

BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF)
OKLAHOMA GAS AND ELECTRIC COMPANY)
FOR AN ORDER OF THE COMMISSION) CAUSE NO. PUD 201100087
AUTHORIZING APPLICANT TO MODIFY ITS)
RATES, CHARGES, AND TARIFFS FOR RETAIL)
ELECTRIC SERVICE IN OKLAHOMA)

Direct Testimony

of

Sheri D. Richard, CPA

on behalf of

Oklahoma Gas and Electric Company

July 28, 2011

1 QUALIFICATIONS, EXPERIENCE AND PURPOSE

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

3 A. My name is Sheri D. Richard. 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 am the Director of Revenue Requirements.
9

10 Q. **Would you please summarize your education and professional background?**

11 A. I earned a Bachelor of Science degree in accounting from Northwestern Oklahoma State
12 University in 1992, and in 1994 I became a Certified Public Accountant, licensed to
13 practice in Oklahoma. I also have a Masters of Business Administration from the
14 University of Phoenix. Prior to joining OG&E, I was employed for 7 years by UICI, a
15 state regulated insurance company. I have been employed at OG&E for over 10 years
16 working in Financial and Regulatory Accounting, managing the Costing and Pricing
17 department and now as Director over the Cost of Service and Regulatory Accounting
18 departments. While at OG&E, I have participated in, coordinated and/or served as the
19 case manager over the preparation of the Minimum Filing Requirements for the current
20 base rate filing in Oklahoma as well as in two previous rate cases, Cause Nos. PUD
21 200500151 and PUD 200800398.
22

23 Q. **Have you previously filed testimony before the Oklahoma Corporation Commission
24 (“Commission”)?**

25 A. Yes. I filed direct testimony in Cause Nos. PUD 200800059 (OG&E’s Quick Start
26 Demand Programs) and PUD 200800398.

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

2 A. The purpose of my testimony is to sponsor the pro forma adjustments to rate base and
3 operating expense, as listed in Charts 1 and 2 below with references to the Company's
4 Application Package, as well as the overall revenue requirement and rate increase
5 calculation.

6 **Chart 1 – Pro Forma Adjustments to Rate Base**

Pro Forma Adjustment	Rate Base Description
WP B 3-1	Capitalized Maintenance Costs
WP B 3-2	Holding Company Assets
WP B 3-3	Adjusts TYE CWIP balance for projects with completion more than 6 months past TYE; reimbursable projects
WP B 3-6 and WP B 3-7	Adjusts CWIP for projects transferred to Plant in Service completed by June 2011
WP B 3-8 and WP B 3-9	Adjusts CWIP for projects transferred to Plant in Service completed by September 2011
WP B 3-12	YE Prepayments Balance to 13 month Average
WP B 3-13	Remove Various Regulatory Assets
WP B 3-15	Plant Held for Future Use

7 **Chart 2 – Operating Expense Pro Forma Adjustments**

Pro Forma Adjustment	Income Statement Description
WP H 2-20	Insurance Expenses
WP H 2-21	Depreciation Expense
WP H 2-22	Holding Company Allocation
WP H 2-23; WP H 2-24 and WP H 2-25	Compensation Related
WP H 2-27	Regulatory Expense
WP H 2-28	Bad Debt Expense
WP H 2-32	Power Supply LTSA Correction
WP H 2-35	Other Regulatory Asset Amortization
WP H 2-37	Entertainment & Gifts

1 (Chart 2 Continued)

Pro Forma Adjustment	Income Statement Description
WP H 2-39	Customer Deposit Interest
WP H 2-40	Advertising Expense
WP H 2-42	Rate Case Expense
WP H 2-43	Vegetation Management
WP H 2-45	Transmission Poles Maintenance Program
WP H 2-48	Acquisition Adjustment Amortization
WP H 2-49	Power Delivery NERC Compliance
WP H 2-50	Gains on Allowance

2
3 PRO FORMA ADJUSTMENTS

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

5 A. The Company's proposed pro forma adjustments are critical to establish fair, just and
6 reasonable rates on a prospective basis and will provide (i) a fair return on Company
7 investment and (ii) the Operations and Maintenance ("O&M") expense level necessary to
8 cover daily operating costs, costs to attract, train and retain employees and costs to
9 conduct maintenance on our facilities.

