

BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

APPLICATION OF THE EMPIRE DISTRICT)
ELECTRIC COMPANY, A KANSAS)
CORPORATION, FOR AN ADJUSTMENT IN)
ITS RATE AND CHARGES FOR ELECTRIC)
SERVICE IN THE STATE OF OKLAHOMA)

CAUSE NO. PUD 201600468

FILED
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REBUTTAL TESTIMONY
OF
MARK E. GARRETT

COURT CLERK'S OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA

REVENUE REQUIREMENT ISSUES

ON BEHALF
OF

OKLAHOMA INDUSTRIAL ENERGY CONSUMERS ("OIEC")

April 3, 2017

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I. WITNESS IDENTIFICATION AND PURPOSE OF TESTIMONY

1 **Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A: My name is Mark E. Garrett. My business address is 50 Penn Place, 1900 N.W.
3 Expressway, Suite 410, Oklahoma City, Oklahoma 73118.

4
5 **Q: DID YOU PROVIDE RESPONSIVE TESTIMONY IN THIS CAUSE ON MARCH**
6 **13, 2017?**

7 A: Yes.

8
9 **Q: ON WHOSE BEHALF ARE YOU APPEARING IN THESE PROCEEDINGS?**

10 A: I am appearing on behalf of Oklahoma Industrial Energy Consumers (“OIEC”).

11
12 **Q: WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

13 A: In my rebuttal testimony, I address the responsive testimony filed by Staff and the
14 Attorney General (“AG”) and I make my recommendations in response to this testimony.
15 A summary of my recommendations is set forth on the following page.

II. SUMMARY OF TESTIMONY AND RECOMMENDATIONS

1 **Q: PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY AND**
2 **RECOMMENDATIONS?**

3 A: With respect to the testimonies filed by Staff and the AG, I make the following
4 conclusions and recommendations:

- 5 ● Staff did not address Empire's lack of sufficient evidence to support the inclusion
6 of plant additions in rates since Empire's last Oklahoma rate case.
- 7 ● Staff acknowledges the rate treatment approved for ratepayers in Empire's
8 Kansas jurisdiction but does not consider such treatment for adoption in
9 Oklahoma.
- 10 ● Staff failed to address the rate treatment approved for ratepayers in Empire's
11 Arkansas jurisdiction.
- 12 ● Staff's recommended 9.9% return on equity for Empire is significantly higher
13 than the Commission's recently awarded 9.5% returns for OG&E and PSO.
- 14 ● Staff's recommendation to include 25% of long-term stock-based incentives in
15 rates is contrary to long-standing precedent in Oklahoma and should be rejected.
- 16 ● The Attorney General's recommended allocation of environmental compliance
17 rider costs using an energy allocation is inappropriate, and the Commission
18 should accept OIEC's recommendation for an equal percentage increase to all
19 classes instead.
- 20 ● Based on Commission Orders issued in the neighboring jurisdictions of Kansas
21 and Arkansas, the Commission should (1) reject Empire's request to collect
22 capital investment costs incurred since Empire's last rate case due to lack of
23 sufficient evidence, (2) authorize the implementation of an Environmental
24 Compliance Rider to recover Riverton 12 and Asbury capital investment costs
25 subject to refund, and (3) require twelve (12) months of actual post-merger cost
26 data to support Empire's next rate case filing which shall occur no sooner than
27 July 1, 2018.
- 28

III. REBUTTAL TO STAFF'S RECOMMENDATIONS

29 **1. LACK OF EVIDENCE FOR PLANT ADDITIONS.**

1 **Q: WHAT DID YOU SAY IN YOUR RESPONSIVE TESTIMONY REGARDING**
2 **EMPIRE'S PLANT ADDITIONS AFTER ITS LAST RATE CASE?**

3 A: In my responsive testimony, I testified that Empire identified \$669.5M of plant additions
4 added since the Company's last rate case in Oklahoma, but only supported \$304M of
5 these additions. Specifically, Empire provided limited testimony to support its
6 environmental upgrades at Asbury and Riverton 12, but provided no testimony to
7 support the remaining additions in the amount of \$365.5M. I further testified that, as a
8 result, the Commission has not been provided with sufficient evidence to determine that
9 the plant additions were prudent investments. I testified that Empire has the burden of
10 proving the reasonableness of the rates it seeks, and that Empire has not met its burden
11 with respect to recovery of the unsupported Plant additions. I testified that the
12 Commission should reject all of the requested increase related to the \$365.5 million of
13 unsupported plant. The Company would be eligible to resubmit these costs for inclusion
14 in rates in the Company's next rate case proceeding.

