

**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 )  
AUTHORIZING APPLICANT TO MODIFY ITS )  
RATES, CHARGES, AND TARIFFS FOR RETAIL )  
ELECTRIC SERVICE IN OKLAHOMA )

Cause No. PUD 200800398

**FILED**  
FEB 27 2009

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

Direct Testimony

of

Howard W. Motley

On behalf of

Oklahoma Gas and Electric Company

February 27, 2009

Howard W. Motley  
*Direct Testimony*

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

3 A. My name is Howard W. Motley. I am Vice President, Regulatory Affairs of Oklahoma  
4 Gas and Electric Company (OG&E or Company). My business address is 321 N. Harvey,  
5 Oklahoma City, Oklahoma 73102.

6

7 Q. **Briefly summarize your education and professional qualifications.**

8 A. I am a graduate of Oklahoma City University, where I received a Bachelor of Science  
9 degree in Business. My career in public utility regulation has spanned 34 years beginning  
10 April 15, 1974 when I accepted an auditing position with the Oklahoma Corporation  
11 Commission (OCC or Commission). As an auditor for the OCC, I performed over 30  
12 audits of public utilities. On August 1, 1979, I was appointed Director of the Public  
13 Utility Division and served for over 10 years in that position until January 1990. During  
14 the next 11 years, I provided professional consulting services in the area of public utility  
15 regulation. I began my employment with OG&E in August 2001 as Manager, Rate  
16 Strategies. I later was promoted to Director, Regulatory Affairs and Strategy. I was  
17 appointed Vice President, Regulatory Affairs on November 15, 2006 by the OGE Energy  
18 Corp. Board of Directors.

19

20 Q. **Have you previously testified before the Commission?**

21 A. Yes.

1 Q. **What are the key points covered by your direct testimony?**

2 A. My testimony compares OG&E's electric rates to the national and regional averages and  
3 demonstrates that our rates historically have been below both averages. I discuss the  
4 three methods of recovering utility costs authorized by this Commission with a particular  
5 emphasis on the use and effectiveness of tariff riders. I explain why tariff riders do not  
6 eliminate regulatory risk. I also support the vegetation management pro forma  
7 adjustment the Company is requesting and discuss the Company's goal of equalization of  
8 rates underlying the Company's rate design proposal.