10
11 **Q. Why are pro forma adjustments to a test year necessary?**

12 A. In order to design rates to reflect revenue, expense and investment levels the utility
13 expects to experience prospectively, the Company makes adjustments to the test year
14 books. The Company has utilized a historical test year with pro forma adjustments, on an
15 annualized basis, reflecting reasonably known and measurable changes. In that process,
16 test year results are adjusted for (i) costs not expected to re-occur, (ii) unusual events or
17 levels of expense, (iii) costs that did not occur but are or will be a normal expense going
18 forward, or (iv) cost adjustments that are determined by the Company or past
19 Commission order not to be the customer's responsibility. In this specific proceeding, pro
20 forma adjustments result in a pro forma test year that recognizes the revenue, expense
21 and investment levels the Company will experience after new rates are implemented
22 sometime in calendar year 2012.

1 Q. **Please explain the general categories of pro forma adjustments proposed by the**
2 **Company.**

3 A. Pro forma adjustments fall into one of the following three categories:

4 (1) *Normalization adjustments* are usually made to revenues and expenses to offset
5 unusual levels of operations recorded during the test year. For example, extreme
6 weather conditions can create abnormal levels of revenues and expenses.
7 Additionally, abnormal levels of operations may occur due to delayed or
8 accelerated projects during a test year. Whether the revenues and expenses are
9 above or below a normal level, a pro forma adjustment is required to project a
10 normal level of operations for the establishment of prospective rates. One example
11 of this type of adjustment is WP H 2-32 for the LTSA adjustment discussed later in
12 my testimony;

13 (2) *Annualization adjustments* recognize that some expense during the Test Year was
14 not reflective of a full years cost. One example of this type of adjustment is WP H
15 2-45 for the Transmission Pole Maintenance Program costs. Because only a partial
16 year of expense was incurred in the test year, this adjustment was made to recognize
17 a full year of expense.

18 (3) *Out of Period pro forma adjustments* consider reasonably known and measurable
19 changes that occur within twelve (12) months of the test year ending December 31,
20 2010. In this proceeding, two good examples are pro forma adjustment WP B 3-6 to
21 rate base and pro forma adjustment WP H 2-25 to operating income. Pro forma
22 adjustment WP B 3-6 recognizes construction expenditures for projects that will be
23 serving customers by June 30, 2011. Pro forma adjustment WP H 2-25 recognizes
24 additional employees that have been or will be hired and progression increases as
25 well as attrition during the period January 1 through September 30, 2011. These pro
26 forma adjustments outside the test year are essential in establishing fair, just and
27 reasonable rates.

1 GENERAL RATE CHANGE

2 Q. **How is OG&E's requested general rate change determined?**

3 A. The calculation of the Company's requested \$73,255,957 general rate change is
4 summarized in Chart 1.

5 **Chart 1**

Line No.	MSFR Schedule	General Rate Change Calculation	
1	B-2	Rate Base	\$3,351,854,028
2	F-1a	Rate of Return	8.750%
3		Return Requirement	293,287,227
4	H-1	Pro Forma Operating Income	(248,424,621)
5		Return Deficiency	44,862,606
6		Federal and State Income Tax	28,393,351
7	B-1	Rate Increase	\$ 73,255,957

6
7 Q. **Please identify and explain the components that are used to determine the**
8 **\$3,351,854,028 rate base value in Chart 1, line 1.**

9 A. Section B, Schedule B-2 displays the total company per book amounts, pro forma
10 adjustments and the resulting Oklahoma jurisdiction rate base. This schedule shows that
11 the Company has invested approximately \$3.35 billion to serve our Oklahoma customers.

