

**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

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CORPORATION COMMISSION
OF OKLAHOMA

Direct Testimony

of

Donald R. Rowlett

on behalf of

Oklahoma Gas and Electric Company

February 27, 2009

Donald R. Rowlett
Direct Testimony

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

2 A. My name is Donald R. Rowlett. I am employed by Oklahoma Gas and Electric Company
3 (OG&E or Company) and my business address is 321 N. Harvey, P. O. Box 321,
4 Oklahoma City, Oklahoma 73101.

5
6 Q. **What position do you hold with OG&E?**

7 A. I hold the position of Director of Regulatory Policy and Compliance.
8

9 Q. **Please state your educational qualifications and employment history with OG&E.**

10 A. I earned a Bachelor of Science degree in Business with an accounting emphasis (1980)
11 and a Masters in Business Administration (1992), from Oklahoma City University. In
12 1983, I became a Certified Public Accountant, licensed to practice in Oklahoma. Prior to
13 joining OG&E, I was employed by Arthur Andersen & Co. as a financial consultant and
14 audit manager. During my employment, I performed audits of financial statements in a
15 variety of industries. Additionally, I participated in the preparation of filings with the
16 Securities and Exchange Commission (SEC) and provided clients with guidance on the
17 financial reporting requirements of the SEC and Generally Accepted Accounting
18 Principles (GAAP).

1 Q. **What are your responsibilities as Director of Regulatory Policy and Compliance for**
2 **OG&E?**

3 A. I am responsible for the analysis, development and communication of regulatory policy
4 for OG&E. This includes establishing policies to be followed by the Company in the
5 Oklahoma, Arkansas and Federal Energy Regulatory Commission (“FERC”) jurisdictions
6 and monitoring compliance with those policies throughout the Company. I have testified
7 on behalf of the Company before the Oklahoma Commission, the Arkansas Public
8 Service Commission and the Environmental and Public Works Committee in the United
9 States Senate.

10

11 Q. **Has this Commission previously accepted your professional qualifications?**

12 A. Yes.

13

14 Q. **Please describe the system of accounting utilized in maintaining the Company’s**
15 **books and records.**

16 A. OG&E maintains its financial and accounting records in conformance with the “Uniform
17 System of Accounts for Public Utilities and Licensees”, CFR Title 18, Part 101, required
18 by the Federal Energy Regulatory Commission (FERC) and adopted by the Oklahoma
19 Corporation Commission (Commission). Financial statements are prepared in accordance
20 with generally accepted accounting principles and audited annually by an independent
21 public accounting firm to assure these principles are applied on a consistent basis and in
22 keeping with the prescribed system of accounts. In addition, the Oklahoma Corporation
23 Commission, FERC, Arkansas Public Service Commission, the Internal Revenue Service

1 and other governmental and regulatory agencies perform periodic audits to assure
2 compliance with their respective requirements.

3
4 **Q. What is the purpose of your testimony in Cause No. PUD 200800398?**

5 A. The purpose of my testimony is to explain the calculation of OG&E's requested general
6 rate change. I also sponsor the Company's financial statements and schedules included in
7 Sections B, C, D, E, H, I, J and K of the Company's Application Package. Finally, I am
8 responsible for supporting several *pro forma* adjustments.

9
10 **Q. How is your testimony organized?**

11 A. My testimony is organized into the following five sections.

12 SECTION I: Commission Procedures

13 SECTION II: General Rate Change

14 SECTION III: *Rate Base Pro Forma* Adjustments

15 SECTION IV: *Operating Income Pro Forma* Adjustments

16 SECTION V: Conclusion

17
18 SECTION I: COMMISSION PROCEDURES

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

20 A. OG&E is requesting a general rate change¹ pursuant to the Commission Rules, Chapter
21 70 Minimum Standard Filing Requirements. The accounting exhibits, schedules,

¹ 165:70-1-2. Definitions. "**General Rate Change**" means ... a change in rates resulting in more than a one percent (1%) increase in a utility's jurisdictional annual gross operating revenues unless otherwise allowed by law. A change

1 testimony and evidence that support the general rate change are included in the
2 Application Package² filed in this cause.

3
4 **Q. Did OG&E provide the Commission advance notice of the Company's Application?**

5 **A.** Yes. Pursuant to OAC 165:70-3-7, a utility is required to provide a 45 day notice to the
6 Commission of its intent to file an application for a general rate change. The notice is
7 required to be in writing and filed with the Commission's Court Clerk. On December 12,
8 2008, OG&E filed a Notice of Intent that the Company would be filing an application on
9 or about January 26, 2008 seeking to implement a plan which would modify the rates and
10 charges for its Oklahoma jurisdiction customers. OG&E subsequently notified the
11 Commission Staff that the Company intended to file its application and supporting
12 documentation by the end of February 2009.

13
14 **Q. What is the amount of the requested general rate change?**

15 **A.** The Company is requesting the Commission to approve a \$110.3 million general rate
16 change. The proposed effective date is the first billing cycle in September 2009.

mandated by regulation or legislation, a change in the terms and conditions of service, a request for a special contract, or a request for a new and/or optional service does not constitute a general rate change.

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

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

2 A. The Company's exhibits were based on the financial results of the test year³ ended
3 September 30, 2008. The Application Package contains twelve (12) *pro forma*
4 adjustments to rate base⁴ and thirty-seven (37) *pro forma* adjustments to operating
5 income⁵.

6

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

8 A. In a rate review, the regulatory objective is to design prospective rates to reflect revenue,
9 expense and investment levels the utility is expected to experience. In some regulatory
10 jurisdictions, a "future" test year is utilized to achieve this goal. In Oklahoma, historical
11 financial results are used but require restatement for (i) actual occurrences not expected to
12 recur and (ii) events that are expected to occur but did not transpire, in whole or in part,
13 during the test year. There may also be costs expected to recur but are viewed as not
14 being the customer's responsibility. In this specific cause, *pro forma* adjustments should
15 recognize the revenue, expense and investment levels that the Company will experience
16 after new rates are implemented in September 2009.

17

18 Q. **Please explain the general categories of *pro forma* adjustments.**

19 A. *Pro forma* adjustments usually fall into one of the following three categories:

³ 165:70-1-2. Definitions. "**Test Year**" means the twelve (12) month period used in determining rate base, operating income and rate of return.

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

⁵ Application Package, Volume II, Section H, Schedule H-3.

1 (1) *Normalization adjustments* are usually made to revenues and expenses to offset
2 unusual levels of operations recorded during the test year. For example, extreme
3 weather conditions can create abnormal levels of revenues and expenses.
4 Additionally, abnormal levels of operations may occur due to delayed or accelerated
5 projects during a test year. Whether the revenues and expenses are above or below a
6 normal level, a *pro forma* adjustment is required to project a normal level of
7 operations for the establishment of prospective rates.

8 (2) *Annualization adjustments* recognize that some action occurred during the test year
9 that will be ongoing and must be captured on a prospective basis. One common
10 annualization adjustment is for payroll or salary increases that occur during the test
11 year. Future payroll costs are usually higher than the amount recorded in the
12 historical financials. The *pro forma* adjustment is necessary to increase payroll costs
13 to a level as if the payroll or salary increase had occurred at the beginning of the test
14 year. In developing a payroll adjustment, the change in the number of employees
15 should also be considered.

