

**BEFORE THE
CORPORATION COMMISSION OF THE STATE OF OKLAHOMA**

IN THE MATTER OF THE APPLICATION OF)
OKLAHOMA GAS AND ELECTRIC COMPANY)
FOR AN ORDER OF THE COMMISSION)
GRANTING PREAPPROVAL OF THE PURCHASE)
OF THE REDBUD GENERATING FACILITY)
AND AUTHORIZING A RECOVERY RIDER)

CAUSE NO. PUD 200800086

Direct Testimony

of

Jesse B. Langston

On behalf of

Oklahoma Gas & Electric Company

March 20, 2008

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CORPORATION COMMISSION
OF OKLAHOMA

I. INTRODUCTION

1
2 **Q. Please state your name, your employer, and your business address.**

3 A. My name is Jesse B. Langston. I am employed by Oklahoma Gas and Electric Company
4 ("OG&E" or "Company") and my business address is 321 N. Harvey, P. O. Box 321,
5 Oklahoma City, Oklahoma 73101.
6

7 **Q. What position do you hold with OG&E?**

8 A. I hold the position of Vice President of Utility Commercial Operations. I have served in
9 this capacity for over 2 years. Prior to assuming my current duties, I served as Director
10 of Corporate Planning for OGE Energy Corporation for approximately four years where
11 my primary duties were to lead the Company's corporate and business strategy
12 development. My current responsibilities include the Company's resource planning
13 efforts. The resource planning team assesses OG&E's power supply requirements and
14 evaluates the resources needed to meet these requirements at the lowest reasonable cost,
15 with due consideration of risk factors.
16

17 **Q. Please summarize your professional experience and educational background.**

18 A. I have been employed by OG&E since 1985. I have over 20 years of experience in the
19 electric utility industry in various areas including corporate planning, business planning,
20 engineering, transmission, distribution, metering, end-use forecasting, load forecasting,
21 telecommunications, corporate marketing, demand-side management and generation
22 planning. Over the past few years, I have led a number of significant initiatives within
23 the Company including the acquisition of McClain and the development of Centennial, a
24 state-of-the-art 400MW natural gas combined cycle plant and a 120MW wind farm,
25 respectively.
26

27 I hold an MBA from Oklahoma City University (May 2002) and a Bachelor of Science
28 degree in Electrical Engineering from Oklahoma State University (1985).

1 Q. **Have you testified previously before the Oklahoma Corporation Commission**
2 **("Commission")?**

3 A. Yes. I have testified before the Commission on several occasions that are each related to
4 OG&E's power supply planning activities. I first testified in Cause No. PUD 200300564
5 related to a request by PowerSmith for purchased power rates and a power purchase
6 contract with OG&E. I testified in Cause No. PUD 200500151 regarding the decision-
7 making process that led to OG&E's acquisition of a 77 percent ownership interest in the
8 combined cycle, gas-fired McClain generating facility. I testified in Cause No. PUD
9 200500059 regarding OG&E's request for approval to construct the Centennial Wind
10 project. Most recently, I testified in Cause No. PUD 200700012 regarding OG&E's
11 application for preapproval of joint development and ownership of Red Rock, a 950 MW
12 ultra-supercritical coal plant.

13
14 Q. **Please describe the transaction that is the subject of this proceeding.**

15 A. On January 21, 2008 OG&E, with two partners, Grand River Dam Authority (GRDA)
16 and the Oklahoma Municipal Power Authority (OMPA) entered into agreements to
17 acquire the 1,230 MW Redbud generating plant from Kelson Holdings, LLC ("Kelson")
18 for \$852 million. These agreements ("the transaction") were the end-products of a
19 competitive sales process conducted by Kelson's investment bank, Goldman Sachs.

20
21 Q. **What is the purpose of your testimony in this proceeding?**

22 A. I will provide an overview of the transaction in which OG&E has agreed to purchase a
23 51% interest in the Redbud plant. My testimony in this proceeding will address three
24 major areas. First, I will describe the Redbud plant, key commercial terms and the
25 regulatory approvals that OG&E requires to close the transaction. Second, I will review
26 the business rationale and decision-making process utilized by OG&E during the bid and
27 negotiation process. Finally, I will identify and describe benefits that will accrue to
28 OG&E's customers from acquiring a controlling interest in Redbud.