12
13 Q. **What is OG&E's requested rate of return in this cause?**

14 A. OG&E is requesting an 8.750% rate of return as depicted on line 2 of Chart 1. The
15 overall cost of capital is established in Section F, Volume II, of the Company's
16 Application Package. Section F has been updated in this filing to reflect the Company's
17 long-term debt and common equity as of June 30, 2011.

18
19 Q. **Please explain the relationship between lines 3 and 4 in Chart 1 above.**

20 A. When the 8.750% rate of return is applied to the Company's jurisdictional investment to
21 provide electric service, the result is a return requirement of \$293,287,227 (Line 3).
22 OG&E's pro forma operating income is \$248,424,621 (Line 4). The \$44,862,606
23 difference (Line 5) is the Company's return deficiency. When federal and state income
24 taxes are added to the return deficiency, a \$73,255,957 rate increase is justified.

1 Q. **Please identify the sections of the Application Package that are used to establish the**
2 **\$248,424,621 pro forma operating income found on Line 4 of Chart 1 above.**

3 A. Sections H, I, J and K support the \$248,424,621 Oklahoma jurisdiction pro forma
4 operating income. Section H, Schedule H-1 displays the total company per book
5 amounts, pro forma adjustments to operating revenues and expenses and resulting
6 Oklahoma jurisdiction operating income.

7

8 **RATE BASE**

9 Overview

10 Q. **What section of the Minimum Filing Requirements contains rate base information?**

11 A. Section B contains schedules and supporting workpapers which present the elements of
12 rate base for the test year and adjustments to the test year rate base. The pro forma rate
13 base is intended to reflect the investment made by the utility at the time new rates are
14 implemented. The adjusted rate base is used to calculate the revenue requirement.¹

15

16 Q. **Why are rate base items adjusted in a rate case?**

17 A. Out of period adjustments that are reasonably known and measurable are included in the
18 determination of a pro forma rate base.

19

20 Q. **Please describe Schedule B-2.**

21 A. Schedule B-2 is an overall summary of rate base including gross plant, accumulated
22 depreciation, construction work in progress, plant held for future use and other rate base.
23 These categories are identified under the “Description” column. Column 1 displays the
24 test year balances as of December 31, 2010. Column 2 reflects accumulated pro forma
25 adjustments to each category and Column 3 reflects the pro forma test year balance.

26

27 Q. **Please describe Schedule B-3.**

28 A. Schedule B-3 is a detail of each adjustment to rate base.

¹ OAC 165:70-5-22

Pro Forma Adjustments to Plant in Service

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Q. Why is pro forma adjustment WP B 3-1 made?

A. In Cause No. PUD 26782, the Commission determined certain maintenance costs were more appropriately capitalized than expensed. This adjustment includes those capital costs in rate base per Order No. 182637 resulting in a net plant pro forma adjustment of \$84,457.

Q. Please explain pro forma adjustment WP B 3-2, Holding Company Asset Allocation.

A. WP B 3-2 includes the Holding Company (“OGE Energy Corp.”) assets in the total company per book “utility plant” value as shown on line 1 of the workpaper. The pro forma adjustment reflects the Company’s allocation of the Holding Company assets to non-utility activity which results in a \$4,345,383 decrease to net plant.

Q. What is the purpose of pro forma adjustment WP B 3-3?

A. This adjustment to rate base removes construction work in progress (“CWIP”) that will not be completed by September 30, 2011, or is reimbursable or relates to projects that have been cancelled since test year end. This adjustment results in a reduction of \$240,277,107.

Q. Please explain pro forma adjustments WP B 3-6 through B 3-9.

A. The Company analyzed the (i) capital expenditure budget for 2011 and (ii) construction work in progress at December 31, 2010. A determination was then made as to which projects would be completed and serving customers by September 30, 2011 and before new rates go into effect. This also allows time for Staff to verify the plant balances before completing their review and filing responsive testimony. Pro forma adjustments WP B 3-6 through B 3-9 increase total company plant in service by \$259,589,487 to recognize these completed and “in-service” construction projects.