15
16 **Q: DID STAFF ADDRESS THE FACT THAT EMPIRE PROVIDED NO EVIDENCE**
17 **TO SUPPORT THE PRUDENCE OF ITS PLANT ADDITIONS AFTER THE**
18 **LAST RATE CASE?**

19 A: No. Staff did not address the issue. Instead, it included all of the plant in the Company's
20 pro forma rate base in its recommended revenue requirement, even though Empire
21 provided no testimony to support the new plant additions.

1
2 **2. RATE TREATMENT FOR EMPIRE IN KANSAS AND ARKANSAS**
3 **JURISDICTIONS**

4 **Q: WHAT RATE TREATMENT DID EMPIRE RECEIVE IN KANSAS?**

5 A: Empire requested a comparably large rate increase of 25.64% in Kansas last year, a
6 jurisdiction in which, like Oklahoma, Empire had not filed a rate case since 2011.¹ The
7 increase in Kansas was driven by the same two factors driving the requested increase in
8 Oklahoma, which included (1) the large increase for the Asbury and Riverton 12
9 environmental improvements; and (2) Empire's failure to timely file rate cases. In
10 Kansas, however, Empire withdrew that rate case, and pursuant to a Settlement
11 Agreement reached in its merger docket in that state, agreed to the following terms: (1)
12 Empire's withdrawal of its Kansas rate case, (2) a moratorium on another rate case filing
13 until May 1, 2018, and (3) collection of the Asbury and Riverton 12 capital costs through
14 an environmental compliance rider, subject to refund and an annual true-up.

15
16 **Q: DID STAFF ACKNOWLEDGE THE KANSAS RATE TREATMENT IN ITS**
17 **RESPONSIVE TESTIMONY?**

18 A: Yes, however, Staff did not recommend such treatment for Oklahoma ratepayers. In
19 addition, Staff failed to mention the rate treatment received by ratepayers in Arkansas,
20 another jurisdiction in which Empire operates. In Arkansas, ratepayers are receiving
21 virtually the same rate treatment ratepayers in Kansas are receiving. Arkansas ratepayers
22 are paying for the Asbury and Riverton 12 environmental compliance costs through an
23 Environmental Compliance Cost Recovery (ECP) rider and Empire has a rate case stay-

1 out provision effectively through 2018.² In Arkansas, Empire is required to have 12
2 months of post-merger actual accounting data before it files its notice of intent for its
3 next rate case. The merger became effective at the end of January 2017, which means
4 Empire cannot file its notice of a rate case until early 2018.³ With a 60-day notice period
5 and a 10-month processing period for rate cases in Arkansas, Arkansas ratepayers will
6 not see a rate change until early 2019. This provides Arkansas ratepayers with two years
7 of rate stability after the merger.⁴

8
9 **Q: IS THE TREATMENT AFFORDED EMPIRE AND ITS RATEPAYERS IN**
10 **KANSAS AND ARKANSAS APPROPRIATE FOR OKLAHOMA**
11 **RATEPAYERS?**

12 A: Yes. To be constitutionally valid, utility rates must be *just, reasonable* and *non-*
13 *discriminatory*. In my opinion, the Oklahoma Commission should prohibit
14 discrimination against Oklahoma ratepayers by not granting the same treatment that was
15 afforded to Kansas and Arkansas ratepayers under similar circumstances. Based on
16 Empire's rate treatment in Kansas and Arkansas, which effectively requires a 2-year rate
17 stabilization plan after the Liberty-Empire merger, a similar rate-freeze period is
18 appropriate for Oklahoma. In Arkansas, the Commission thought it important for rates
19 to stabilize for a period after the merger and accepted an agreement of the parties for
20 Empire to not file another rate case until after it had twelve months of actual post-merger

¹ Docket No. 16-EPDE-101-RTS.

² See Order No. 4 in Docket No. 16-052-U at page 19.

³ *Id.* at 19.

⁴ *Id.* at 19-20.