1 Q. **What was your role in this transaction?**

2 A. I was responsible for the overall Redbud transaction and my involvement included
3 participation in the bid, due diligence and negotiation phases of the process. The
4 Resource Planning Department reports to me and consequently I provided direction to
5 that group during the process.

6
7 Q. **Are there any other OG&E witnesses supporting the acquisition of Redbud?**

8 A. Yes. OG&E is sponsoring the testimony of six other witnesses, as shown in the following
9 table.

10

Table 1
Other OG&E Witnesses

Witness	Title	Testimony Areas
Jim Hatfield	Chief Financial Officer and Senior Vice President	Relief sought by the Company, including revenue recovery mechanisms
John Reed	Chairman and CEO of Concentric Energy Advisors ("CEA")	Current market environment and an independent valuation of the Redbud plant
Leon Howell	Manager Resource Planning	Resource planning analysis supporting the transaction
John Wendling	Vice President Power Supply	Operational characteristics and benefits of Redbud
Phil Crissup	Director Transmission Policy	Federal Energy Regulatory Commission ("FERC") regulatory approval process and discuss the potential for market power mitigation transmission investments
Roger Walkingstick	Director Costing & Pricing	Redbud recovery rider, revenue requirement true-up and customer impact

11

12 Q. **Please summarize the major factors which led to OG&E's decision to acquire an**
13 **interest in the Redbud plant.**

14 A. As addressed in my testimony and the testimony of other OG&E witnesses, our decision
15 to acquire a 51% interest in Redbud was based on several factors:

- 1 1. The Redbud transaction price represents the lowest reasonable cost to our
2 customers, as supported by our resource planning analyses, extensive due
3 diligence, and third-party plant valuations. The Redbud transaction price of \$852
4 million (\$693/kw) is approximately 24% less than the cost of new construction;
5 current estimates for combined cycle plants exceed \$900/kw. In addition, the
6 Redbud plant represents "iron-in-the-ground" capacity that is not subject to
7 development and construction cost risks.
- 8
- 9 2. The purchase allows the Company to acquire a relatively new, highly efficient gas
10 fired generation plant that will enable us to meet our growing load obligations.
11 Due in part to the Commission's Red Rock decision, Order No. 545240, dated
12 October 7, 2007, and the uncertainties attributable to future environmental
13 regulation, it is apparent that our next capacity addition would be a gas-fired
14 option, whether it be the result of a new build, acquisition or purchase power
15 agreement ("PPA").
- 16
- 17 3. The facility is ideally located within our service area with adequate transmission
18 capability to deliver into the OGE system.
- 19
- 20 4. The acquisition of Redbud will enhance reliability of supply for our customers
21 and lower our production costs by allowing dispatch of this facility ahead of
22 older, less efficient units. It also complements our planned expansion of wind
23 energy and DSM programs.

24
25 Section IV of my testimony is devoted to describing these benefits in detail.

26
27 **II. TRANSACTION SUMMARY**

28 **Q. Please summarize the Redbud transaction.**

29 **A.** On January 21, 2008, the Company entered into a Purchase and Sale Agreement ("PSA")
30 to acquire 100% of Redbud Energy LP, from three entities controlled by Kelson. Redbud
31 Energy LP's principal asset is the Redbud generating facility located near Luther,
32 Oklahoma.

1 Immediately upon closing the purchase, OG&E will dissolve Redbud Energy LP and sell
2 a 49% undivided interest of the plant through an Asset Purchase Agreement (“APA”) to
3 OMPA and GRDA, which will own a 13% and 36% undivided interest in the plant. The
4 purchase from Kelson will not close unless OMPA and GRDA have each deposited their
5 respective purchase price amounts in an escrow account. After these two transactions are
6 completed, OG&E will retain a 51% undivided interest in Redbud or 627 MW based on
7 the nameplate capacity.

8
9 The new owners have agreed to pay Kelson \$852 Million or \$693/kW, subject to a net
10 working capital adjustment. OG&E’s portion of the unadjusted purchase price is \$434.5
11 million. The APA mirrors the PSA in all material respects with the exception of Article
12 IV, which provides that OMPA and GRDA must rely on the representations and
13 warranties made by Kelson to OG&E and they cannot look to OG&E to enforce those
14 commitments on their behalf. A third agreement, the Ownership & Operating Agreement
15 (“O&O Agreement”), governs the ownership and operation of the Redbud facility
16 following the consummation of the transaction.