9

10 Q. **How is your direct testimony organized?**

11 A. My direct testimony is organized into the following sections:

12 Section I: Electric Rate Comparison

13 Section II: Methods for Recovering Costs

14 Section III: Tariff Riders and Regulatory Risk

15 Section IV: Vegetation Management Costs (Pro Forma Adjustment)

16 Section V: SmartPower Tariff Rider

17 Section VI: Rate Design

18

19 **SECTION I: ELECTRIC RATE COMPARISON**

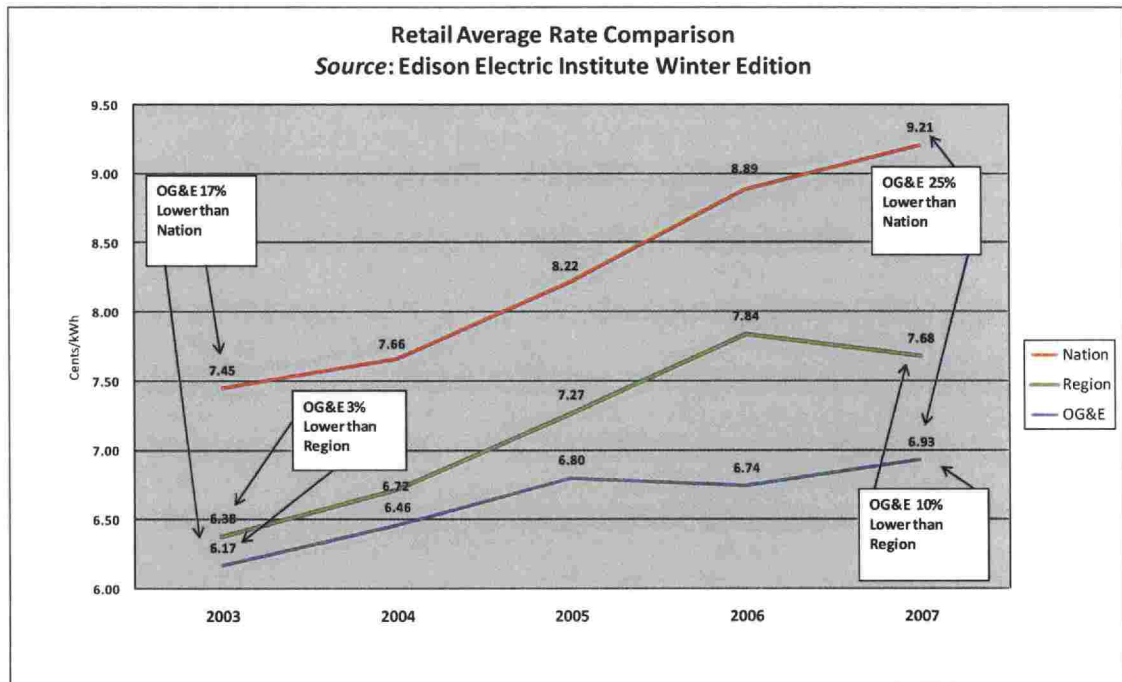
20 Q. **How do OG&E'S rates compare with other electric rates in the nation and region?**

1 A. Based on the most recent calendar year studies by the Edison Electric Institute<sup>1</sup> (EEI),  
2 Exhibit HWM-1 illustrates the comparison of OG&E's average electric rates, residential  
3 rates, commercial rates and industrial rates to national and regional averages.  
4

5 Q. **How does OG&E's retail average rates compare to the nation and region?**

6 A. OG&E's retail average rate has been below the nation and region since 2003 and is  
7 substantially lower in 2007. OG&E's retail average rates<sup>2</sup> have ranged between 17% to  
8 25% below the national averages and 3% to 10% below regional averages during the five  
9 year period. Chart 1, which is also contained in Exhibit HWM-1, illustrates the EEI study  
10 results for OG&E's retail average rates compared to the nation and region over the period  
11 2003-2007.  
12

Chart 1



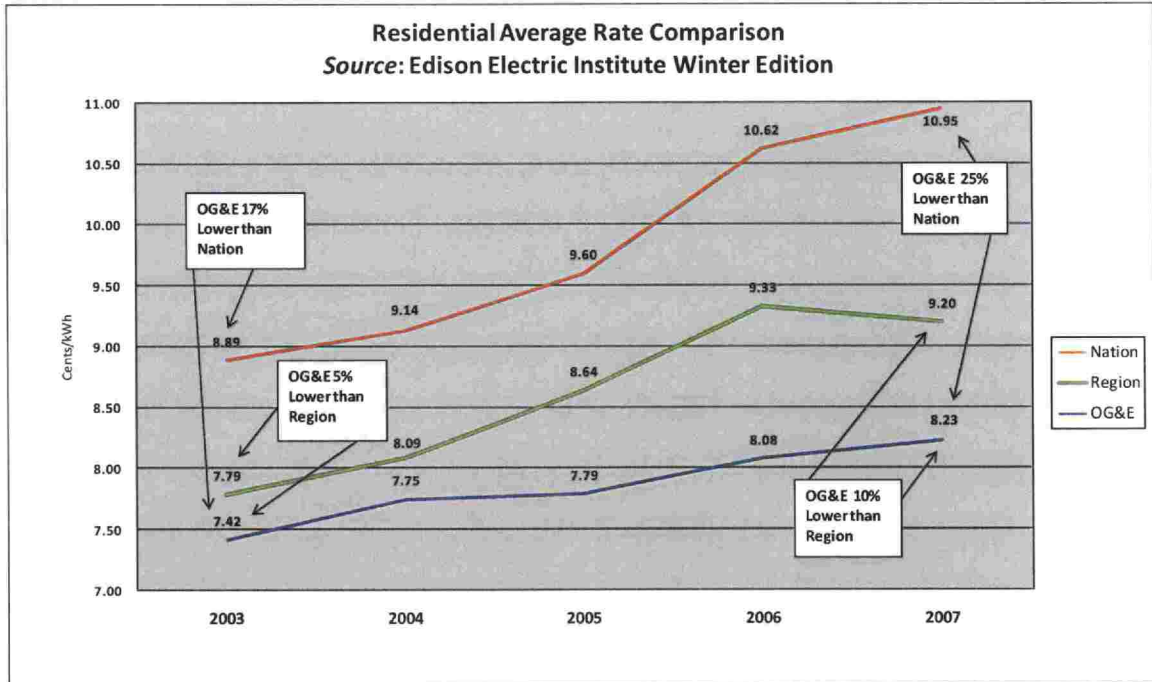
<sup>1</sup> Edison Electric Institute, Typical Bills and Average Rates Report Winter.