Q. Why was an adjustment made to Plant Held for Future Use?

A. Adjustment WP B 3-15 results in a decrease of \$783,312 by removing plant held for future use with an acquisition date older than ten years. In previous rate filings, the

1 Company has included all investment for Plant Held for Future Use. However, some have
2 argued that a limited timeframe is more appropriate. Although assets older than 10 years
3 may still provide benefits to ratepayers in the future, the Company only included the most
4 recent 10 years in pro forma net plant.

5
6 **Q. What other adjustments to plant in service has the Company made in this case?**

7 A. Adjustments were made to net plant for smart grid related assets (WP B 3-14) as
8 discussed by OG&E witness Malini Gandhi. Also, as discussed by OG&E witness
9 Donald R. Rowlett, plant was reduced for certain transmission costs recovered from other
10 Load Serving Entities in the Southwest Power Pool (WP B 3-16). These adjustments
11 result in a decrease to net plant of \$37,274,096.

12
13 Other Pro Forma Adjustments to Rate Base

14 **Q. Please describe pro forma adjustment WP B 3-12.**

15 A. This pro forma adjusts the year end prepayments balance to a 13 month average which is
16 more representative of the ongoing balance and results in a decrease of \$455,616 to rate
17 base.

18
19 **Q. What is the purpose of adjustment WP B 3-13?**

20 A. This adjustment to rate base removes various regulatory assets that are specific to the
21 Arkansas jurisdiction, receiving alternative recovery or will be fully amortized by the
22 time new rates go into effect and results in a decrease of \$16,167,583 to rate base.

23
24 **Q. Are there additional adjustments to rate base?**

25 A. Yes. WP B 3-4 and WP B 3-5 are pro forma adjustments to fuel inventories and gas in
26 storage that are addressed by OG&E witness James Proctor.

1 INCOME STATEMENT

2 Overview

3 **Q. In what schedule are the revenues and expenses reflected?**

4 A. Schedule H-2 contains the overall summary of revenues and expenses including
5 depreciation and taxes. The revenue, operating expenses and income tax categories are
6 identified under the "Description" column. Column 1 displays the total Company
7 financial results for the test year ended December 31, 2010. Column 2 and thereafter
8 reflects accumulated pro forma adjustments to the operating income statement.

9
10 **Q. Why is the income statement adjusted in a rate case?**

11 A. Pro forma adjustments are made to establish a forward looking or pro forma income
12 statement to measure prospective earnings under which to set new rates. OG&E witness
13 Adam Bigknife testifies as to the revenue pro forma adjustments. My testimony addresses
14 expense adjustments.

15
16 Insurance

17 **Q. Please explain pro forma adjustment WP H 2-20 to insurance expense?**

18 A. The Company compared test year insurance expense to the projected insurance expense
19 for policy period 2011/2012 when new rates will be in effect. The difference between test
20 year and these projections was then recorded as a pro forma adjustment, reducing
21 expenses by \$621,252. The adjusted levels of insurance expense include pro forma
22 amounts for OG&E and OGE Energy Corp. The amounts for the Holding Company are
23 allocated to OG&E using a four year average allocation factor based on the Distrigas
24 method.

25 Depreciation Expense

26 **Q. Please summarize the WP H 2-21 pro forma adjustments to Depreciation Expense.**

27 A. The depreciation and amortization expense for the test year was \$205,520,071. A
28 depreciation study commissioned by the Company resulted in rates that would produce a
29 reduction in depreciation expense. However, because of an increase in pro forma plant-
30 in-service, this adjustment increases depreciation expense by \$8,113,826 to
31 \$213,633,898.