16 (3) *Out-of-period adjustments* consider known and measurable changes that occur
17 outside the end of the test year. In this cause, two good examples are *Pro Forma*
18 Adjustment No. 9 to rate base and *Pro Forma* Adjustment No. 29 to operating
19 income. *Pro Forma* Adjustment No. 9 recognizes construction expenditures for
20 projects that will be serving customers by March 31, 2009, which is within six
21 months of the test year. *Pro Forma* Adjustment No. 29 recognizes additional
22 employees that will be hired after the close of the test period. These out-of-period

1 adjustments are critical in establishing fair and reasonable rates that will be
2 implemented in September 2009.
3

4 **Q. Is there a hard dead-line for consideration of out of period adjustments?**

5 A. No. Out of period adjustments are sometimes challenged based on 17 O.S. §284, which
6 reads, "*the Commission shall give effect to known and measurable changes occurring or*
7 *reasonably certain to occur within six (6) months of the end of the test period upon which*
8 *the rate review is based.*" Some focus on the word "**within**". Based on that limited
9 reading, some argue for a six-month **limitation** for out-of-period adjustments.
10

11 **Q. What is OG&E's viewpoint regarding out-of-period adjustments?**

12 A. The Company agrees that the Commission must give effect to out-of-period adjustments
13 occurring within six months such as *Pro Forma* Adjustments 9 and 29, just discussed; but
14 the Company understands the Commission has the discretionary authority to approve
15 justified known and measurable changes subsequent to the six-month period. The
16 Company filed a legal brief in PUD 455 addressing 17 O.S. §284. The legal brief
17 established that the Commission has broad discretion to accept or reject known and
18 measurable changes to test year financial information outside the six-month period.
19

20 **Q. Has the Commission ruled on this point recently?**

21 A. Yes. In the most recent PSO rate order (Cause No. PUD 200800144, Order No. 564437)
22 the Commission stated, "Although the Commission is mandated to adopt known and
23 measurable changes that occur within the 6 months post-test year, the Commission also

1 has the option of going beyond the 6 month post test year to consider appropriate
2 adjustments.” (Page 7 of the Order.)
3

4 Q. **Is OG&E proposing out-of-period adjustments that occur after March 31, 2009?**

5 A. Yes, as I discuss in more detail later in my testimony, OG&E is proposing to determine
6 the amortization of unrecovered pension expense based on the regulatory asset balance at
7 August 31, 2009. The Company is also requesting the Commission to approve a level for
8 coal inventory based on current replacement costs projected to June 30, 2009.
9

10 SECTION II: GENERAL RATE CHANGE

11 Q. **How is OG&E’s requested general rate change determined?**

12 A. The calculation of the Company’s requested \$110,325,328 general rate change is
13 summarized in Chart 1.
14

Chart 1

Line No.	MSFR Schedule	General Rate Change Calculation ⁶	
1	B-2	Rate Base	\$2,862,736,554
2	F-1a	Rate of Return	<u>9.640%</u>
3		Return Requirement	275,967,804
4	H-1	<i>Pro Forma</i> Operating Income	<u>(208,443,747)</u>
5		Return Deficiency	67,524,057
6		Federal and State Income Tax	<u>42,801,271</u>
7	B-1	Rate Increase	\$ 110,325,328

15
16 Q. **Please identify and explain the components that are used to determine the**
17 **\$2,862,736,554 rate base value in Chart 1, line 1.**

1 A. Section B, Schedule B-2 displays the total company per book amounts, *pro forma*
2 adjustments and the resulting Oklahoma jurisdiction rate base. This schedule shows that
3 the Company has invested approximately \$2.86 billion to serve our Oklahoma customers.
4 The components of the \$2.86 billion Oklahoma jurisdiction *pro forma* rate base are
5 identified under the “Description” column. The “Reference” column provides the location
6 of detailed schedules that support the total company investment for each component in
7 Column 3. The fourth column reflects accumulated *pro forma* adjustments to rate base.
8 Schedule B-3 itemizes each *pro forma* adjustment by component. The total company *pro*
9 *forma* values are then allocated to determine the Oklahoma jurisdiction rate base of \$2.86
10 billion. OG&E witness Greg Veitch, Manager Cost of Service sponsors the Oklahoma
11 jurisdiction allocation factors shown on Schedule B-2.

12
13 **Q. What adjustments are proposed to the total company per book rate base?**

14 A. Schedule B-4 catalogs twelve (12) *pro forma* adjustments that total \$(42,777,600). These
15 adjustments are required to establish the appropriate rate base value (*investment level*) for
16 ratemaking purposes. Schedule B-4 also contains (i) descriptions and amounts for each
17 *pro forma* adjustment, (ii) list of Company witnesses and (iii) workpaper references.

18
19 **Q. What is OG&E’s requested rate of return in this cause?**

20 A. OG&E is requesting a 9.640% rate of return as depicted on line 2 of Chart 1. The overall
21 cost of capital is established in Section F, Volume II, of the Company’s Application

⁶ Application Package, Volume II, Section B, Schedule B-1.

1 Package. Section F has been updated in this filing to reflect the Company's long-term
2 debt and common equity as of December 31, 2008.

3
4 **Q. Briefly explain the calculation of the 9.640% rate of return.**

5 A. As illustrated in Schedule F-1a, the capital ratio is long-term debt 45.858% and common
6 equity 54.142%. Considering the cost of each component, 6.559% for long-term debt and
7 12.250% for the equity return requested by the Company, the resulting rate of return is
8 9.640%.

9
10 **Q. Please explain the relationship between lines 3 and 4 in Chart 1 above.**

11 A. When the 9.640% rate of return is applied to the Company's jurisdictional investment to
12 provide electric service, the result is a return requirement of \$275,967,804 (Line 3).
13 OG&E's *pro forma* operating income is \$208,443,747 (Line 4). The \$67,524,057
14 difference (Line 5) is the Company's return deficiency. When federal and state income
15 taxes are added to the return deficiency, a \$110,325,328 rate increase is justified.

16
17 **Q. Please identify the sections of the Application Package that are used to establish the**
18 **\$208,443,747 *pro forma* operating income found on Line 4 of Chart 1 above.**

19 A. Sections H, I, J and K support the \$208,443,747 Oklahoma jurisdiction *pro forma*
20 operating income. Section H, Schedule H-1 displays the total company per book amounts,
21 *pro forma* adjustments to operating revenues and expenses and resulting Oklahoma
22 jurisdiction operating income.

1 Q. **Please explain Schedule H-1.**

2 A. The revenue, operating expenses and income tax categories are identified under the
3 “Description” column. The second column displays the total company financial results for
4 the test year ended September 30, 2008. The third column reflects accumulated *pro forma*
5 adjustments to the operating income statement. Schedule H-2 itemizes each *pro forma*
6 adjustment by category. The total company *pro forma* values are then direct assigned or
7 allocated to the Oklahoma jurisdiction. OG&E witness Greg Veitch sponsors the
8 Oklahoma jurisdiction allocation factors shown on Schedule H-1.

9

10 Q. **What adjustments are proposed to the total company operating income?**

11 A. Schedule H-3 catalogs thirty-seven (37) *pro forma* adjustments that increase total
12 company operating income \$1,946,740. These adjustments are required to establish a
13 forward looking income statement to measure prospective earnings under new rates.
14 Schedule H-3 also contains (i) the description and amount for each *pro forma* adjustment,
15 (ii) a list of Company witnesses, and (iii) workpaper references.