<sup>2</sup> Average rate based on all customer classes.

1 Q. How do OG&E's residential customer rates compare with the nation and region?

2 A. OG&E's residential average rates ranged from 17% to 25% lower than the nation and  
3 from 5% to 10% lower than the region. Chart 2, which is also contained in Exhibit  
4 HWM-1, provides the 2003–2007 comparison for residential customer rates.  
5

Chart 2



6

7 Q. Have you prepared similar illustrations for the commercial and industrial customer  
8 average rates?

9 A. Yes. Exhibit HWM-1 includes the same five year comparison for both the commercial  
10 and industrial average rates.

11

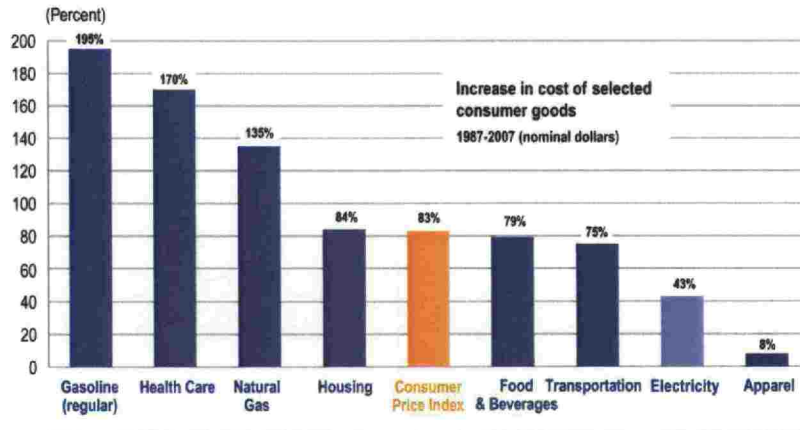
12 Q. How do commercial and industrial average rates compare to the nation and the  
13 region in 2007?

1 A. OG&E's commercial average rate was 24% below the nation and 11% below the region.  
2 OG&E's industrial average rate was 15% below the nation and 14% below the region.

3  
4 Q. **Have electric rates increased over the last 20 years more than other consumer goods**  
5 **or the Consumer Price Index?**

6 A. No. As illustrated in Chart 3, according to an EEI presentation, over the 20-year period  
7 1987 through 2007, electric rates in the nation have risen 43% as compared to the  
8 Consumer Price Index (CPI) increasing 83%. The cost of other consumer goods increased  
9 even more. For example, gasoline increased 195%, health care by 170%, natural gas by  
10 135% and housing by 84%.