1 Q. **Who conducted the depreciation study?**

2 A. The Company retained Gannett Fleming to prepare a depreciation study utilizing data as
3 of December 31, 2009. OG&E witness John Spanos of Gannett Fleming sponsors the
4 depreciation study and resulting depreciation rates.
5

6 Holding Company Allocation

7 Q. **Please explain pro forma adjustment WP H 2-22, Holding Company**
8 **Reclassification.**

9 A. This pro forma adjustment is a reclassification and adjustment to O&M expenses for
10 Holding Company's expenses allocated to the utility.
11

12 Q. **Please describe how WP H 2-22 is calculated.**

13 A. These Holding Company expenses charged to the utility are recorded as O&M expense
14 on the utility's books. This adjustment reclassifies \$3,848,602 of costs from O&M
15 expense to the appropriate categories in order to properly allocate costs to jurisdiction
16 and class and does not result in an increase or decrease to the Company's overall O&M
17 expense.
18

19 Compensation

20 Q. **Has the Company made any pro forma adjustments to compensation?**

21 A. Yes. WP H 2-23 is an adjustment for year-end pay increases. WP H 2-24 is an adjustment
22 to incentive pay. WP H 2-25 is an adjustment for increased compensation related to
23 additional positions.
24

25 Q. **What categories of pay are included in compensation?**

26 A. Compensation includes regular labor, overtime labor, sick leave, incentive pay and
27 vacation pay.
28

29 Q. **What is incentive pay?**

30 A. Incentive pay is not guaranteed and is at risk of forfeiture each year depending on
31 whether or not certain Company and Business Unit targets or goals are met.

1 Q. **Why are all aspects of compensation important?**

2 A. The Company's entire compensation package is designed to attract and retain key talent
3 at a competitive price. OG&E offers total compensation packages that are consistent with
4 the market value for similar jobs in similar industries. The compensation package is
5 important in determining whether the Company is competitive and offering market value
6 for a particular job.

7

8 Q. **Can there be confusion as to the appropriate method of assessing prudence for
9 compensation?**

10 A. Yes. Rather than determining if the overall cost for retaining an employee is appropriate,
11 some people focus on the method for calculating the components of compensation. For
12 example, if the Company paid an engineer \$150,000 a year in base salary very few would
13 question that expenditure. However, if the combination of the salary, benefits and
14 incentives for that engineer total \$150,000 some would challenge the appropriateness of
15 the incentive piece of his compensation.

16

17 Q. **Could the Company move incentive pay into base salaries so as to recover all of its
18 costs?**

19 A. Yes. The Company could do this. However, this does not encourage or focus employees
20 on cost control or other Company strategies. The Company utilizes incentive pay to
21 manage costs and provide focus towards the Company goals. As a result of the goals
22 associated with incentive pay, Company employees are invested in the performance of
23 the Company. In addition, the Company believes high performing members should be
24 rewarded for superior performance.

25

26 Q. **What are some of the arguments sometimes made for excluding incentive
27 compensation?**

28 A. Some contend that incentive pay should be disallowed because the payments are
29 uncertain. The Company has proposed an average of incentive payments based on the last
30 4 years. This is nothing more than a standard normalization adjustment. Another
31 contention is that incentive payments based on earnings encourage employees to promote

1 sales and discourage conservation. This ignores the fact that the Company generates
2 earnings from its demand side management programs. In addition, incentive plans
3 encourage efficiency because earnings are the net of revenues and expenses.
4

5 **Q. Would the Company's pro forma compensation pay reflect market value without**
6 **the incentive pay component?**

7 A. No. To establish the market value for jobs, the Company's compensation department
8 reviews jobs that are comparable in the marketplace based upon defined duties and
9 responsibilities. OG&E uses independently verifiable annual compensation surveys
10 published by professional associations and consulting firms for this purpose.
11

12 **Q. Would the elimination of incentive pay result in below market value compensation**
13 **for OG&E employees?**