17
18 **Q. Please describe the Redbud generating facility.**

19 **A.** Redbud is 1,230 MW gas-fired combined-cycle plant located near Luther, Oklahoma and
20 situated on 320 acres of land. The plant uses four GE 7FA combustion turbines with a
21 heat recovery system comprised of four additional steam turbines. These eight turbines
22 are supplemented with four duct burners that boost the output of the plant to meet peak
23 demand conditions. Accordingly, this configuration allows Redbud to serve base-load,
24 mid-merit and peaking needs based on the dispatch needs of our portfolio. Redbud
25 completed operational testing in 2003 and began commercial operations in May 2004.
26 Redbud is interconnected to OG&E's transmission system and relies on transmission
27 services arranged by the Southwest Power Pool (“SPP”) and is governed by the FERC.
28 Redbud is also interconnected to ONEOK Partners, LP's interstate gas transmission
29 system. Energy management services are currently provided by Westar Energy, Inc. and
30 plant operations are performed by North American Energy Services Company. Redbud

1 has long-term agreements with General Electric International, Inc. OG&E witness John
2 Wendling discusses these agreements in more detail.

3
4 **Q. Does OG&E have experience with the Redbud plant?**

5 A. Yes. As noted above, Redbud is located within our operating control area and is a
6 transmission service customer of OG&E. In 2003, before Redbud began commercial
7 operations, OG&E discussed a potential acquisition of the Redbud plant with Intergen,
8 the previous owner, before ultimately acquiring the McClain plant. Finally, OG&E has
9 purchased energy and capacity from Redbud since 2005, most recently under a Purchase
10 Power Agreement ("PPA") for 300 MW to meet OG&E's 2008 and 2009 load
11 requirements.

12
13 **Q. Did OG&E perform any tests on the Redbud units?**

14 A. Yes. As part of OG&E's due diligence process, OG&E retained the services of
15 Mechanical Dynamics and Analysis, LTD to perform an operational test on January 8,
16 2008. The operational test results indicate that the Redbud plant meets or exceeds
17 performance design. John Wendling, Vice President of Power Supply at OG&E, will
18 describe the results of this test more fully in his testimony.

19
20 **Q. Is the closing of the transaction subject to any regulatory conditions?**

21 A. Yes. In addition to several customary commercial closing conditions detailed in Article
22 VII of the PSA and certain conditions imposed on GRDA and OMPA by law, the closing
23 is subject to: (1) receipt of an order from FERC authorizing the transactions contemplated
24 by the PSA and APA pursuant to Section 203 of the Federal Power Act; (2) an order from
25 this Commission recognizing the prudence of the transactions; and (3) an order by the
26 Commission approving a cost recovery mechanism. The order must be "reasonably
27 satisfactory" to OG&E both as to form and substance.

28
29 **Q. Can the agreement to acquire Redbud be terminated?**

30 A. Yes. The PSA can be terminated by mutual written consent of the purchaser and seller.
31 The agreement also allows either party to terminate if the closing has not occurred on or

1 before 300 days after the execution of the PSA. The termination date can be extended
2 beyond 300 days in the seller's sole discretion not to exceed 180 days if the conditions
3 that I have just described are not satisfied.
4

5 **Q. How will the plant be operated between the execution of the transaction agreements**
6 **and the closing date?**

7 A. The current owners of Redbud will continue to operate the plant until the transaction
8 closes and ownership changes hands. However, the buyers have negotiated terms in the
9 PSA that ensure that the value of the asset is maintained during this period. For example,
10 the seller cannot sell any material assets materially change the level of inventory, enter
11 into power or fuel contracts for terms longer than one year from the signing date, except
12 if contracts are with any of the three purchasers (and then, only up to their pro rata share
13 of the output of the facility).
14

15 **Q. How will major capital investments and operating decisions be made by the new**
16 **owners?**

17 A. The O&O agreement governs the ownership and operation of the Redbud facility
18 including, but not limited to Governance, Defaults, Dispute Resolution, Operations,
19 Limits on Liability and Fuel Procurement. OG&E will be Operations Manager with
20 oversight from an Executive Committee with representation by each owner of the plant in
21 accordance with each owner's respective ownership share. However, major issues, such
22 as material changes to the Operations & Maintenance Agreement or other material
23 contracts, require a "supermajority" (+60%) approval. This effectively requires that
24 OG&E and at least one other owner to approve these supermajority decisions.
25

