yes. In Cause No. 201500273, Final Order 662059, the Commission allowed recovery
24 through the Fuel Clause Adjustment for those PTCs associated with Centennial Wind
25 Farm, expiring in 2017. However, the Commission found that the ratemaking treatment
26 for all subsequently expiring PTCs should be addressed in a subsequent rate case or some
27 other proceeding.

28
29 Q. **What treatment is OG&E requesting for Production Tax Credits (“PTCs”)?**

30 A. OG&E is requesting that a rider be established to track the difference between the PTCs
31 customers are receiving in base rates versus the actual PTCs received from the OU Spirit

1 and Crossroads wind farms operations. The purpose of this rider is to account for the
2 variability of PTCs due to the fluctuating wind generation and plan for the scheduled
3 expiration of the PTCs associated with OU Spirit and Crossroads facilities.
4

5 **Q. Are there any other reasons for this change?**

6 A. Yes. As mentioned above, the PTCs are available for the first ten years of production
7 from the facility. Beginning in the eleventh year, the PTCs are no longer available. By
8 implementing this PTC rider, the level of PTCs credited to customers can be adjusted to
9 reflect the actual level of credits being generated.
10

11 **Q. Does this change impact the revenue requirement requested in this Cause?**

12 A. No. There is no impact to revenue requirement in this Cause.
13

14 **Q. When do the PTCs for OU Spirit and Crossroads expire?**

15 A. OU Spirit PTCs expire in December of 2019, while the last of the Crossroads PTCs will
16 expire in March of 2022. By establishing a rider now, the Company can accurately
17 reflect the PTCs being earned each month. If the current treatment of PTCs is left
18 unchanged, once the credits begin to expire, customers will be receiving the benefit,
19 while the Company no longer receives the tax credit. The mechanics of the proposed
20 FTCPTC Rider is fully discussed by OG&E witness Cash.
21

22 **Q. Will customers benefit from this change?**

23 A. Although the intent of this rider is to capture the impact of the expiration of PTCs
24 associated with OU Spirit and Crossroads, customers could benefit, in the short term,
25 when the level of PTCs generated each year are greater than the level estimated in base
26 rates.
27

28 Environmental Compliance

29 **Q. Is OG&E recommending a regulatory asset for Environmental Compliance?**

30 A. Yes. In Cause No. PUD 201600059, Final Order No. 652208, OG&E's plan to comply
31 with the requirements of Regional Haze by installing dry scrubbers, at Sooner Units 1

1 and 2, was approved. OG&E is asking for deferred accounting treatment for the
2 environmental compliance assets and operating costs of the scrubber assets on its Sooner
3 Units 1 and 2, which are planned to be used and useful in 2018.
4

5 **Q. What is OG&E asking for in this regulatory asset?**

6 A. The Company will accrue a regulatory asset consisting of the non-fuel operation and
7 maintenance expenses, depreciation, cost of capital associated with the capital investment
8 and ad valorem taxes related to the scrubber assets. Elements used to calculate the
9 regulatory asset will be subject to the Commission order in this Cause such as
10 depreciation rates, ROE, and capital structure.
11

12 **Q. What impact will this have on rates in this Cause?**

13 A. None. The regulatory asset will accrue the aforementioned costs and will impact rates
14 when it is presented in OG&E's next general rate case.
15

16 Incentive Compensation

17 **Q. Does the Company believe it should be able to recover the costs of all compensation**
18 **that it pays to its employees?**

19 A. Yes. OG&E pays its employees a total compensation package composed of a base salary
20 and incentive compensation. An attractive total compensation package allows OG&E to
21 be competitive in the job market and attract and retain the necessary people to provide
22 excellent service to our customers. As explained by OG&E witness Ruden, if the
23 Company did not offer short-term incentive compensation, OG&E's total compensation
24 levels would be 12.3% below market. OG&E must provide market-based compensation,
25 which includes attractive incentive compensation.
26

27 **Q. Could OG&E just increase base salaries and remove incentive compensation from**
28 **its compensation packages altogether?**

29 A. Yes, but this is not a very attractive option. We strongly believe that it is important to
30 link a portion of compensation to performance. Incentive compensation allows
31 individual employees to be rewarded when they help the Company succeed in operating

1 under safe conditions, achieving improvements in customer satisfaction, managing O&M
2 costs, and generally running the utility well. While OG&E could just pay a base salary at
3 a higher level, it would remove this important link between employee compensation and
4 individual and Company performance.

5
6 **Q. Does it make sense that the Commission has continually excluded incentive**
7 **compensation from rates?**

8 A. No. In every rate case, OG&E has asked for recovery of the total amount of
9 compensation that it pays OG&E employees. Despite evidence that this incentive
10 compensation is necessary to attract and retain employees and to keep up with market
11 compensation practices, the Commission routinely disallows 100% of long-term
12 incentive compensation and 50% of the short-term incentive compensation. No party has
13 ever even taken issue with the level of total compensation or has challenged OG&E's
14 need to pay incentive compensation. Those parties just do not want incentive
15 compensation included in rates. The rationale for exclusion these reasonable and
16 necessary costs comes from the use of some financial metrics in assessing performance.

17
18 **Q. Does the Company agree with the rationale for such a disallowance of incentive**
19 **compensation from rates?**

20 A. No. Incentive compensation is a very necessary and reasonable expense for the utility. It
21 makes little sense to disallow those necessary expenses because some of the metrics are
22 financial in nature and involve a review of the Company's financial performance. As
23 OG&E Witness Ruden discusses, these financial metrics simply indicate how well run
24 the Company is and they end up benefiting customers as well. Disallowance simply
25 penalizes the Company for paying its employees compensation amounts that are required
26 by the market.