11 **Chart 3**



Sources: U.S. Department of Labor, Bureau of Labor Statistics (BLS), and U.S. Department of Energy, Energy Information Administration (EIA).  
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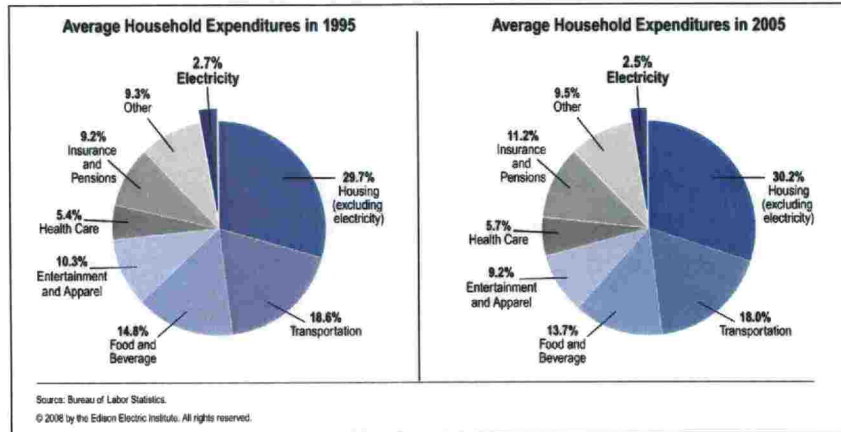
12

13 Q. **Was there an additional chart in the EEI presentation that places into perspective**  
14 **electric cost as it relates to the average household budget?**

15 A. Yes. Chart 4 depicts the changes in household expenditures over a ten year period. In  
16 1995, electricity was 2.7% of the average household budget. This amount decreased to

1 2.5% in 2005. This is a decrease of approximately 7.4% over the ten year period. Health  
2 care, housing, insurance and pensions increased while entertainment, apparel and  
3 transportation decreased.

4 **Chart 4**



5  
6 **Q. Do you have a final comment regarding OG&E's rates?**

7 **A.** Yes. Although costs are increasing and a rate increase is necessary at this time, OG&E  
8 has maintained lower than national and regional rates for several years because of the  
9 Company's continuous efforts to hold down costs. Jesse Langston describes in detail our  
10 efforts to control generation costs, including the acquisition of new power plants at  
11 advantageous prices and construction of a new wind farm. Similarly, Scott Forbes  
12 describes the Company's efforts to control O&M expenses.

13  
14 **SECTION II: METHODS FOR RECOVERING COSTS**

15 **Q. Are the base rates established by the Commission in rate cases the only way for**  
16 **OG&E to recover its costs to provide reliable electric service?**

17 **A.** No. As summarized in Chart 5, there are three methods that the Commission traditionally  
18 employs to allow OG&E to recover the costs to provide service.

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**Chart 5**

<b>Recovery Mechanisms</b>	<b>Summary of Costs</b>	<b>Oversight Process With Hearing</b>
Base Rates	Operating costs, depreciation, debt interest, income taxes and operating income.	Rate Case Audit
FCA Tariff Rider	Fluctuation ( <i>up or down</i> ) of fuel costs and purchased power.	Annual Prudence Review
Other Tariff Riders	Special projects or extraordinary expense.	Reports and True-Ups

Q. **Please explain the base rates recovery method.**

A. Base rates are established in rate cases, like this proceeding, to reset the price charged our customers, based on more current costs. For instance, in this proceeding OG&E is requesting the Commission to increase base rates based on 2008 costs instead of 2004 costs used in our last rate case. Today, our customers are paying 2004 prices for electricity that costs considerably more to produce. This timing problem is generally referred to as regulatory lag. The oversight process for establishing base rates is provided through a comprehensive audit of OG&E's investment, revenues and expenses to determine the need for the increase.

Q. **Please discuss the Fuel Cost Adjustment (FCA) tariff rider.**

A. The FCA is the tariff rider that was established by the Commission in the late 1970's to deal with the volatility of fuel caused by the Arab oil embargo. Previously, fuel costs were built into base rates and only changed by rate cases. The rider ensures that fuel costs recovered from customers match actual costs. The cost of natural gas, coal, and other fuel burned in the Company's generation plants and power purchased from others are passed directly on to our customers without a markup or profit for the Company.