14 A. Yes. If the incentive pay is eliminated from the compensation expense, the resulting
15 amount would not reflect the market value of the services provided by OG&E's
16 employees. The Company asked Mercer, an internationally prominent consulting firm
17 specializing in HR matters, to study OG&E's compensation package. Michael J.
18 Halloran, a senior partner in the firm, will provide testimony regarding the study. The
19 Mercer report indicated that without annual incentive pay "OG&E would be well below
20 competitive market levels."
21

22 **Q. Has the PUD staff previously recommend approval or inclusion of incentive pay?**

23 A. Yes. In Cause No. PUD 200800398, Commission staff witness Trent Alan Campbell
24 reviewed the total compensation levels for OG&E employees, including incentive pay,
25 and found it was reasonable. Campbell's testimony states, "The plan rewards employees
26 for meeting operating goals, energy efficiency, and accountability throughout the
27 Company. TeamShare is also used as a motivator to attract and retain quality employees.
28 If this portion of payroll was paid in full through base salary, base salaries would still be
29 found reasonable at current total compensation levels..."

1 Q. **What is the purpose of pro forma adjustment WP H 2-23, Payroll and Related**
2 **Taxes?**

3 A. These pro forma adjustments are designed to reflect employee compensation at year end
4 2010. First, payroll items were annualized based on the employees and wage levels
5 during the last full two-week pay period in December 2010 to determine the test year
6 payroll expense. Finally, to capture the pay increase which was effective in the two week
7 pay period from December 20, 2010 through January 2, 2011, the Company annualized
8 that pay period. The resulting difference between test year and the projected 2011
9 payroll, including the increase, represents the pro forma adjustment resulting in an
10 increase to operating expenses in the amount of \$4,295,604.

11
12 Q. **How was the pro forma adjustment WP H 2-24 for incentive pay calculated?**

13 A. As I mentioned earlier, the Company averaged the last four year payouts for short-term
14 incentive. To arrive at the amount of the expense level for the short-term incentive
15 component of compensation the ratio of expense based on total payroll was applied.
16 When payroll taxes are included, this results in an increase to operating expenses of
17 \$2,109,874.

18
19 Q. **What is purpose of pro forma adjustment WP H 2-25?**

20 A. In addition to year end pay increases and changes in incentive pay, the Company has
21 budgeted for additional personnel in 2011 as compared to year end 2010. OG&E included
22 costs through September 2011, which will allow time for Staff to verify payroll costs
23 before completing their review and filing responsive testimony. Therefore, the Company
24 has made a pro forma adjustment increasing operating expenses by \$2,430,505.

25
26 Regulatory Expense

27 Q. **How was pro forma adjustment WP H 2-27, Regulatory Expense calculated?**

28 A. This adjustment is the result of four adjustments. First, the Company normalized
29 regulatory costs for various causes in the Oklahoma jurisdiction excluding rate cases.
30 This increases operating expenses by \$91,912. Secondly, the Company increased
31 operating expenses by \$20,292 to reflect increased FERC fees. However, the Company

1 also removed the amortization of the deferred asset for rate case expenses because this
2 asset will be fully amortized by the time new rates go into effect. This results in a
3 decrease of \$371,888. In addition, the Company removed the Annual Public Utility
4 Assessment Fee (“APUAF”) in the amount of \$1,406,129 because the APUAF fee is
5 already recovered through a surcharge to customer’s bills. The net effect of these
6 adjustments results in a decrease of \$1,665,813 to operating expense.

7
8 Bad Debt Expense

9 **Q. Please explain WP H 2-28, pro forma adjustment to bad debt.**

10 A. The bad debt pro forma adjustment includes cost for uncollectable revenues the Company
11 has incurred, net of the fuel component of the customer’s bill. This adjustment is made to
12 reflect the expected increase in uncollectables (bad debt) not associated with fuel. The
13 fuel component of bad debt flows through the fuel clause.

14
15 **Q. How is the bad debt expense pro forma calculated?**

16 A. The Company utilized a four year uncollectable rate and multiplied it by the pro forma
17 revenues net of fuel to arrive at a new uncollectable expense. This adjustment increases
18 the operating expenses \$578,247.