16

17 Q. **What is the Oklahoma jurisdiction total revenue requirement based on the *pro***
18 ***forma* test year results?**

19 A. OG&E’s Oklahoma jurisdiction total revenue requirement is \$1,845,320,478 as reflected
20 in Schedule B-1, line 10. The \$1,569,352,674 expense level is found on Schedule H-1,
21 line 19. Chart 2 below describes each expense category and amount. The remaining
22 \$275,967,804 represents the operating income required to fund interest payments on debt
23 and a fair return to OG&E shareowners.

Chart 2

Operating Expenses and Taxes ⁷	
Description	Amount
Fuel	\$ 781,747,772
Purchased Power	159,226,474
Other O&M	309,088,195
Customer Deposit Interest	2,226,268
Depreciation	157,961,191
Amortization of Regulatory Asset	9,922,311
Miscellaneous Taxes	90,177
Property Taxes	47,246,209
Payroll Taxes	10,886,306
Income Tax	<u>90,957,771</u>
Total	\$1,569,352,674

SECTION III: RATE BASE PRO FORMA ADJUSTMENTS

Q. Please identify the *Pro Forma* Adjustments to rate base that you sponsor.

A. I am sponsoring *Pro Forma* Adjustments 1, 2, 3, 6, 7, 8, 9, 10, 11 and 12 which are supported by the referenced workpapers. Some of these adjustments are routine in every rate case or self-explanatory based on the description in Schedule B-4. The following *Pro Forma* Adjustments require some additional explanation:

No. 2 – *Holding Company Asset Allocation*

No. 4 – *Fuel Inventories*

No. 5 – *Gas in Storage*

No. 7 – *Cash Working Capital*

No. 9 – *CWIP Expenditures for the Period October 2008 through March 2009*

No. 10 – *Remove Storm Regulatory Asset*

No. 11 and No. 12 – *Post-closing Redbud Adjustments*

⁷ Application Package, Volume II, Section H, Schedule H-1.

Holding Company Asset Allocation

1
2 Q. **Please explain *Pro Forma* Adjustment No. 2, Holding Company Asset Allocation.**

3 A. Schedule B-3 includes the holding company assets in the total company per book “utility
4 plant” value on line 1. *Pro Forma* Adjustment No. 2 allocates \$24,339,415 to non-utility
5 activity. The breakdown of the adjustment is \$21,921,842 utility plant-in-service and
6 \$2,417,573 construction work in progress. After deducting \$16,977,939 of accumulated
7 depreciation, the net adjustment is a reduction to rate base of \$7,361,476. The accounting
8 detail for *Pro Forma* Adjustment No. 2 is found in OG&E’s Supplemental Filing
9 Package, W/P B-3-2. The Company allocated 24.38% of the holding company assets to
10 non-utility activity based on the allocation methodology supported by the schedule found
11 in OG&E’s Supplemental Package, W/P B-3-2a. The cost centers identified on this
12 workpaper utilize one of four allocation methods: (i) Distrigas; (ii) headcount; (iii)
13 utilization percentage; or, (iv) direct assignment. For example, the costs included in cost
14 center X0007820 are directly assigned to the Company, because they pertain to software
15 systems that support the utility only i.e., Customer Care System and outage management.
16 Likewise, the depreciation costs included in cost center X8888050, Computer Equipment,
17 are allocated based on actual utilization.

18
19 Q. **What is the history behind the holding company allocation?**

20 A. OG&E’s parent holding company, OGE Energy Corp., was formed in 1995 and a
21 corporate reorganization was implemented in 1996. As part of the corporate
22 reorganization, most corporate services and related assets were transferred from OG&E to
23 OGE Energy Corp. (holding company). The holding company assets are still primarily

1 used to support utility activities and services and should be included in OG&E's rate
2 base. OG&E approached the Commission regarding its intent to adopt a Holding
3 Company structure. This notification was in part to avoid future confusion and second
4 guessing of how business was conducted among the Holding Company, OG&E and other
5 subsidiaries.

6
7 **Q. Are you familiar with the Memorandum of Understanding that is referenced in**
8 **Commission Order No. 399818 acknowledging the formation of OGE Energy Corp?**

9 **A.** Yes, I am. As a matter of fact, I participated in discussions with members of the Staff and
10 a representative of the Attorney General's office during the process.

11
12 **Q. Can you describe the process?**

13 **A.** Yes. OG&E filed an application in Oklahoma and in Arkansas notifying each commission
14 of the formation of the Holding Company. Both Commissions conducted a discovery
15 process through the issuance of data requests.

16 I participated in several meetings with the Oklahoma Commission Staff and the Attorney
17 General's representative in which many issues were discussed. The topic of how costs
18 should be allocated was discussed at great length. As a result of these discussions, OG&E
19 memorialized the consensus of these discussions in the Memorandum of Understanding
20 attached to Order No. 399818. The methodology for allocation of Holding Company costs
21 was among these areas of understanding. Generally, the understanding reached was that
22 costs would be allocated in three ways. First, if there was a direct cause and effect
23 relationship, costs should be allocated on that basis. Second, in instances where there was

1 an obvious allocation method, that method would be applied (for example, if two
2 subsidiaries benefited equally from a cost it would be split 50/50). Third, all other costs
3 would be allocated following the Distrigas allocation formula.
4

5 **Q. Has the Distrigas allocation method been accepted by this Commission?**

6 A. Yes. In OG&E's last rate case (PUD2005000151, Order No. 516261) the Commission
7 found that the use of the Distrigas method as presented by OG&E should be adopted as
8 the "appropriate methodology for allocation of General Corporate Overhead to the
9 Company." (page 99 of Order No. 515261). In reaching this conclusion the Commission
10 found that the continuing and consistent use of the Distrigas formula "serves to minimize
11 distortions and fluctuations in the allocation of costs."
12

13 **Q. Please explain the terms "Affiliate transactions", "Affiliate Costs", "Holding
14 Company Cost Allocations", "Corporate Allocations", and "Corporate Overhead
15 Allocations".**

16 A. Within the general context of this testimony, these terms may be used interchangeably to
17 refer to OGE Energy Corp. ("Holding Company") costs charged/allocated to its two
18 active subsidiaries, OG&E and Enogex.

19 As in many corporate organizations, the Holding Company exists primarily to perform
20 general and administrative, non-operating-type services for or on behalf of its subsidiaries
21 in a centralized manner. As such, the Holding Company is not an operating company
22 generating operating revenues. For example, these services include Human Resources

1 (HR), Information Technology (IT), Facilities, Legal, Accounting, and Treasury
2 functions.

3
4 **Q. What type of services do the costs allocated from the Holding Company represent?**

5 A. Holding Company costs generally reflect shared, corporate overhead costs that must be
6 charged or allocated to the subsidiaries.

7 Most services of the Holding Company fall within one of two main types:

8 (1) Shared Services

9 (2) Corporate Services

10 Corporate Services includes services of a more general nature benefiting the entire
11 corporate organization such as corporate accounting and planning, legal, and executive
12 services. The costs of these services are allocated out to others based on the Distrigas
13 method. This group also includes HR and employee benefits, which are allocated based
14 on headcount.

15 Shared Services includes services such as facilities, computers, PC network, Enterprise
16 system, telephone system, fleet maintenance, purchasing and material warehousing
17 services. These services are generally charged based on specific orders, direct charge,
18 usage or headcount where the benefit of such services is more easily tracked.