26 **III. OG&E's DECISION-MAKING PROCESS**

27 **Q. When did OG&E learn of the opportunity to acquire Redbud?**

28 A. In late October 2007, OG&E was contacted by UBS Investment Bank ("UBS") who
29 informed OG&E of an ongoing auction process to sell a package of Kelson assets that
30 included Redbud. The process was being conducted by Goldman Sachs. OG&E
31 subsequently executed a confidentiality agreement with Kelson and was provided with

1 the offering memorandum and limited access to the transaction data room. Kelson's
2 offering memorandum described a plan to sell four natural gas combined cycle plants as a
3 package. However, OG&E expressed an interest in the Redbud facility on a stand-alone
4 basis and Kelson agreed to consider a bid for Redbud separately from the rest of the
5 portfolio.

6
7 **Q. What factors contributed to OG&E's decision to pursue making a bid for Redbud?**

8 A. Redbud's location within OG&E's control area, the age of the Redbud plant and OG&E's
9 reliance on Redbud for energy through the years was reason enough to spark our interest
10 in the sale process. OG&E's analysis indicated that we had a need for capacity in a time
11 frame that could be met by an acquisition of Redbud. OG&E had been counting on its
12 proposed Red Rock plant to meet this need until the Commission decision in Cause No.
13 PUD 200700012. As described by Leon Howell in his testimony, OG&E concluded,
14 after the Red Rock decision, that natural gas-fired capacity, through a PPA, a new build
15 or acquisition, was the most viable capacity option within the next five years. We were
16 aware that Redbud has the operational flexibility to serve a range of needs throughout the
17 year including base load, peaking and mid-merit needs. In particular, we recognized that
18 Redbud's operational capabilities would complement our prospective investments in
19 wind energy.

20 In addition, the Redbud plant represents "iron-in-the-ground" capacity that is not subject
21 to development and construction cost risks. It also has interconnections to natural gas and
22 electric transmission facilities that can be costly infrastructure for new plants. More
23 importantly, we expect purchase power costs to increase substantially and become
24 volatile due to the tightening of the SPP market, a situation has been aggravated by the
25 cancellation of planned coal plants. Finally, capacity needs vary within the SPP and we
26 believe the market in OG&E's service territory is much tighter than the SPP as a whole.

27
28 **Q. OG&E has an agreement to purchase power from Redbud through 2009. Why did
29 OG&E feel it was important to pursue purchasing the plant in this auction process?**

30 A. If another entity purchased Redbud or the present owners refinanced their debt, it is not
31 clear when, if ever, OG&E would have another opportunity to acquire Redbud. The

1 Kelson sales process represents a potential one-time opportunity for OG&E to lock in
2 value for its customers. In short, I believe it would have been irresponsible for OG&E not
3 to participate in this process given the capacity shortage in our service territory and other
4 factors that I have described.

5
6 **Q. Please describe in detail the timeline of the Kelson process.**

7 A. As I have said, OG&E's involvement in Kelson's auction process began in late October
8 2007. The timing communicated by Goldman Sachs, the seller's financial advisor,
9 required OG&E to move quickly. We executed a Confidentiality Agreement on
10 November 9th and were provided with the Offering Memorandum documents at that
11 time. OG&E submitted a first round bid on November 15, 2007. The Company's
12 transaction team was granted expanded on-line access to the data room on November 26,
13 2007 and received a briefing from Kelson's top management two days after that. We
14 conducted an official site visit on December 6, 2007.

15
16 Simultaneously, OG&E was evaluating potential partners in the transaction. This led to
17 the December 7, 2007 Memorandum of Understanding ("MOU") with GRDA and
18 OMPA. On behalf of the newly formed partnership arrangement, OG&E submitted a
19 second bid (along with a marked-up draft of the proposed PSA) on December 18, 2007.
20 Due diligence took place throughout this timeframe and continued through the month of
21 negotiations that ultimately resulted in executed transaction agreements on January 21,
22 2008.

23
24 **Q. Did OG&E consider using a competitive bid process to evaluate alternatives to the
25 acquisition of Redbud?**

26 A. Yes. The Company fully understands the valuable information a competitive bid process
27 provides the Commission as it considers the prudence of the purchase of any new
28 resource. In addition, the RFP process is equally helpful to OG&E's decision makers
29 when considering complex acquisition decisions.