1 Q. **In what other circumstances has the Commission used tariff riders?**

2 A. Tariff riders are generally employed to recover costs of special projects, like the  
3 Centennial wind farm, or extraordinary costs such as storm restoration expense. Tariff  
4 riders are discussed in detail in the next section.

5  
6 Q. **How are base rates and the FCA reflected in a customer's bill from OG&E?**

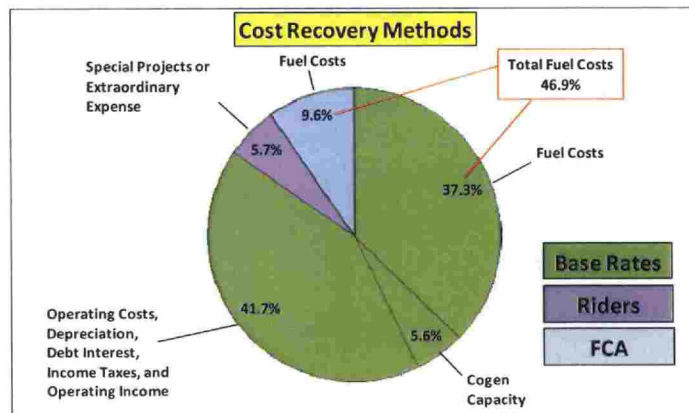
7 A. A large portion of a customer's bill goes to pay for fuel costs. A specific level of fuel  
8 costs is designed to be recovered in base rates with the fluctuation in fuel cost being  
9 charged or credited through the FCA. Chart 6 illustrates how total fuel costs are  
10 recovered in base rates and the FCA. Total fuel cost is approximately 47% of the  
11 customer's bill. Approximately 42% of the customer's bill goes to pay operating costs,  
12 depreciation, debt interest, income taxes and operating income.

13  
14 Q. **What portion of a customer's bill is attributed to tariff riders other than the FCA?**

15 A. The Company is currently recovering \$99.5 million through tariff riders for special  
16 projects such as security, the Centennial wind farm, and the Redbud power plant. As  
17 depicted in Chart 6, this represents approximately 5.7% of the customer's bill.

18

**Chart 6**



1 In this proceeding, OG&E's rate design proposal is to move the \$99.5 million recovery of  
2 costs from tariff riders to base rates. The Company also has the cogeneration credit rider  
3 (CCR) that offsets base rates by \$80.5 million. The CCR is reflected as an offset to the  
4 base rate portion of Chart 6. The Company is also proposing, through rate design, to  
5 decrease base rates \$80.5 million and reduce the current credit customers receive through  
6 the CCR by \$80.5 million. These rate design changes to base rates and the CCR have no  
7 effect on the \$110.3 million rate increase requested in this proceeding.  
8

### 9 SECTION III: TARIFF RIDERS AND REGULATORY RISK

10 Q. **Has the Commission allowed recovery of extraordinary expenses in the past?**

11 A. Yes. Beginning in the 1980s, the Commission Staff's general policy was to recommend  
12 recovery of extraordinary expense. In 1982, the Commission authorized PSO to recover  
13 the costs associated with the Black Fox Nuclear Project. Since then, the Commission has  
14 authorized recovery of certain extraordinary expenses through tariff riders. In other  
15 instances, the Commission has authorized a regulatory asset to minimize the impact of a  
16 significant plant acquisition or extraordinary expense like damage from a severe storm.  
17 Both types of regulatory decisions are efforts by the Commission to allow a utility the  
18 "opportunity to earn" its authorized rate of return.  
19

20 Q. **Please provide an example of a Commission decision involving recovery of such  
21 costs by authorizing a regulatory asset.**

22 A. In 1988, when I was the Public Utility Division Director, in Cause No. 920001342 the  
23 Staff recommended (i) the deferral of PSO's costs associated with the December 1987 ice

1 storm and (ii) approval of “an appropriate amount in cost-of-service relating to the  
2 amortization of these unusual storm recovery expenses.” In PSO’s next rate case, the  
3 Commission issued Order No. 378891 granting PSO a regulatory asset of \$6 million for  
4 the 1987 ice storm and 1992 wind storm costs and authorized the recovery of \$1.2 million  
5 per year over the next five years.