19
20 **Q. Can you explain what you mean when you say, “based on head count”?**

21 A. Based on head count means that a cost would be allocated based upon the number of
22 employees assigned to a particular group. Human Resources (HR) is a good example. The
23 HR department administers common human resource programs such as Equal

1 Employment Opportunities, medical and dental plans, and payroll administration. When
2 all of the costs of administering these programs is accumulated, the resulting amount is
3 divided by the total number of employees. The result of this calculation is a rate per
4 employee assigned to a particular department. For illustration, let's say the amount is
5 \$1,000 per employee. Since Enogex has roughly 515 employees it would get a charge of
6 \$515,000.

7
8 **Q. Are costs allocated or charged to groups within the Holding Company?**

9 **A.** Yes. For example, the Accounting department (a Corporate Service) uses or benefits
10 from the services of the HR, IT, and Facilities groups in order to conduct its accounting
11 activities. Thus, the Accounting group receives costs from many other service groups,
12 then the total of these costs is accumulated with the other direct costs in the Accounting
13 group and the total Accounting group cost is allocated to subsidiaries based on Distrigas.
14 All of these Holding Company costs are ultimately charged out among departments and
15 to subsidiaries based on usage and benefit of such services.

16 Affiliate costs can also relate to costs charged between any of the three companies
17 mentioned, but in the context of this testimony, these terms will refer to Holding
18 Company costs charged or allocated to OG&E and Enogex, with our primary focus on
19 costs charged to the utility, OG&E.

20
21 **Q. When you refer to Enogex, are you including Enogex and all of its subsidiaries?**

22 **A.** In the context of Holding Company allocations, the term "Enogex" is used to represent
23 Enogex and all of its subsidiaries.

1 Q. **How have total administrative and general expenses changed since the formation of**
2 **the Holding Company?**

3 A. Since 1995, total Administrative and General costs (including Miscellaneous General
4 Expense) have remained relatively constant, demonstrating that through efficiencies and
5 synergies gained through centralization of corporate/shared services, OG&E has
6 successfully mitigated the effects of inflation generally experienced by our economy since
7 the mid 90's.

8
9 Q. **What techniques exist to ensure that expenses are correctly being charged or**
10 **allocated to the utility?**

11 A. There are structural controls in place to ensure that costs are charged to the proper
12 department or company. Many of the rules that govern the distribution of Holding
13 Company costs are configured in OG&E's internal SAP accounting system. Incentives
14 have also been created to ensure correct allocation of common costs. The "Teamshare"
15 incentive compensation plan includes measurements which encourage and reward cost-
16 cutting performance with no sacrifice in safety or the reliability of service. Costs received
17 from the Holding Company are included in operating group's responsible costs. This
18 performance measure has caused managers and employees to scrutinize costs more
19 closely, and it has assisted the utility in its efforts to ensure the fairness of pricing and
20 allocation of corporate overhead costs.

21 This incentive aligns the interest of the utility employees with the interests of the
22 ratepayers. Utility operating managers can increase their incentive compensation to the
23 extent they can effectively manage Holding Company and other costs. Managers can turn

1 back unused computers; make sure only necessary phone lines are requested or reduce the
2 square footage occupied. Each of these services are transferred from the Holding
3 Company on a unit basis so operating managers have an incentive to use less and lower
4 the charge to their operations.

6 Fuel Inventories

7 **Q. Please explain *Pro forma* Adjustment No 4, Fuel Inventories?**

8 **A. *Pro forma* Adjustment No. 4 (i) increases the level of inventories to reflect 60 days of**
9 **coal, (ii) adjusts coal inventory value to current replacement cost and (iii) adjusts fuel oil**
10 **inventory to average levels on hand. The majority of this adjustment, \$29,505,963, is**
11 **related to the coal inventory. During the test year OG&E's 13 month average level of coal**
12 **inventory was approximately 1,977,000 tons. *Pro forma* Adjustment No. 4 is based on**
13 **1,980,000 tons. The increase in the proposed investment in coal inventory is primarily**
14 **due to increased rail transportation cost. At September 30, 2008 the Company's weighted**
15 **average cost of coal in inventory was \$20.10 per ton. As a result of new rail transportation**
16 **rates from the Union Pacific and the Burlington Northern Santa Fe, which went into**
17 **effect January 1, 2009, the replacement cost of delivered coal is projected to increase to**
18 **approximately \$36 per ton. This increase will cause the projected weighted average cost**
19 **of coal to be approximately \$33 per ton by the end of June 2009. In accordance with**
20 **Commission rules, OG&E's fuel inventory levels are based on the weighted average cost.**
21 **As coal is consumed it flows through the fuel adjustment clause at its historical weighted**
22 **average cost. As the coal consumed is replaced it increases the amount recorded in**
23 **inventory at its current cost including transportation costs. Therefore, the weighted**

1 average cost of coal will reflect the new costs being incurred. The Company's *pro forma*
2 adjustment reflects the \$33 weighted average cost per ton applied to the requested 60 day
3 level of 1,980,000 tons.
4

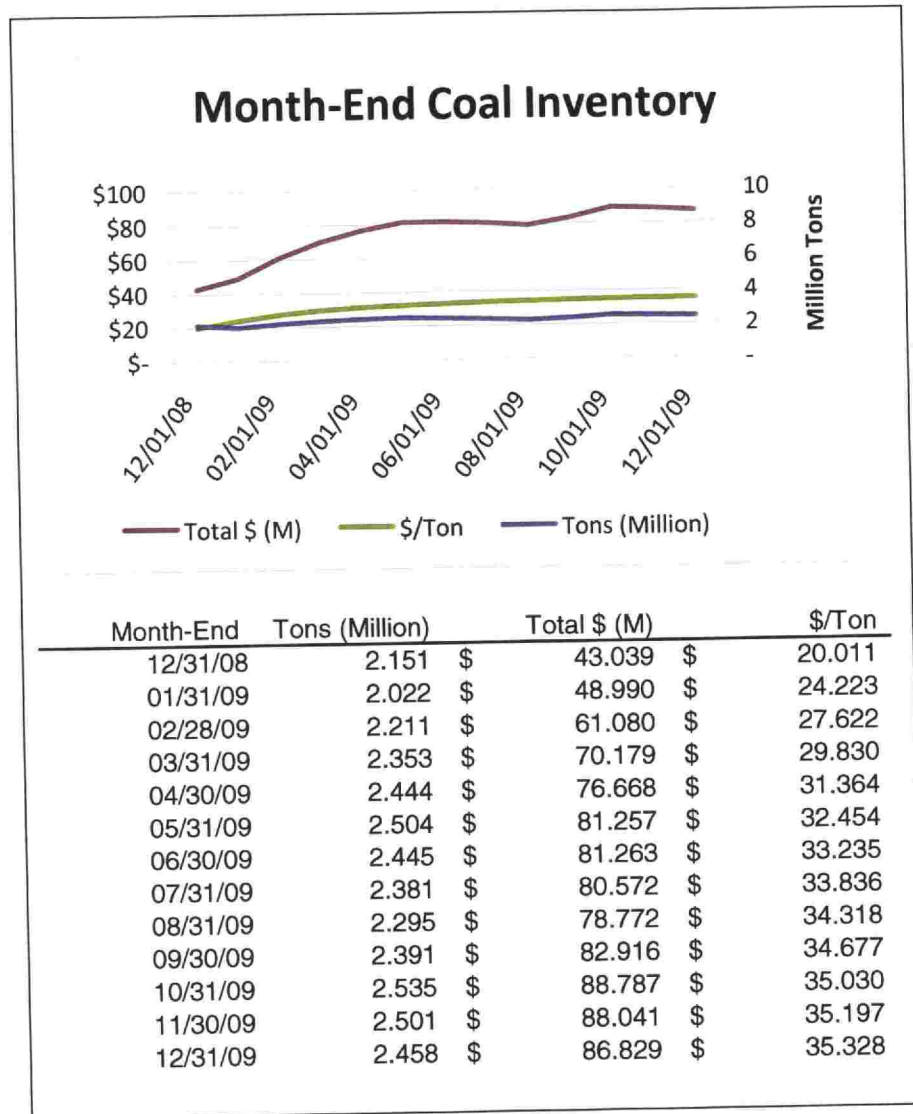
5 **Q. Do you have further support for basing OG&E's request on the weighted average**
6 **cost of \$33 per ton for coal inventory?**