19
20 Long Term Service Agreement (“LTSA”) Expense Correction

21 **Q. Please explain WP H 2-32, LTSA Expense Correction.**

22 A. This pro forma adjustment was made to normalize the test year expense by reversing the
23 one-time LTSA correcting entry made in 2010. In the test year, OG&E’s accounting
24 department re-evaluated the method for calculating the expense and capital components
25 of the LTSA for both Redbud and McClain. As a result, there was a one-time decrease to
26 production expense in the amount of \$5,905,566. The pro forma adjustment increases
27 expense by \$5,905,566 in order to normalize production expense.

1 Other Regulatory Asset Amortization

2 Q. **What is amortization?**

3 A. Amortization is a process for recovering a cost over time. Amortization is the term used
4 for intangible assets whereas depreciation is the term used for tangible assets.

5
6 Q. **Please explain pro forma WP H 2-35, Other Regulatory Asset Amortization.**

7 A. This adjustment removes the amortization for regulatory assets existing in the test year
8 that will be fully amortized by the time new rates are effective. It also increases expense
9 for the amortization of regulatory assets approved but not recovered since the Company's
10 last base rate filing. The net effect of these adjustments is an increase to operating
11 expense of \$145,657.

12
13 Entertainment and Gifts

14 Q. **Please explain the Pro Forma Adjustment WP H 2-37, Entertainment and Gifts.**

15 A. Pro Forma Adjustment WP H 2-37 adjusts test year expense by decreasing O&M for gifts
16 and entertainment by \$126,953. These costs were deemed promotional in nature by the
17 Company.

18
19 Customer Deposit Interest

20 Q. **Please explain WP H 2-39, pro forma adjustment for Customer Deposit Interest?**

21 A. These expenses are not included in the utility operating expense category as reported in
22 FERC Form 1. The Company made the pro forma adjustment increasing operating
23 expenses by \$1,337,412 to bring these costs back into the reported expenses used to
24 calculate net income and base rates.

25
26 Advertising Expense

27 Q. **Please explain how WP H 2-40, pro forma adjustment to Advertising was calculated.**

28 A. Title 17, Section 180 of the Oklahoma Statute defines the advertising expenses that may
29 be included by a public utility in its operating expenses for ratemaking purposes. OG&E
30 excluded advertising expenses which did not meet the statutory definition. This resulted
31 in a pro forma adjustment reducing expense by \$153,286.

1 Rate Case Expense

2 **Q. Please explain WP H 2-42, pro forma adjustment to Rate Case Expense.**

3 A. The costs reflected in this adjustment are estimates of the expense the Company expects
4 to incur in Oklahoma rate cases, specifically this rate case. The Company included a two
5 year amortization to the cost, which is the same treatment applied in the last rate case
6 application Cause No. PUD 200800398. This adjustment increases operating expense by
7 \$563,950.

8
9 Vegetation Management

10 **Q. What is the process for identifying and assigning Vegetation Management costs to**
11 **the Oklahoma jurisdiction?**

12 A. The Company established a process to track distribution related vegetation management
13 costs by jurisdiction, using orders and other accounting codes. There are certain
14 vegetation management costs that cannot be directly assigned to jurisdictions. For
15 example, OG&E's generation serves customers in all jurisdictions through its
16 transmission system. Therefore, the test year distribution vegetation management costs
17 were directly assigned to each jurisdiction and the transmission vegetation management
18 costs were allocated to the respective jurisdictions.

19
20 **Q. Please explain Pro Forma Adjustment WP H 2-43, Vegetation Management.**

21 A. Pro Forma Adjustment WP H 2-43 represents an annual decrease of \$203,532. This
22 decrease in vegetation management costs reflects the Company's expected expenditure
23 level for 2011. Of this amount, the Oklahoma jurisdiction is actually assigned a reduction
24 of \$365,090 of vegetation management costs while other jurisdictions are assigned an
25 increase of \$161,559. These costs are separate from the expenditures for aggressive
26 vegetation management, a component of the System Hardening Program Rider. OG&E
27 witness Tammy Turnipseed explains why the Company believes it is important to
28 increase funding for aggressive vegetation management efforts.