1 However, an RFP process to support a long-term resource commitment can easily take up
2 to 8 months from design of the RFP to execution of an agreement with the winning
3 bidder(s); and an RFP consistent with the Competitive Procurement Rules certainly
4 cannot be carried out in 30 to 45 days. Consequently, there was simply no time to
5 conduct a competitive solicitation and comply with the accelerated schedule imposed by
6 the seller.

7
8 Instead of an RFP, the Company relied on various market analyses and evaluations by an
9 independent expert to determine the appropriate sale price for Redbud. These analyses
10 are described more fully later in my testimony. As I have already stated, John Reed's
11 testimony will describe his evaluation.

12
13 **Q. Why did OG&E begin discussions with potential partners?**

14 A. OG&E understood that it could not purchase 100% of the plant. We also knew that other
15 load serving entities in Oklahoma were likely in a similar situation. OG&E contacted
16 OMPA who is currently our partner in the McClain plant. We have had an outstanding
17 business relationship OMPA and believed that they would have an interest in partnering
18 again on this opportunity. OG&E then contacted GRDA who we saw as a logical partner
19 on this project. This is our first opportunity to enter into a business arrangement with
20 GRDA and I am confident they will be good partners as well.

21
22 **Q. What types of customers are served by GRDA and OMPA?**

23 A The GRDA serves 21 cities, 1 distribution cooperative, 2 public power joint action
24 agencies representing approximately 105 municipalities and approximately 80 industrial
25 customers located primarily in the Mid America Industrial Park. OMPA serves 35 cities
26 or about 230,000 electric consumers throughout the State of Oklahoma. Both GRDA and
27 OMPA believe Redbud is critical for long term reliability at a reasonable cost to their
28 Oklahoma customers.

29
30 **Q. Did the partners retain the services of any outside advisors?**

1 A. Yes. UBS was retained by OG&E, OMPA and GRDA due to the market knowledge and
2 experience of its Power and Utilities team. The UBS team also had direct experience
3 working with Kelson and a keen understanding of Kelson's transactional needs. The
4 partners retained Sargent & Lundy LLC to conduct an independent engineering
5 assessment of the facility as part of the operational plant due diligence. Sargent & Lundy
6 is a leading provider of services to the fossil fuel industry and expert in the design,
7 construction and operation of gas-fired power plants. The partners also retained
8 Mechanical Dynamics and Analysis LTD to perform an operational test to confirm the
9 operational characteristics of the plant.

10
11 In addition, OG&E retained CEA to perform an independent external market valuation of
12 the Redbud plant that was completed before we executed the transaction agreements.
13 CEA is a leading energy consulting firm and has been identified by SNL Financial as
14 among the top ten financial advisors in energy transactions over the past four years. Mr.
15 John Reed describes this analysis in detail in his testimony.

16
17 **Q. What did OG&E bid in the first round?**

18 A. OG&E submitted a price range of \$680/kW to \$740/kW in the first round.

19
20 **Q. How was this range determined?**

21 A. The Company elected to submit its bid in the form of a range that would allow us to
22 adjust our final bid as we learned more through the due diligence process and our
23 ongoing resource planning analyses. We utilized several sources of information in
24 establishing our initial bid range. The data points included an internal analysis calculated
25 by OG&E based on information provided by Kelson (\$675/kW), a valuation performed
26 by ICF on behalf of Kelson (\$688/kW), a portfolio valuation analysis prepared by
27 OG&E's resource planning group (\$723/kW-\$848/kW, including risk); a comparable
28 sales analysis provided by UBS (\$799/kW in the most recent period), and an internal
29 OG&E estimated new build construction cost based on Burns & McDonnell estimates
30 (\$904/kW).

1 Q. **Please describe the due diligence effort conducted by OG&E?**

2 A. After our initial bid was accepted, OG&E formed an extensive due diligence team that
3 produced a report detailing its findings. The team examined several areas including, but
4 not limited to organizational structure, material contracts, credit agreements, fuel supply,
5 electric transmission, operations and maintenance, insurance, tax, regulatory, information
6 technology, real estate, environmental and human resources issues.

7

8 Q. **Did the Company also review potential new transmission costs?**

9 A. Yes. There are two potential sources of new transmission costs throughout the bid
10 process. First, additional transmission investments may be required to allow the owners
11 to receive 100% of their pro-rata output of the plant. The actual investment, if any, will
12 be determined by the SPP as part of their review of the partners' requests for transmission
13 service. The SPP will also determine the allocation of these costs to the partners based on
14 its transmission analysis. Second, additional transmission costs may result from the
15 FERC Section 203 filing. Both issues are discussed in the testimony of Phil Crissup. I
16 should note that OG&E expects that its share of any transmission investment required by
17 the SPP will not be a significant factor in the transaction.