7 A. Yes. First, the \$33 per ton average cost is based on current prices that went into effect in
8 January 2009. Second, the weighted average cost of coal inventory is expected to exceed
9 \$33 per ton by the time the order in this case is issued.
10

11 **Q. Has the Company analyzed the coal inventory projections?**

12 A. Yes. Chart 3 demonstrates the anticipated cost of coal inventory through 2009. By the end
13 of August 2009 (when an order in this case is anticipated) the cost of OG&E's inventory
14 is expected to be \$34.318 and by the end of 2009 the cost will be \$35.328 per ton.

Chart 3



Gas in Storage

5 Q. **Are there any other adjustments to fuel inventories?**

6 A. Yes. *Pro Forma* Adjustment No. 5 decreases rate base by \$7,640,331.

7
8 Q. **Please explain this decrease.**

9 A. The volumes of gas in storage were higher at the end of the test year than average. The
10 adjustment also reflects projected decreases in the weighted average cost per MMBtu.

Cash Working Capital

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Q. Please explain *Pro Forma* Adjustment No. 7, Cash Working Capital.

A. A component of OG&E's rate base is cash working capital. The majority of the rate base components are specific values found on the Company's books as reflected on Schedule B-2. In order to arrive at a reasonable level for cash working capital, the Company performed a lead-lag study. The study determines the average amount of capital invested by the shareowners in excess of the specific investments in other rate base components. The lead-lag study was performed under my direction. The Company is requesting the Commission to include (\$4,427,690) of cash working capital in the calculation of rate base for this proceeding.

Q. What were the results of the lead-lag study?

A. The study showed that on average \$4,427,690 of the cash working capital needs of the Company were supplied from non-investor sources. Therefore, the Company is requesting the Commission to adjust rate base by reducing it by \$4,427,690.

Q. Please discuss the lead-lag study employed in this case.

A. The lag in collection of revenues was determined using the Company's electronic customer accounting system, thus allowing for measurement based on including all the revenue data for the year ending September 30, 2008. With the exception of certain expenses and earnings having zero lead items, the lead days for the various categories of

1 cost of service were determined through studies of actual sample data.⁸ These included
2 detailed studies for fuel, purchased power, labor, taxes and other operating and
3 maintenance expenses.

4
5 **Q. Where can one find the calculation of cash working capital for this case?**

6 **A.** Schedule E-1 is the summary of cash working capital. Line 1 of that Schedule shows the
7 revenues for the test year ended September 30, 2008, the average lag in the collection of
8 those revenues of 38.15 days and dollar-days. That dollar-days amount is used to
9 determine the net lag days on a dollar-weighted basis and is simply the revenue lag period
10 multiplied by test year revenue.

11 Lines 2 through 13 are the various items included in cost of service. The sum of these
12 costs equals the total revenues on line 1. Hence, that is the reason the study is called the
13 total revenue requirement approach.

14 Each of these cost amounts is multiplied by its corresponding period of lead days
15 determined in the lead-lag study. That resulting product represents the dollar-days
16 amounts for each cost. The weighted-average lead of 38.36 days is determined by
17 dividing the sum of the dollar-days for cost of service items by the total cost of service.

18 This quotient is shown as a negative (in parentheses) because lead days offset the revenue
19 lag. The net lag of (0.21) days [lag days of 38.15 minus lead days of 38.36 equals (0.21)]
20 is shown on line 15.

⁸ I discuss later in my testimony that to properly develop the cash working capital study one must assign a zero lead day period to depreciation expense, deferred income tax expense, accumulated deferred investment tax credit expense and common equity earnings.

1 Just below the total cost of service per books, on line 14, is the daily cost of service of
2 \$5,731,095 which is determined by dividing the cost of service total by 365 days.
3 Similarly, in the column headed "Total Company *Pro Forma*" the *pro forma* revenue
4 requirement is shown and below it is the daily amount of \$5,450,964.

5 On line 16 the unadjusted cash working capital requirement is shown for both the test
6 year per books and for the *pro forma* revenue requirement. This is determined by
7 multiplying the daily amounts for each determined above by the net lag of (0.21) days
8 shown on line 15. Those products are adjusted for the sales and franchise tax collections
9 and other cash working capital amounts to determine the totals shown on line 19 for the
10 test period per books and for the *pro forma* revenue requirement. On line 19, the
11 Commission will find that OG&E is proposing a *pro forma* cash working capital amount
12 of (\$4,427,690) be included in rate base.

13
14 **Q. Do you think your application of the lead-lag study provides a reasonable amount**
15 **for cash working capital?**

16 A. Yes. I believe the results of the lead-lag study have been applied using the most
17 theoretically sound basis available. That is, I have employed the total revenue
18 requirements approach. Under that approach, all components of the revenue requirement
19 are examined in arriving at a reasonable value for cash working capital.

20
21 **Q. What does the lead-lag study measure?**

22 A. Customers incur an obligation to compensate the Company as they receive service.
23 However, the Company must wait from the date that service is rendered to the date when

1 the cash is collected from rate payers and, therefore, OG&E's investors must provide cash
2 working capital during this delay.

3 If the Company were operating on a cash and carry basis, it would pay cash each day, (1)
4 to employees, vendors, and others who supplied labor or materials required in the
5 delivery of service, (2) to taxing authorities, and (3) to equity and debt investors for the
6 recovery of and return on invested capital. Obviously, cash payments on a daily basis are
7 not practical, thus, the Company has use of working capital from the date employees,
8 vendors, and others render service or supply materials, to the date the Company pays for
9 such services and materials. This reduces incremental cash investors must invest. The
10 lead-lag study involves determining the average timing of cash flows coming in from
11 customers to those going out for fuel purchases, power purchases, labor, and other
12 operating expenses.

13
14 **Q. How does a lead-lag study employ these concepts?**

15 **A.** The major objective of a lead-lag study is to determine the amount of invested capital
16 required in addition to that for rate base components such as net electric plant,
17 prepayments and material and supplies. Lead-lag studies generally measure lags and leads
18 consistently by analyzing all sources and uses of cash working capital.

19 However, there is a difference of opinion regarding the categories of cost of service to be
20 included in the study. One practice is to limit lead-lag studies to operating expenses and
21 taxes. However, the revenue requirements approach is more complete and includes all
22 operating expenses, taxes, and return on investment. Unlike some other approaches, it
23 includes expenses such as depreciation, deferred income tax expense, and amortization of

1 the investment tax credit. In my opinion, the revenue requirements approach is a more
2 accurate estimate of the amount of cash working capital that must be supplied by the
3 investors.