1 cost data to include in its filing. I believe this is an important requirement. After a
2 merger or acquisition, cost levels can shift considerably under new management.
3 Consequently, the Commission would want to see at least one year, and maybe two
4 years, of actual data before setting new rates. Thus, I recommend that the Commission
5 require that Empire provide to the Commission at least twelve months of actual post-
6 merger accounting data to include in its next rate case application. In other words, the
7 historical test year in Empire's next rate case application should be a 12-month period
8 that includes all post-merger cost data. This will result in rate treatment in Oklahoma
9 that is consistent with the rate treatment in both Kansas and Arkansas.

10 **3. STAFF'S RECOMMENDED 9.9% ROE IS SIGNIFICANTLY HIGHER**
11 **THAN THE 9.5% ROE RECENTLY AWARDED TO OG&E AND PSO.**

12 **Q: WHAT IS THE ISSUE REGARDING STAFF'S RECOMMENDED RETURN ON**
13 **EQUITY ("ROE")?**

14 A: Staff does not explain why it is recommending a 9.9% ROE for Empire when the
15 Commission in two recent litigated rate cases has awarded 9.5% returns to both
16 Oklahoma Gas and Electric Company ("OG&E")⁵ and Public Service Company of
17 Oklahoma ("PSO").⁶ Staff would need to distinguish Empire in some way that would
18 justify a much higher return. Since the top end of Staff's range for Empire is 8.0%, it
19 cannot point to a financial basis for its higher recommended return for Empire.
20 Moreover, from an operational basis, Empire's allowed return should be much lower

⁵ Cause No. PUD 201500273.

⁶ Cause No. PUD 201500208.

1 than the returns of OG&E and PSO, because Empire's quality of service and reliability
2 are so much lower. Awarding Empire a higher return would be tantamount to rewarding
3 the Company for poor operational performance. Instead, the Commission should award
4 an ROE of 9.0%, consistent with the recommendation of OIEC witness David Garrett.

5 4. **STAFF'S RECOMMENDATION TO INCLUDE 25% OF LONG-TERM**
6 **STOCK-BASED INCENTIVES IS CONTRARY TO LONG-STANDING**
7 **PRECEDENT AND SHOULD BE REJECTED.**

8 **Q: WHAT DID STAFF RECOMMEND FOR LONG-TERM INCENTIVE**
9 **COMPENSATION EXPENSE?**

10 A: Staff recommended a disallowance of only 75% of Empire's long-term incentive
11 compensation.⁷ This recommendation is misguided for all of the reasons I included in
12 my responsive testimony. In particular, this Commission has consistently excluded the
13 stock-based incentives for electric utilities. In fact, this Commission recently deliberated
14 this issue in OG&E's and PSO's recently-concluded rate cases, Cause No. PUD
15 201500273 and Cause No. PUD 201500208. In the Final Orders entered in these
16 Causes, the Commission decided that 100% of long-term incentive compensation should
17 be excluded from rates. It is difficult to understand why Staff continues to ignore the
18 precedent of this Commission and the guidance of virtually every other commission in
19 the country on this issue. There is no valid ratemaking reason to include financial-based
20 stock incentive costs for upper management in rates. In fact, the debit and credit entries
21 for these awards wind up in the same accounts – the capital accounts of the utility

22 ^{7/} See G. Rush Responsive Testimony at page 43, lines 18–20.

1 meaning stock-based incentives are not even a real cash expense. Thus, if any amount
2 for these incentives is included in rates, the Company will collect cash from ratepayers to
3 recover these costs, but will never actually remit that cash to the executives who earn the
4 awards. Instead, the Company simply retains the money for itself.

5 **V. REBUTTAL TO AG'S RECOMMENDATIONS**

6 **1. THE ATTORNEY GENERAL'S RECOMMENDED ENERGY**
7 **ALLOCATION OF ENVIRONMENTAL COMPLIANCE RIDER COSTS**
8 **IS INAPPROPRIATE AND SHOULD BE REJECTED.**

9 **Q: WHAT IS THE ISSUE WITH THE ATTORNEY GENERAL'S**
10 **RECOMMENDED RECOVERY OF THE ENVIRONMENTAL COMPLIANCE**
11 **RIDER?**