18

19 Q. **How did OG&E arrive at the final price that it was willing to pay for Redbud?**

20 A. OG&E based its decision on the results of due diligence, our assessment of the fair
21 market value of the plant, OG&E's internal resource planning analyses and comparable
22 market sales. Based on the above factors and advice from our advisor, UBS, the owners
23 elected to remain at the low end of our initial indicative bid range, at \$852 million or
24 \$693/kW, subject to a working capital adjustment. Before executing the transaction
25 agreements, CEA completed a market valuation that provided an independent
26 confirmation of the reasonableness of the final price offered to acquire Redbud.

1 **IV. CUSTOMER BENEFITS**

2 Q. **What will you address in this section of your testimony?**

3 A. I will present a discussion of the many benefits to OG&E's customers of completing the
4 acquisition of Redbud. I have referred to these benefits throughout my testimony but
5 they are gathered in this section and, in certain cases, expanded upon.
6

7 **1. Redbud is an Excellent Plant and is Relatively New**

8 Q. **Why is Redbud an excellent plant to own and operate?**

9 A. During its less than four-year operating life, Redbud has been primarily serving the mid-
10 merit and peak load requirements of its contract customers, including OG&E. More
11 importantly, our due diligence revealed that Redbud has not experienced any operating or
12 maintenance issues that were not correctly addressed and that periodic maintenance has
13 been performed in accordance with "prudent operator practices" as recommended by
14 Redbud's equipment suppliers and manufacturers. Therefore, we are acquiring a plant
15 that we have every reason to expect to perform well and serve our customers reliably
16 throughout its remaining life. In addition, the recent McClain acquisition has significantly
17 improved our operational knowledge of GE 7FA technology, and has provided valuable
18 experience operating this technology.
19

20 **2. Redbud's Location Is Ideal**

21 Q. **Why is Redbud's location ideal?**

22 A. Redbud is located near OG&E's Oklahoma City load center. Because the developers of
23 Redbud have already paid for the transmission facilities necessary to interconnect with
24 the SPP and deliver capacity to their customers, OG&E will have minimal investment in
25 additional transmission facilities to serve our load requirements. In the event OG&E
26 acquired an existing asset outside of its service area or executed a PPA or constructed a
27 new asset, OG&E customers would likely pay more for associated new transmission
28 investments than any increase in transmission costs associated with the Redbud
29 acquisition. As evidenced by our 2007 short-term capacity RFP, it is either physically
30 impossible or costly for many potential sellers to deliver capacity to OG&E without
31 additional transmission investment.

1 **3. Redbud Improves Reliability and Meets OG&E's Capacity Needs**

2 **Q. How does Redbud improve OG&E's reliability?**

3 A. The addition of a relatively new plant to an aging portfolio improves the reliability of
4 supply. Due to its "4x1x1" configuration, OG&E will be able to operate the plant as four
5 units and continue to provide power when a one or more of the turbine are shut down.
6 The fact that Redbud is located within OG&E's service area and proximate to our largest
7 load center also contributes to an increase in the reliability of supply as it provides some
8 protection against transmission outages in other parts of SPP and in neighboring regions.

9
10 **Q. How does Redbud meet OG&E's capacity needs?**

11 A. As described by Mr. Howell, OG&E has a need for capacity beginning in 2010 after the
12 expiration of the current Redbud PPA. Our estimate of the need to exactly meet SPP's
13 minimum capacity requirement is 424 MW in 2010 and grows by approximately 100
14 MW per year, assuming that OG&E does not retire any of its aging plants. As described
15 in our 2006 IRP submittal, OG&E's intent was to rely on PPAs as a bridge strategy until
16 a coal plant (i.e. Red Rock) was placed in service. The Redbud acquisition will satisfy
17 OG&E's capacity needs through approximately 2012, at which time we will need to add
18 more capacity. These short-term capacity needs will be served by natural gas-fired
19 capacity whether OG&E continues a PPA-based strategy, builds a combination of CC
20 and CT plants, or acquires an asset.