4
5 **Q. Have you included depreciation expense, deferred income tax expense, amortization**
6 **of the investment tax credit and return on common equity in your study?**

7 **A.** Yes. Still, with respect to the return on common equity, the Company understands that
8 some believe the delay in investors receiving a return on common equity until customers
9 pay their utility bills is already incorporated, implicitly, in the cost of equity analysis used
10 to set the allowed return on equity. I will address the lead time for investors receiving a
11 return on common equity in more detail later but, in short, the Company does not agree
12 with that assumption making it necessary to include cash working capital for that delay.
13 However, given the inherent subjectivity in interpreting that concept, the Company can
14 understand why the Commission may not allow cash working capital for the zero lead
15 time for the common equity return.

16 That said, the Company firmly believes the Commission should allow cash working
17 capital for depreciation expense, deferred income tax expense and amortization of the
18 investment tax credit through the lead-lag study. These expense items should be assigned
19 a zero lead time in that study.

20
21 **Q. Why do you believe the lead-lag study should include depreciation expense, deferred**
22 **income tax expense and amortization of the investment tax credit?**

1 A. Because the basic reason for including cash working capital in rate base is to compensate
2 investors for investing cash in the Company and these three categories of expenses all
3 affect cash flow and rate base requirements. For example, with regard to depreciation
4 expense, cash was invested in un-depreciated plant during construction. The provision
5 for depreciation expense in utility rates allows for the recovery of such prior cash
6 expenditures from ratepayers receiving service. Yet, the recovery of cash for depreciation
7 expense is not received from rate payers until bills are paid. That is, the receipt of cash by
8 OG&E is delayed by the revenue lag, but the plant balance is reduced by the amount of
9 depreciation expense when recorded, thus, decreasing the rate base immediately.

10

11 **Q. Please explain in more detail how investors should receive a return on cash invested**
12 **in plant before and, temporarily, after recording depreciation expense.**

13 A. The investor receives a return on the equity investment in plant through utility rates from
14 the Commission including such plant in the Company's rate base. The investor receives
15 recovery of that equity investment in plant through utility rates from the Commission
16 including such plant's depreciation expense in the Company's operating expenses.

17 The rate base is immediately reduced through recording depreciation expense. That
18 means rate base is reduced when recognizing prospective recovery of such depreciated
19 investment will be received later when customer bills are paid. That is, the rate base is
20 reduced simultaneously with the recording of depreciation expense in accumulated
21 depreciation, thus, immediately removing that portion of plant investment from the
22 investment base receiving a return through utility rates. Removing that portion of plant
23 investment from the investment base, receiving a return through utility rates, occurs

1 before the revenue to recover the provision for depreciation expense is received in cash
2 from ratepayers. Specifically, the depreciation expense is not recovered from rate payers
3 until after the revenue lag.

4 In this case, the Company collects cash for depreciation expense through revenues, on
5 average, about 38.15 days after service is rendered. Unless this 38.15-day revenue lag is
6 reflected in the cash working capital allowance and is included in rate base, that portion
7 of investor supplied capital will not have an opportunity to earn an equity return during
8 the lag period. To correctly allow for the required cash working capital investment caused
9 from depreciating plant, the Commission should recognize a zero lead time for
10 depreciation expense in the cash working capital calculation. Otherwise the Company's
11 equity investors will not receive a return on their investment for the 38.15 day period
12 between when plant is depreciated and when the related cash is recovered through its
13 rates.

14
15 **Q. How should deferred income tax expense and amortization of the investment tax
16 credit be treated in the lead-lag study?**

17 **A.** The treatment for deferred income tax expense is the same as that for depreciation
18 expense discussed above. In determining revenue requirements, the provision for deferred
19 income tax expense is included in expenses and the balance of accumulated deferred
20 income tax expense is deducted from rate base. Just as is the case with depreciation, the
21 accumulated deferred income taxes are deducted from rate base upon recording deferred
22 income tax expense, yet the deferred income tax has not been collected from customers
23 during the revenue lag period.

1 The treatment in the lead-lag study for investment tax credits is also the same as for
2 depreciation and deferred income taxes. As these credits are amortized, the amortization
3 reduces income tax expense collected through revenue requirements. The unamortized
4 balance is a reduction of rate base. Unlike for depreciation expense and deferred income
5 tax expenses, in this case, rate base is increased by the amortization of investment tax
6 credits. However, as for depreciation expense and deferred income tax expense, that
7 increase to rate base occurs before the customer has the benefit from paying lower income
8 taxes through rates.

9 If amortization of investment tax credits is not treated correctly in the lead-lag study, the
10 rate payer actually pays a return on the increased rate base before receiving the income
11 tax benefit through rates. One can see that the only difference here from that for
12 depreciation expense and deferred income tax expenses is that correctly treating
13 amortization of investment tax credits decreases cash working capital requirements, thus
14 benefiting customers.

15 In conclusion, the Company firmly believes the Commission should assign a zero lead
16 time in the lead-lag study for depreciation, deferred income tax and investment tax credit
17 expenses.

18
19 **Q Why should the equity return be included in the lead-lag study with a zero lead**
20 **time?**

21 **A.** Conceptually, this matter is the same as for depreciation, deferred income tax and
22 investment tax credit expenses. The return on common equity is part of the cost of service
23 included in utility rates. Since revenues are collected after a lag of about 38.15 days, the

1 equity investors must wait for recovery of their return on investment until the end of the
2 lag period. When the common equity earnings are not included in the cash working
3 capital study with a zero lead time, the equity investor does not receive a return on those
4 funds, invested as un-recovered earnings, between their realization and when they are
5 recovered through rates.

6
7 CWIP Expenditures for the Period October 2008 through March 2009

8 **Q. Please explain *Pro Forma* Adjustment No. 9, CWIP Expenditures for the Period of**
9 **October 2008 through March 2009.**

10 A. As discussed earlier in my testimony, the Commission accepts out-of-period adjustments
11 that are known and measurable within six months of the test year. The Company analyzed
12 its capital expenditure budget through March 2009 and identified construction projects
13 that will be completed and serving customers by March 31, 2009. *Pro Forma* Adjustment
14 No. 9 increases total company rate base by \$79,763,990 to recognize these construction
15 projects. A complete list of all the projects can be found in the Company's Supplemental
16 Package, Volume I, W/P B 3-9. That schedule identifies the major construction projects,
17 generally over \$1 million, categorized by production, transmission and distribution; and,
18 it also lists the work order number, description and amount for each major project.

19
20 Remove Storm Regulatory Asset

21 **Q. Please explain *Pro Forma* Adjustment No. 10, Remove Storm Regulatory Asset.**

22 A. Through Adjustment No. 10, I remove the portion of the regulatory asset included in the
23 Company's rate base that relates to the ice storm of December 2007. Since these costs are

1 being recovered separately through a rider, they cannot also be recovered through base
2 rates. Since the regulatory asset per books includes the amount related to the ice storm, it
3 must be removed to avoid redundant recovery for the asset value of \$33,328,059.
4

5 Post-closing Redbud Adjustments

6 **Q. Please explain *Pro Forma* Adjustments No. 11 and No. 12, Post-closing Redbud**
7 **Adjustments.**

8 A. OG&E acquired an ownership interest in the Redbud generating plant in 2008. As of test
9 year end, the Company's books included plant and accumulated depreciation for Redbud
10 based on estimates. Subsequent to September 30, 2008, the Company has established the
11 actual net-asset values for Redbud. The purpose for Adjustments No. 11 and No. 12 is to
12 replace the estimated value of Redbud plant and accumulated depreciation recorded at
13 test year end with the actual values.