6  
7 **Q. Please provide an example of recovery of an extraordinary expense under a tariff  
8 rider.**

9 A. In Cause No. PUD 200100455, Commission Order No. 470044 authorized OG&E to  
10 recover its costs associated with the January 2002 ice storm. Page 13 of the Commission  
11 order states:

12 The Commission further finds that it is in the **public interest, and is fair, just and**  
13 **reasonable** for the company to recover the operation and maintenance expense  
14 incurred during the January 2002 ice storm in the amount of five million, four hundred  
15 thirty-one thousand, ninety-five dollars (**\$5,431,095**) **through the Company’s Rider**  
16 **for Off System Sales of Electricity.** (Emphasis added.)

17  
18 **Q. What is the most recent OG&E tariff rider approved to recover an extraordinary  
19 expense?**

20 A. The Storm Cost Recovery Rider was approved by the Commission in Order No. 558445  
21 issued in Cause No. PUD 200800215 and provides for the recovery of OG&E’s actual  
22 storm costs for the four-year period 2006 through 2009. This rider was a result of the  
23 extraordinary expenses incurred in the 2007 ice storm restoration effort and serves to  
24 levelize the recovery of storm restoration costs over a longer period of time.

1 Q. **Has the Commission recently approved tariff riders that allow OG&E to recover the**  
2 **revenue requirement associated with special projects?**

3 A. Yes. In the past five years, the Commission has approved the following tariff riders for  
4 OG&E; (1) the Security Rider; (2) the Centennial Wind Energy Project Rider (CWEPR);  
5 and (3) the Redbud Acquisition Recovery Rider (RARR).

6  
7 Q. **Please summarize these special project tariff riders.**

8 A. The CWEPR authorized OG&E to recover the revenue requirement for the Centennial  
9 project, a 120 MW wind energy facility, which is now on line and providing power to the  
10 OG&E system. In 2008, the Centennial wind farm fuel savings exceeded the revenue  
11 requirement charged through the CWEPR by about \$1 million.

12 The Redbud Acquisition Recovery Rider (RARR) provides for the recovery of the  
13 revenue requirement related to OG&E's ownership of the Redbud generation facility. The  
14 Redbud plant will produce energy savings and facilitate the addition of wind energy  
15 resources on the OG&E system.

16 The Security Rider was authorized after the September 11th terrorist attack to address  
17 homeland security measures for critical infrastructure.

18  
19 Q. **Do these tariff riders serve to eliminate OG&E's regulatory risk?**

20 A. No. The tariff riders approved by the Commission have generally related to special  
21 projects for which the Company requested preapproval. In this rate case, those special  
22 projects are Security, Centennial and Redbud. These projects represent approximately  
23 \$700 million of the \$1.6 billion OG&E has invested in its electric system since 2004. As

1 shown on Chart 6, page 8, these three tariff riders represent less than 6% of the  
2 Company's current revenues. While preapproval mitigates regulatory lag for these  
3 projects, the Company is still exposed to traditional regulatory lag.  
4

5 **Q. Would you please elaborate?**

6 A. The Company's increased costs resulting from the \$900 million in capital expenditures  
7 not currently being recovered and the \$48 million increase in its operation and  
8 maintenance expense since 2004 remain subject to the traditional ratemaking process and  
9 regulatory lag.  
10

#### 11 **SECTION IV: VEGETATION MANAGEMENT COSTS**

12 **Q. What expense level for vegetation management is OG&E requesting in this case?**

13 A. OG&E is requesting \$19,592,337 total company vegetation management expense level.  
14 Of this amount, \$17,496,421 is allocated to the Oklahoma jurisdiction. In the test year,  
15 the Company incurred \$15,569,711 in total expense for vegetation management which  
16 required a pro forma adjustment of \$4,022,626.  
17

18 **Q. Why is such a large pro forma adjustment required?**

19 A. OG&E's 2008 targeted expenditure level for vegetation management was around \$19.2  
20 million. As just stated, the test year only resulted in \$15.6 million. However, by  
21 December 31, 2008 the Company had expended \$18.9 million. Due to certain  
22 circumstances, much of the 2008 budget was deferred and spent during the fourth quarter.