21
22 **4. Redbud is being Acquired at the Lowest Reasonable Cost**

23 **Q. Please explain why OG&E believes that it has acquired Redbud at the lowest
24 reasonable cost.**

25 A. Our resource planning analyses indicate that Redbud is part of the optimal resource plan
26 when considering both cost and risk factors. The price also reflects a significant discount
27 off of the cost of a new CC plant. The Redbud transaction price of \$852 million
28 (\$693/kw) is approximately 24% less than the cost of new construction; current estimates
29 for combined cycle plants exceed \$900/kw.

1 The price paid is fair from other perspectives as well. It is supported by extensive due
2 diligence and third-party valuations. An independent valuation of Redbud, as described
3 by Mr. Reed, concluded that the price was slightly below the low range of Redbud's value
4 as a merchant plant.

5
6 We further believe that the price compares favorably to what could materialize if OG&E
7 were to continue to rely on PPAs to meet this portion of its requirements over the next
8 several years. Mr. Howell presents the results of a resource planning analysis that
9 compares a PPA-based strategy to the Redbud acquisition. This analysis indicates that the
10 Redbud and PPA-based strategy are virtually identical, before consideration of any debt
11 imputation. Redbud is also advantaged due to the fact that it is already build and has
12 known costs as compared to the PPA strategy that is subject to potentially adverse swings
13 in market conditions.

14
15 **5. Redbud Provides Protection Against the Risks of a Tightening SPP Market**
16 **Conditions, New Carbon Regulations, and Increasing Natural Gas Prices**

17 **Q. How does the Redbud acquisition provide protection against tightening market**
18 **conditions?**

19 **A.** I have indicated why the price that OG&E paid is a fair price. The acquisition of Redbud
20 also serves as protection against the potential that prices will be higher than we have
21 projected in our analyses as a result of a number of factors that could drive capacity costs
22 higher. Those factors include tightening regional market conditions, higher construction
23 costs that influence market prices, and the installation of equipment to meet stricter
24 emissions requirements. Should these factors contribute to capacity prices rising at a
25 more accelerated pace, then OG&E will have locked in a better price for Redbud,
26 deferred the need for the next portfolio addition (including potentially a higher priced
27 asset or PPA acquisition), and avoided paying higher PPA prices over the interim period.

28
29 **Q. How does an additional 627 MW of natural gas-fired capacity provide protection**
30 **against future CO₂ regulations?**

1 A. Natural gas emits CO₂ but at a much lower rate than coal-fired plants. While DSM and
2 wind provide a greater protection against CO₂ prices being higher than expected after
3 new regulations are passed, natural gas-fired capacity serves this same objective when
4 compared to coal-fired capacity.
5

6 **Q. How does the Redbud acquisition protect OG&E against higher natural gas prices?**

7 A. Although Redbud is fueled by natural gas, it is much more efficient than OG&E's older
8 gas plants and therefore helps moderate the impact of higher natural gas prices on our
9 customers. Redbud also complements our planned expansion of wind energy and DSM
10 programs which, in turn, moderates the effect of higher natural gas prices.
11

12 **6. Redbud is Preferred to a PPA-Based Strategy**

13 **Q. How did OG&E evaluate the Redbud acquisition as compared to a PPA-strategy?**

14 A. This analysis, described by Mr. Howell, compares the price paid today for Redbud to a
15 series of short-term PPAs with prices that increase every year to reflect the expected
16 tightening of the market. As I mentioned, OG&E's 2007 RFP for capacity in the 2008-
17 2010 timeframe resulted in prices that exhibited this trend. This comparison essentially
18 measures the tradeoff between a slightly higher price of Redbud in the first few years
19 (necessary to complete the long-term transaction) against a stream of PPA prices that
20 exceed the Redbud sales price when demand and supply are in balance. As I noted above,
21 this analysis indicates that the Redbud and PPA-based strategy are virtually identical,
22 before consideration of any debt imputation and capacity price risk.
23

24 **7. Redbud Does Not Have Construction Cost Risk**

25 **Q. Does "iron-in-the-ground" have an advantage over new build generation?**

26 A. Yes, at least based on the present environment. New power plant construction costs have
27 risen dramatically over the past two to three years. The landscape for building new
28 power plants has shifted in a way that gives a preference to an acquisition of an operating
29 asset. By acquiring Redbud, our customers will be shielded from risks associated with
30 often unpredictable cost escalations, scheduling delays, and other uncertainties of new
31 generation construction projects.