14 A calculation for Adjustments No. 11 and No. 12 can be found in the Company's
15 Supplemental Package, Volume I, in W/P B 3-11 and W/P B 3-12, respectively. These
16 workpapers present, by account, the adjustment to Redbud plant and Redbud accumulated
17 depreciation of \$2,741,279 and \$3,217,873, respectively.
18

19 SECTION IV: *OPERATING INCOME PRO FORMA* ADJUSTMENTS

20 **Q. Please identify the *pro forma* adjustments to operating income that you sponsor.**

21 A. I am sponsoring *Pro Forma* Adjustments 5, 9, 12-14, 16, 20-26, 28, 30, and 35 which are
22 supported by the referenced workpapers. Some of these adjustments are routine in every

1 rate case or self-explanatory based on the description in Schedule H-3. The following

2 *Pro Forma* Adjustments require some additional explanation:

3 No. 5 – *Removing Fuel Cost Adjustment*

4 No. 9 – *True-Up of Fuel Cost Adjustment*

5 No. 12 – *Ad Valorem Taxes*

6 No. 13 – *Pension and Medical Costs*

7 No. 16 – *Depreciation Expense*

8 No. 20 – *Rate Case Expense*

9 No. 21 – *Bad Debt Expense*

10 No. 22 – *Business Process Improvement*

11 No. 23 – *Remove 2007 Ice Storm Expense*

12 No. 24 – *Southwest Power Pool*

13 No. 25 – *Amortization of Pension Regulatory Asset*

14 No. 26 – *Redbud – O&M*

15 No. 28 – *Other O&M Adjustment*

16 No. 30 – *Vegetation Management 2009*

17
18 Fuel Cost Adjustment

19 Q. **Please explain *pro forma* adjustments No. 5 and No. 9.**

20 A. *Pro Forma* Adjustments No. 5 and No. 9 should be considered together. *Pro Forma*
21 Adjustment No. 5 reduces operating revenues by \$59,844,314 to eliminate test year fuel
22 adjustment revenues. *Pro Forma* Adjustment No. 9 increases operating revenues
23 \$167,267,182 to synchronize *pro forma* operating revenues with the *pro forma* level of

1 fuel expense included in operating expenses. OG&E's fuel adjustment clause adjusts
2 operating revenues to reflect the level of actual fuel expense incurred, therefore it is
3 necessary to synchronize fuel revenues and fuel expenses in determining *pro forma*
4 operating income.

5 Ad Valorem Taxes

6 **Q. Please explain *Pro Forma* Adjustment No. 12, Ad Valorem Taxes.**

7 A. This adjustment increases property taxes by \$3,791,820, which is based on historic
8 changes in valuations and millages. The adjustment also includes the expected tax
9 liability for the recently acquired Redbud plant. These estimates can be updated during
10 the staff's auditing process if actual ad valorem taxes become known. The estimates are
11 provided in the Company's Supplemental Package, Volume I, in W/P H 2-12.

12 Pensions and Medical Costs

13 **Q. Please explain *Pro Forma* Adjustment No. 13, Pension and Medical Costs.**

14 A. Based on an actuarial valuation report, the Company's pension and medical costs for
15 2009 will increase \$3,791,905 over the actual test year expenditures. *Pro Forma*
16 Adjustment No. 13 increases pension and medical costs to recognize the increase. The
17 calculation of the adjustment is provided in the Company's Supplemental Package,
18 Volume I, in W/P H 2-13.

19 The actuarial valuation report is for calendar year 2009, based upon events that occurred
20 in 2008. The pension and medical costs identified in that report are being recorded on the
21 Company's books for 2009. OG&E retained Watson Wyatt Worldwide, to prepare the
22 Company's actuarial report.
23

1 Q. **Please explain how benefit liabilities are determined.**

2 A. Pension and retiree medical expenses are the two primary benefits which result in benefit
3 liabilities. To cover future pension obligations relating to past, current and future
4 employees, OGE Energy Corp. created a company-wide pension plan. OG&E makes
5 annual contributions to the plan that are invested in equity securities, corporate bonds and
6 government obligations. The level of plan contributions is generally equal to the net
7 periodic benefit cost. When necessary, additional contributions are made to maintain a
8 long-term funded status of between ninety and one hundred percent of the projected
9 benefit obligation. Annually, the Company retains an independent actuary to prepare an
10 actuarial valuation of the pension plan. Among other things, this valuation determines the
11 net periodic benefit cost. The valuation also documents the funded status of the plan by
12 comparing the projected benefit obligation to the fair value of assets held by the plan.

13
14 Q. **What are the factors that have lead to the increases in OG&E's pension costs?**

15 A. The primary causes for increased costs between the test year and those proposed in the
16 Company's filing relate to external economic events. Those are primarily low discount
17 rates and negative rates of return on plan assets in the financial market.

18
19 Q. **Please explain what measures the Company has taken to control medical expenses.**

20 A. OG&E has implemented some shifting of costs from the Company to the employees and
21 retirees by increasing the participants' contribution amounts as well as minor plan design
22 changes. The Company has increased medical deductibles and implemented a
23 prescription deductible. The prescription co-payments have also been increased. New

1 employees are no longer eligible for retiree medical coverage. The claims administration
2 was transferred to Blue Cross, Blue Shield Custom Group Services, a claims
3 administrator who offers a preferred provider network with substantial negotiated
4 discounted services. The plan design provided significant incentives for members to use
5 providers in this network. Effective January 1, 2004, the reimbursement for network
6 provider services was reduced from 90% to 80% and the deductible per member was
7 increased to \$200. While OG&E has experienced increasing medical costs over the last
8 several years, these changes have resulted in significant savings to the plan when
9 compared to the national trend in medical costs.

10
11 **Q. Can you give examples of steps that are being taken to mitigate OG&E's exposure**
12 **to this general trend of rising medical costs?**

13 **A.** Yes. Examples include cost shifting for retirees by moving them to a target cost sharing
14 of post-retirement medical benefits. For active employees, the Company has moved from
15 a co-pay system to a co-insurance structure and adjusted the benefit reimbursement
16 percentages. OG&E is also conducting an education campaign and establishing a health
17 internet portal to help our members to become better healthcare consumers.

18
19 **Depreciation Expense**

20 **Q. Please summarize the *pro forma* adjustments to depreciation expense.**

21 **A.** Section H, Schedule H-1, line 10 reflects a \$143,964,482 test year "per book"
22 depreciation expense. The Company has proposed adjustments that increase the

1 \$143,964,482 to \$179,155,678. The increase to depreciation expense is \$35,191,196 as
2 identified in Chart 4 below.

3 **Chart 4**

DEPRECIATION EXPENSE <i>Pro Forma Adjustment Summary</i>		
Adjustment	Description	Amount
No. 16	<i>Pro Forma</i> Level	\$ 29,436,520
No. 17	Holding Company O&M Reclassification	<u>5,754,676</u>
	Total <i>Pro Forma</i> Adjustment	\$35,191,196

4
5 **Q. Please explain *Pro Forma* Adjustment No. 16.**

6 **A.** *Pro Forma* Adjustment No. 16 increases depreciation expense \$29,436,520. The
7 calculation of the adjustment is provided in the Company's Supplemental Package,
8 Volume I, in W/P H 2-16. The adjustment incorporates the *pro forma* balance of
9 depreciable plant and currently approved depreciation rates.