27
28 **Q. Do financial metrics even constitute 50% of the short-term incentive compensation**
29 **performance measures?**

30 A. No. Even if the Commission were to limit the amount of short-term incentives included
31 in rates, 50% reduction does not reflect the amount of financial metrics used in the

performance measures. A more accurate breakdown between operational and financial metrics is more like 75% and 25%, respectively.

Q. What is OG&E requesting with regard to the recovery of incentive compensation in this proceeding?

A. The Company is asking for the inclusion of 100% of its short term incentive compensation in rates. The Company is not seeking inclusion of long term incentive compensation ("LTI") in rates in this proceeding. While OG&E believes that recovery of costs associated with LTI is appropriate, the Company is not requesting recovery of LTI at this time. The Company reserves the right to seek recovery of LTI in future rate review proceedings.

INTRODUCTION OF OG&E WITNESSES

Q. Please identify the OG&E witnesses and purposes of their testimonies.

A. Table 2 lists OG&E's witnesses and a brief description of the purpose of each testimony.

Table 2: OG&E Witness List

Witness	Title	Purpose of Testimony
Donald R. Rowlett	Managing Director, Regulatory	Identifies each of the Company witnesses, outlines the relief requested, explains why OG&E is seeking a rate increase at this time and discusses key issues such as environmental compliance, customer options, and ROE.
Roger Morin, Ph.D.	Emeritus Professor of Finance at the Robinson College of Business, Georgia State University and Professor of Finance for Regulated Industry at the Center for the Study of Regulated Industry at Georgia State University. Principal in Utility Research International.	Provides independent analysis of the Company's cost of equity and recommends an allowed rate of return on equity ("ROE") in the range of 9.3% to 10.7% to allow the Company to both attract capital on reasonable terms and maintain financial strength.
Russell R. Evans, Ph.D.	Associate Professor of Economics, Oklahoma City University, Executive Director of the Steven C. Agee Economic Research and Policy Institute, and Director of the Center for Regional Economic Forecasting and Policy Analysis	Highlights the broad economic principles that will be considered in this case and discusses the importance of the case to the state economy.
Stephen Merrill	Chief Financial Officer	Explains how the authorized Return on Equity ("ROE") granted in this cause will be vitally important to OG&E's future operations and to the customers we serve.
Robert J. Burch	Director, Power Supply Services	Describes the Company's decision to retire the old Mustang units and to implement its Mustang Modernization Plan and the Company's contracting

		and construction processes
Gregory McAuley	Director, RTO Policy & Development	Describes why, the Mustang site provides unique reliability benefits to the transmission system and why those benefits are important for both daily operations and system restoration situations, which is important to OG&E and its customers.
Leon Howell	Director, Resource Planning & Investment	Describes the 2014 Integrated Resource Planning process that was relied upon to develop OG&E's generation plan for resource needs
Lanny Nickell	Vice President of Engineering for the Southwest Power Pool, Inc.	Supports Witness McAuley's testimony by providing SPP's perspective on why CTs at Mustang are needed for reliable transmission operations
Phillip Webster	Associate Vice President, Black & Veatch	Describes the study conducted by Black & Veatch which supports OG&E's decision to retire the existing Mustang units
John Spanos	Senior Vice President, Gannett Fleming Valuation and Rate Consultants, LLC	Sponsors the Company's Depreciation Study.
Jeffery Kopp	Manager, Business Consulting for Burns and McDonnell	Sponsors the Company's Decommissioning Study.
Patricia Ruden	Director, Total Rewards	Supports the reasonableness of OG&E's compensation plans and practices.
Jason J. Thenmadathil	Senior Regulatory Accountant	Sponsors the Company's <i>pro forma</i> adjustments to operating expense and to remove rider cost from the test year in Schedule H.
Jason Bailey	Director, Revenue Requirements	Sponsors the Company's <i>pro forma</i> adjustments to rate base in Schedule B.
Seth Knight	Senior Cost analyst	Sponsors the <i>pro forma</i> revenue and sales adjustments to Schedule H
Shawna Satterwhite	Lead Cost Analyst	Supports the Company's development of the jurisdictional and class allocations and class cost of service studies.
Gwin Cash	Manager, Cost of Service and Rate Administration	Supports tariff changes, modifications, and additions.
Bryan J. Scott	Director, Pricing and Load Research	Describes the goals, principles and information sources that impact development of OG&E's rate design.
William H. Wai	Manager, Pricing	Sponsors OG&E's proof of revenue (Schedule M-4) and updated tariffs (Schedule N).

IV. CONCLUSION

Q. Do you have any concluding remarks?

A. Yes. OG&E is a company with rates well below the national average, offers electric service that is highly reliable and has customers who repeatedly rank the Company as the best in the region and among the best in the nation. For a relatively small investor-owned electric utility, OG&E is recognized in the electric utility industry as being a leader. The

1 Company gained those distinctions through hard work, good planning, innovative
2 thinking and a strong focus on the customer in all that it does.

3 OG&E comes before the Oklahoma Corporation Commission with the request to
4 increase rates and I believe the requested rate increase is fair, just and reasonable and in
5 the public interest, OG&E respectfully requests that this increase in rates be granted.
6

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

8 A. Yes.