1 Q. **Why did vegetation management expense increase in 2008?**

2 A. Vegetation management expense increased in calendar 2008 as the Company worked to  
3 comply with both the NERC requirements for transmission and the Commission's  
4 requirement of a four-year trim cycle for distribution lines. System-wide, OG&E spent a  
5 total of \$18,942,076 on vegetation management in 2008. This total is comprised of  
6 \$15,156,859 in distribution line expense and \$415,813 in distribution substation grounds  
7 expense, for a total distribution expense of \$15,572,672. Also included in the total  
8 vegetation management expense for 2008 is \$3,258,793 for transmission line expense and  
9 \$110,611 for transmission substation grounds expense, for a total of \$3,369,404 in  
10 transmission expense.

11  
12 Q. **Why did OG&E's vegetation management expenses increase in the fourth quarter  
13 of 2008?**

14 A. In July of 2008, OG&E had almost all of its budgeted vegetation management activities  
15 under contract. Then in August, and later in mid-September, two large hurricanes (Gustav  
16 and Ike) hit the gulf region in succession. In response to requests for mutual assistance  
17 from utilities in that region, OG&E released most of its vegetation management contract  
18 crews. OG&E normally operates with about 100 crews, but for a period of about two  
19 months during which cleanup from the hurricanes was occurring, the Company had only  
20 about half that number working in its service area. The contracted workforce did not  
21 begin to return to OG&E until mid-October, after the close of the test year. At that point,  
22 additional crews were added to catch up with the work that was already under contract.

1 Based on this accelerated vegetation management activity the Company was able to  
2 achieve 98.6% of the original budget.

3  
4 **Q. Has the Company developed a new process to identify the Oklahoma jurisdiction's**  
5 **actual vegetation management expense and storm restoration costs?**

6 A. Yes. In 2008, the Company developed a process to capture actual vegetation management  
7 expense and storm restoration costs by jurisdiction. This process was developed mainly  
8 due to the 2007 ice storm when transparency of actual vegetation management expense  
9 and storm restoration costs was needed by specific retail jurisdictions. The ultimate  
10 benefit of this process is the tracking of these costs for regulatory decisions in a rate case  
11 or tariff rider. Additionally, this tracking mechanism will be needed if the Commission  
12 approves the Company's system hardening application.

13  
14 **Q. Why is the increase in vegetation management expense necessary?**

15 A. The increase in expense for distribution lines is necessary to implement a four-year trim  
16 cycle and to comply with the Oklahoma Commission's rule OAC 165:35-25-15(c). In  
17 addition, OG&E believes that a four-year cycle is the best way to ensure its customers  
18 reliable, safe and uninterrupted service. The increase in expense for transmission lines is  
19 necessary to comply with the new NERC standard FAC-003-1, which imposes penalties  
20 reaching more than \$1,000,000 for a failure to comply. That standard can be found at  
21 <http://www.nerc.com/files/FAC-003-1.pdf>.

1 Q. **Do OG&E's customers benefit from vegetation management?**

2 A. Yes. Our customers receive substantial benefits from the work accomplished with these  
3 expenditures. The purpose of this program is to reduce or eliminate tree-related outages  
4 on either transmission or distribution lines. Outages adversely affect customers because  
5 they disrupt and sometimes halt commercial activity and degrade the quality of life.  
6 Tree-related outages are exceptionally damaging because they can pose severe safety  
7 hazards when lines are downed. The cost of tree-related outages to the Company and  
8 ultimately to its customers is significant in terms of restoration costs and damage to  
9 facilities. OG&E believes that the increased expenses of vegetation management will  
10 result in benefits to both customer and Company by preventing outages.