10
11 **Q. Who supports the Adjustment No. 17 shown in Chart 3?**

12 **A.** Company Witness Ms. Sheri Bunn provides testimony supporting Adjustment No. 17.

13
14 **Rate Case Expense**

15 **Q. Based on *Pro Forma* Adjustment No. 20, what is the Company requesting for Rate**
16 **Case Expense?**

1 A. The Company is requesting a level for rate case expense of \$1,531,507 for the Oklahoma
2 jurisdiction. The calculation of the adjustment is provided in the Company's
3 Supplemental Package, Volume I, in W/P H 2-20.

4
5 **Bad Debt Expense**

6 **Q. Please explain *Pro Forma* Adjustment No. 21, Bad Debt Expense.**

7 A. Through *Pro Forma* Adjustment No. 21, I increase the test year "per book" bad debt
8 expense by \$3,350,396 to a *pro forma* amount of \$5,289,563. The *pro forma* level of bad
9 debt expense reflects a four-year average charge-off rate of 0.2783%. The calculation of
10 the adjustment is provided in the Company's Supplemental Package, Volume I, in W/P H
11 2-21.

12 **Business Process Improvement (BPI)**

13 **Q. Please explain *Pro Forma* Adjustment No. 22, BPI.**

14 A. During the test year the Company incurred outside service costs in connection with a
15 project to improve certain business processes. It was determined that these cost would not
16 recur. Therefore they were removed from the test year expense level.

17
18 **Remove 2007 Ice Storm Expense**

19 **Q. Please explain *Pro Form* Adjustment No. 23, Storm Expense.**

20 A. Through Adjustment No. 23, I remove amortization in the amount of \$409,333 from cost
21 of service relating to costs of the December 2007 ice storm. These costs should not be
22 included in base rates because they are collected through a Commission authorized rider.
23 Since the transmission and distribution expense per books includes amortization of cost

1 related to the ice storm, it must be removed to avoid redundant recovery of \$409,333. The
2 breakdown of the adjustment by account is provided in the Company's Supplemental
3 Package, Volume I, in W/P H 2-23.
4

5 Southwest Power Pool

6 **Q. Please explain Pro Form Adjustment No. 24, Southwest Power Pool.**

7 A. As a result of the Southwest Power Pool (SPP) assessment structure, OG&E is
8 experiencing fees from the SPP in excess of the expenditures during the test year. During
9 the test year the Company paid \$9,747,710 in fees to the SPP. However, based on
10 annualizing costs at March 2009 levels using current assessment fees and current demand
11 and net energy statistics, the Company expects to incur payments to SPP going forward of
12 \$12,609,300 per year. Through Adjustment No. 24, I increase OG&E's operating costs by
13 \$2,861,589 to account for the higher SPP fees.
14

15 **Q. What are the components of the overall SPP fees?**

16 A. The SPP fees consist of eight components. These components are itemized in the
17 Company's Supplemental Package, Volume I, in W/P H 2-24.
18

19 Amortization of Pension Regulatory Asset

20 **Q. Please explain Pro Form Adjustment No. 25, Amortization of Pension Regulatory**
21 **Asset.**

22 A. Through Adjustment No. 25, I include amortization of the pension regulatory asset in
23 operating expenses in the amount of \$9,653,550. This adjustment amortizes the asset over

1 a two-year period. The Commission authorized “OG&E to set up regulatory asset and
2 liability accounts to track changes in pension expense.” (Cause No. PUD 200500151,
3 Order 516261 page 101.) The Company has accumulated as a regulatory asset increases in
4 pension expenses that have occurred since the effective date of the Commission’s last
5 order. The regulatory asset balance also includes a projection of unrecovered pension
6 expenses accruing from the end of the test year through August 31, 2009, the period
7 before an order in this cause is expected.

8
9 **Q. What was the basis of the two year amortization period?**

10 **A.** OG&E expects that it will file a new general rate case within two years from the effective
11 date of the order received in this cause. The Company proposes that the under recovered
12 pension costs be amortized over the period through which rates that result from this cause
13 are anticipated to be in effect.

14
15 **Q. Do you believe the regulatory tracking mechanism established by the Commission to**
16 **recognize the volatility in pension expense should be continued?**

17 **A.** OG&E has experienced unusual volatility in the level of pension expense in the last
18 several years. Most recently, this volatility can be attributed to the crisis that has occurred
19 in financial markets. The regulatory asset/liability treatment established by the
20 Commission captures both increases and decreases in pension expense. Until the financial
21 markets return to normal the tracking mechanism initiated by the Commission captures
22 these changes to be in reflected in future rates.

1 Redbud O&M

2 Q. **Please explain Pro Form Adjustment No. 26, Redbud O&M.**

3 A. OG&E acquired an ownership interest in the Redbud generating unit in 2008. The effect
4 of Adjustment No. 26 is to include an annual level of operations and maintenance
5 expenses in the test year cost of service for Redbud. The components of the adjustment
6 include major maintenance expense of \$3,001,289; other operations and maintenance
7 expenses of \$710,025; and, utilities expenses of \$918,348 for a total adjustment of
8 \$4,629,662. This adjustment does not include an allowance for ad valorem taxes,
9 insurance or payroll. Those expenses are incorporated in the test year cost of service
10 through other Company adjustments.

11
12 Other O&M Adjustment

13 Q. **Please explain Pro Form Adjustment No. 28, Other O&M Adjustment.**

14 A. Adjustment No. 28 reduces operating expenses by \$11,394,130. This adjustment consists
15 of \$6,772,527 related to the capitalization of overhead costs and \$4,621,603 is related to
16 the cost incurred due to the unscheduled outage of Muskogee Unit 5. An adjustment was
17 made during the test year to recognize the overcapitalization of certain construction
18 overhead costs. This adjustment will not recur and test year expenses should be adjusted
19 to reflect a normal level of costs. As part of the Company's routine O&M budgeting
20 process it was concluded that the Muskogee Unit No. 5 unplanned outage that occurred
21 during the test year was an unusual expense.

Vegetation Management 2009

1
2 Q. **Please explain Pro Form Adjustment No. 30, Vegetation Management 2009.**

3 A. OG&E is proposing a more extensive package of vegetation management procedures for
4 2009 and thereafter in the Company's application Cause No. PUD 200800387 for a
5 system hardening program. In his testimony in this proceeding, Company Witness Mr.
6 Howard W. Motley also discusses new internal processes that capture separately the
7 vegetation management costs in the Oklahoma and Arkansas jurisdictions. In addition, he
8 discusses the benefits derived from the vegetation management procedures.

9 Through Adjustment No. 30, I include the incremental costs associated with the Company
10 increasing its vegetation management expense in 2008 to comply with Commission rules.

11 The calculation for the incremental costs for inclusion in base rates is presented in the
12 Company's Supplemental Package, Volume I, in W/P H 2-30. One can see from that
13 workpaper that the total operations and maintenance expense related to vegetation
14 management procedures for distribution and transmission plant increases from
15 \$15,569,711 during the test year to an annualized level going forward of \$19,592,337 for
16 an increase of \$4,022,626.

17
18 SECTION V: CONCLUSION

19 Q. **Do you have final comments?**

20 A. Yes. The Company's exhibits are based on financial results for a test year ending
21 September 30, 2008 adjusted for known and measurable changes. OG&E requests the
22 Commission to give serious consideration to all of the Company's *pro forma* adjustments.

23

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

2 A. Yes.