1 Transmission Poles Maintenance Program

2 Q. **Please explain WP H 2-45, pro forma adjustment for Transmission Poles**
3 **Maintenance Program.**

4 A. During 2010, OG&E implemented a study to inspect steel transmission pole footings to
5 determine repair or replacement needs. This study continued into 2011. After an
6 assessment of the findings, a 10 year program cycle was developed to inspect
7 transmission poles, analyze the findings, and make any needed repairs. This program is
8 similar to the inspection program the Company has for wood transmission poles and is an
9 important step the Company is taking to ensure reliable service for its customers. The
10 Company is requesting an annual cost of \$407,973 to be included in base rates. Because
11 \$117,355 was expensed during the test year, the Company is only requesting an
12 additional \$290,618.

13
14 Acquisition Adjustment Amortization

15 Q. **Please explain WP H 2-48, pro forma adjustment to Acquisition Adjustment**
16 **Amortization.**

17 A. The amortization for certain acquisition adjustments is reflected below the net utility
18 operating income line as shown in FERC Form 1, page 117, line 44. An acquisition
19 adjustment is based on the difference between the purchase price of an asset and its
20 original cost. The majority of this pro forma adjustment is related to the acquisition
21 adjustment for the Redbud Power plant. This adjustment increases operating expense by
22 \$5,789,118.

23
24 Power Delivery NERC Compliance

25 Q. **Please explain WP H 2-49, pro forma adjustment for Power Delivery NERC**
26 **Compliance.**

27 A. This pro forma adjustment results in an increase to operating expense of \$1,484,211. In
28 October 2010, NERC issued a directive to the utility industry, which required OG&E to
29 take several actions to correct any discrepancies between the design and the actual field
30 condition of transmission field facilities. The Company was required: 1) to provide a plan
31 by December 15, 2010 to conduct an assessment and perform remediation; 2) by April 7,

1 2011 to identify and report to the appropriate Reliability Coordinators and Regional
2 Entities all transmission facilities meeting certain conditions; and 3) to correct the issues
3 as soon as possible but no later than October 7, 2012, unless granted prior NERC
4 approval to extend the time period. The pro forma adjustment for Power Delivery NERC
5 Compliance reflects the costs for complying with the NERC directive.

6 **Q. What is the Company doing to comply with the NERC directive?**

7 A. The Company is employing the services of a vendor that utilizes a technology called
8 Light Detection and Ranging (“LiDAR”). This technology is used to scan and capture
9 information related to the Transmission lines to determine conductor to vegetation and
10 conductor to ground clearances. This is accomplished by flying the lines with a helicopter
11 equipped with the LiDAR technology. The data captured through this technology is then
12 loaded into Computer Aided Design and Drafting (“CADD”) software systems for
13 analysis. This analysis is then used to identify potential clearance issues and to develop
14 action plans for correcting any issues. The project begins in 2011 and incurs costs into
15 2013.

16
17 Gains on Allowances

18 **Q. Please explain WP H 2-50, pro forma adjustment to Gains on Disposition of**
19 **Allowances.**

20 A. In Order No. 558445 and Order No. 569281, the Commission authorized OG&E to retain
21 the proceeds from the sale of SO₂ allowances. This adjustment removes from income
22 \$2,363,976 of gains from the sale of SO₂ allowances.

23
24 **CONCLUSION**

25 **Q. Do you have any final comments?**

26 A. OG&E has prepared its application with a test year ending December 31, 2010 and pro
27 forma adjustments for reasonably known and measurable changes to reflect an expected
28 level of expense going forward and respectfully requests that the Commission approve
29 the requested rate increase.

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

2 A. Yes.