11  
12 **SECTION V: SMARTPOWER TARIFF RIDER**

13 Q. **Is OG&E requesting a tariff rider to recover the cost of the SmartPower project in  
14 Norman?**

15 A. Yes. OG&E witness Kenneth Grant explains OG&E's request for Commission approval  
16 of the Norman SmartPower project. If that project is authorized, OG&E is requesting  
17 approval of a tariff rider that will become effective when full deployment of the meters  
18 has been completed. The Company expects full deployment to be completed by June  
19 2010.

20  
21 Q. **What is the annual revenue requirement for the Norman SmartPower project?**

22 A. The annual revenue requirement is currently estimated to be \$5.3 million. This  
23 calculation is based on the expected capital investment and O&M expense described in

1 Kenneth Grant's testimony. The annual revenue requirement will be allocated to  
2 customer classes based on the production demand allocator approved by the Commission  
3 in this proceeding. Based on the estimated costs, the residential customer will pay  
4 approximately 34 cents per month for this project. The Company expects to report the  
5 initial findings of the project to the Commission in the late fall of 2010. The tariff rider  
6 will recover actual not estimated costs and will be effective until the costs are recovered  
7 or until the unrecovered costs are included in a future rate case.

8  
9 **SECTION VI: RATE DESIGN**

10 **Q. What is the amount of the rate increase requested in this case?**

11 A. OG&E is requesting a rate increase in the amount of \$110.3 million. There are two  
12 primary drivers behind the Company's need to file this rate case. OG&E has made  
13 substantial investments and has experienced an increase in operation and maintenance  
14 expense.

15  
16 **Q. How does OG&E determine the portion of the \$110.3 million assigned to each  
17 customer class?**

18 A. The basis upon which rate design decisions are made begins with an allocated cost of  
19 service to each customer class. The cost of service distributes the overall cost based on  
20 the customer class paying the Company's equalized rate of return. After determining  
21 what the customer class should pay, that amount is compared to what the customer class  
22 is currently paying. This comparison will usually reveal that some customer classes are

1 not paying enough and other customer classes are paying too much. At this point, the  
2 decision process becomes more practical than mathematical.

3  
4 **Q. What do you mean by the decision process becomes more practical?**

5 A. For many years, OG&E has proposed a movement toward equalization of rates.  
6 Unfortunately, because of the large disparity between rates of return for specific customer  
7 classes, the task of moving customer classes toward parity has been difficult.

8  
9 **Q. Has the Company made progress in moving toward equalization of rates between  
10 customer classes?**

11 A. Yes. The Company has made progress toward equalization of rates, but we have not been  
12 able to achieve parity in the Oklahoma jurisdiction. However, OG&E has had equalized  
13 rates in the Arkansas jurisdiction for several years based on a phased-in process.

14  
15 **Q. Is it practical to achieve equalized rates in this proceeding?**

16 A. No. In my opinion, the \$78.5 million increase that would be required to bring the  
17 residential customer class to parity is too great. In this case, the Company is proposing to  
18 move the residential customer class to 90% parity. The proposed increase is  
19 approximately \$56.4 million of which approximately \$48 million is recovered through an  
20 increase to the residential customer charge. The customer charge will increase from \$6.50  
21 to \$13.00 per month. Currently Public Service Company of Oklahoma charges \$14.95 as  
22 a customer charge. As discussed in the direct testimony of Bryan Scott, the  
23 Company's actual cost that should be recovered in the customer charge is over \$20.00

1 Q. **Please explain how the shortfall in recovering the residential customers' cost of**  
2 **service affects other customer classes?**

3 A. In determining how to spread the shortfall, the Company considered the current relative  
4 rate of return for each major customer class and the amount each customer class  
5 historically has paid to subsidize the residential customer. Based on these considerations,  
6 OG&E is proposing a 117.2% relative rate of return for all customer classes except  
7 Public Schools and the lighting classes to fund the shortfall of the residential customer  
8 class.

9

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

11 A. Yes.