12 **A:** Like OIEC, the Attorney General recommends that Empire should be allowed to recover
13 only the capital costs associated with the Asbury and Riverton 12 environmental
14 compliance upgrades through a rider mechanism. However, the Attorney General
15 recommends that these costs be allocated to and collected from the customers on an
16 energy (kWh) basis. The allocation of such costs using an energy allocator is not a cost-
17 based allocation of these costs. Since the Asbury and Riverton 12 capital costs are
18 production plant costs, they should be allocated using a production plant allocator. In
19 Oklahoma, capital costs associated with production assets have always been allocated on
20 a demand basis, not on an energy basis, and this is the appropriate allocation of these
21 costs.^{8/} An energy based allocation of these costs would create a significant subsidy to
22 the residential class from the industrial classes. In essence, it would unfairly penalize the

8/ NARUC Electric Utility Cost Allocation Manual, January 1992, page 45, Section 111.A.

1 high load factor commercial and industrial customers. Since the residential class already
2 has a significant subsidy that needs to be reduced, not increased, the AG's
3 recommendation should not be accepted.
4

5 **Q: DID YOU RECOMMEND THAT ECP RIDER COSTS BE ALLOCATED TO**
6 **THE CUSTOMER CLASSES ON A DEMAND BASIS?**

7 A: No. In my rate design testimony I testified that, ideally, the capital costs for the Asbury
8 and Riverton 12 environmental upgrades would be allocated to Empire's customer
9 classes on a demand basis using the 4CP Average and Excess methodology. But, as a
10 middle ground position, I recommended that the ECP rider costs be allocated to the
11 customer classes based on existing revenues in each class. The result of this allocation
12 would be that all customers receive an equal percentage increase as result of the added
13 ECP costs. In other words, if the ECP results in an overall 9.53% increase in base rates,
14 each customer class would receive a 9.53% base rate increase. This would ensure that
15 all customers share equally in the additional ECP rider costs.
16

17 **Q: IS THIS STILL YOUR RECOMMENDATION?**

18 A: Yes.
19
20
21

1 **V. CONCLUSION AND RECOMMENDATIONS**

2 **Q: PLEASE SUMMARIZE THE RECOMMENDATIONS IN YOUR RESPONSIVE**
3 **TESTIMONY REGARDING EMPIRE'S REQUESTED RATE INCREASE.**

4 A: In my responsive testimony I testified that the Commission should authorize a rider for
5 the capital costs of the Asbury and Riverton 12 projects, subject to refund in Empire's
6 next Oklahoma rate case. All other cost increases should be rejected at this time and
7 could be considered in Empire's next Oklahoma rate case filing

8

9 **Q: DO YOU HAVE ANY FURTHER FINDINGS AND RECOMMENDATIONS AT**
10 **THIS TIME?**

11 A: Yes, I make the following recommendations in response to the testimonies filed by Staff
12 and the AG:

- 13 • That Empire's rate case should be dismissed or affirmatively rejected due to
14 insufficient evidence supporting the inclusion of plant additions in rates since
15 Empire's last rate case.
- 16 • That the rate treatment received by ratepayers in Empire's Kansas and Arkansas
17 jurisdictions for recovery of Riverton 12 and Asbury environmental compliance
18 costs through a rider is appropriate for adoption in Oklahoma.
- 19
- 20 • That the recommended 9.9% return on equity for Empire is significantly higher
21 than the Commission's recently awarded 9.5% returns for OG&E and PSO.
- 22 • That Staff's recommendation to include 25% of long-term stock-based incentives
23 is contrary to long-standing precedent and should be rejected.
- 24 • That the Attorney General's recommended allocation of Environmental
25 Compliance Rider costs using an energy allocation of these costs is inappropriate,
26 and instead, the Commission should adopt OIEC's recommendation for an equal
27 percentage increase to all classes instead.

1 • That based on the Commission Orders issued in the neighboring jurisdictions of
2 Kansas and Arkansas determining rates for Empire ratepayers, the Commission
3 should (1) reject Empire’s request to collect capital investment costs in rates due
4 to lack of sufficient evidence, (2) authorize the implementation of an
5 Environmental Compliance Rider to recover Riverton 12 and Asbury capital
6 investment costs and (3) require twelve (12) months of actual post-merger cost
7 data to support a future rate case filing of Empire no sooner than July 1, 2018.

8 **Q: DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

9 **A:** Yes, it does.

10

11

12

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