1 As an existing plant, OG&E will not have to develop new transmission facilities. The
2 transmission review and approval process, siting, and development can take as long as or
3 longer than constructing the plant. Acquisition of an existing asset also avoids the need
4 for siting, permitting and other land-use development issues.
5

6 **Q. What factors are contributing to the rapid escalation in construction costs?**

7 A. As discussed in the testimony of Mr. Howell, power plant construction cost escalation is
8 being driven largely by global demands for raw materials (e.g., steel), fabricated
9 equipment, and EPC services.
10

11 **8. Redbud Improves OG&E's Portfolio**

12 **Q. How did OG&E analyze Redbud's fit into its portfolio?**

13 A. Mr. Howell describes our assessment of Redbud's fit into our existing portfolio as well as
14 its fit into a potential future portfolio with additional wind generation. Natural gas plants
15 that are able to ramp capacity contributions up and down are particularly valuable as a
16 complement to wind energy which is subject to varying and difficult to predict operating
17 conditions.
18

19 **Q. What benefits will accrue to OG&E's customers from adding a more efficient
20 resource to the portfolio?**

21 A. OG&E dispatches its portfolio on a least cost basis. The addition of Redbud, a plant that
22 is significantly more efficient than many of OG&E's existing natural-gas fired plants, will
23 provide savings to OG&E's customers. Redbud is comparable to the new build and PPA
24 options on a cost basis and also with respect to natural gas price risk and carbon policy
25 risk. However, it avoids the cost risk associated with new construction and the market
26 risk associated with a PPA.
27

28 **9. OG&E's Control Of Redbud Provides Additional Benefits**

29 **Q. How does OG&E's control of Redbud provide value to OG&E's customers?**

30 A. Ownership and control of Redbud's operations has another advantage over continuing as
31 a contract purchaser under a PPA. As an owner and operator, OG&E will be able to

1 dispatch the plant as part of its entire supply portfolio to maximize benefits. More
2 specifically, OG&E will be able to dispatch this plant, along with its other plants and
3 contracts, to improve the overall efficiency of the portfolio. As an owner of the plant, and
4 unlike a PPA, OG&E's customers will continue to receive benefits if the plant continues
5 to operate after it is fully depreciated.

6
7 **Q. Are there any other benefits that you would like to mention?**

8 A. Yes. There are benefits that accrue to the customers of our partners, GRDA and OMPA,
9 many of whom are located in Oklahoma. GRDA believes that it is imperative to its
10 customers that an intermediate generation resource be added to their generation portfolio,
11 reducing their vulnerability of relying on market purchases which may be limited and
12 more costly when the transmission grid is congested. Additionally, the diversity resulting
13 from the acquisition of Redbud will also reduce GRDA's exposure to rising railroad fuel
14 transportation costs and coal prices.

15
16 GRDA believes that the addition of Redbud to its portfolio will provide its customers
17 with scale and efficiency benefits. As a result of this purchase, GRDA will be able to
18 meet its customer requirements, diversify its fuel portfolio without an adverse impact to
19 customer rates. GRDA could not undertake such a large scale project on its own.

20
21 **Q. What is your understanding of why OMPA believes the purchase of Redbud is a
22 good business decision?**

23 A. OMPA notes similar benefits and notes that the purchase price for the Redbud plant is
24 roughly one-half of the construction cost of a new gas fueled plant announced by a sister
25 agency in Florida. They also note that an operating plant has significant value in today's
26 challenging power plant siting environment.

27
28 **V. REQUESTED COMMISSION FINDINGS**

29 **Q. What relief is OG&E requesting of the Commission in this proceeding?**

30 A. As explained by OG&E witness James Hatfield, the Company is requesting the
31 Commission to issue an order that includes the following findings: (i) OG&E's decision

1 to purchase a 51% interest in Redbud is prudent; (ii) the generation facility is used and
2 useful upon closing the transaction; (iii) authorization of a rider to recover Redbud's
3 annual revenue requirement until OG&E's next rate case is completed and new rates
4 implemented; and (iv) the full investment or purchase price, return on and amortization
5 for transaction costs, operation and maintenance expenses, depreciation and ad valorem
6 taxes related to Redbud shall be included in the Company's cost of service in its next rate
7 case. My testimony explains in more detail the requested relief in this proceeding.
8

9 Q. **Does this conclude your prepared direct testimony?**

10 A. Yes, it does.