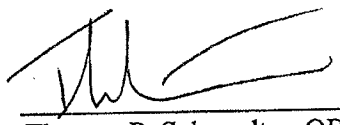
BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

APPLICATION OF THE EMPIRE DISTRICT ELECTRIC COMPANY, A KANSAS CORPORATION, FOR AN ADJUSTMENT IN ITS RATES AND CHARGES FOR ELECTRIC SERVICE IN THE STATE OF OKLAHOMA	)))))	**CAUSE NO. PUD 201600468**

OKLAHOMA INDUSTRIAL ENERGY CONSUMERS' PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Oklahoma Industrial Energy Consumers ("OIEC") respectfully submits the proposed Report and Recommendations of the Administrative Law Judge attached hereto.

Respectfully submitted,



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CERTIFICATE OF SERVICE

On this 25th day of May, 2017, a true and correct copy of the above and foregoing was sent via electronic mail to the following interested parties:

Jack P. Fite
Empire District Electric Company

Brandy L. Wreath
Natasha Scott
Patrick Ahern
Olivia Waldkoetter
Public Utility Division
Oklahoma Corporation Commission

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BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

APPLICATION OF THE EMPIRE DISTRICT ELECTRIC COMPANY, A KANSAS CORPORATION, FOR AN ADJUSTMENTS IN ITS RATES AND CHARGES FOR ELECTRIC SERVICE IN THE STATE OF OKLAHOMA	))))))	CAUSE NO. PUD 201600468

HEARING: May 10 – 12, 2017
2101 North Lincoln Boulevard, Oklahoma City, Oklahoma 73105
Before Ben Jackson, Administrative Law Judge

APPEARANCES: Jack P. Fite, Attorney *representing* Empire District Electric Company
Natasha Scott, Deputy General Counsel, Olivia Waldkoetter, Assistant General Counsel, and Patrick Ahern, Assistant General Counsel, *representing* Public Utility Division, Oklahoma Corporation Commission
Jared B. Haines and Dara Derryberry, Assistant Attorneys General, *representing* Office of the Attorney General, State of Oklahoma
Thomas P. Schroedter, Attorney *representing* Oklahoma Industrial Energy Consumers

REPORT AND RECOMMENDATIONS OF THE ADMINISTRATIVE LAW JUDGE

I. Procedural History

II. Summary of Evidence

A. Empire

1. Bradley P. Beecher

(a) Bradley P. Beecher Direct Testimony filed on December 21, 2016

2. Bryan S. Owens

(a) Bryan S. Owens Direct Testimony filed December 21, 2016

3. Aaron J. Doll

(a) Aaron J. Doll Direct Testimony filed December 21, 2016

4. Bethany Q. King

(a) Bethany Q. King Direct Testimony filed December 21, 2016

5. **Jeffrey P. Lee**

   (a) **Jeffery P. Lee Direct Testimony filed December 21, 2016**

6. **Mark Quan**

   (a) **Mark Quan Direct Testimony filed December 21, 2016**

7. **David Swain**

   (a) **David Swain Adoption of Testimony of Brad Beecher filed on April 03, 2017**

   (b) **David Swain Cross -Examination (from Transcript of May 10, 2017 A.M. Proceedings, beginning on page 17)**

Mr. Swain adopted Brad Beecher's testimony. (5/10/17 a.m. Tr. at 18). Mr. Beecher was CEO of Empire, but left Empire on March 31, 2017, which was after the merger between Liberty and Empire. *Id.* Swain's role as President of Central Region followed the merger. *Id.* at 18-19.

Mr. Swain testified that the merger became effective in January of 2017. *Id.* at 19. The Company filed this rate proceeding in December, 2016, based on a test year ending June 30, 2016. *Id.* The six-month post-test year period ended before the merger became effective. *Id.* Mr. Swain testified that the information relating to operating expenses, capital structure, and capital investments that are included in this case relate to the period of time before the merger took place. *Id.* at 19-20.

Mr. Swain testified that Liberty has a cost allocation mechanism for sharing costs among the various utilities that are owned by the parent company. *Id.* at 20. He testified, however, that the information before the Commission in this case relates to Empire's allocation and corporate costs. *Id.* at 20-21. Mr. Swain testified that Liberty provided testimony in the various merger dockets in Oklahoma, Arkansas, and Kansas that the Company would provide an updated cost allocation six months after the merger. *Id.* at 21. Mr. Swain acknowledged that it is possible that the cost allocation method would bring efficiencies in O&M that would lower the costs to Oklahoma ratepayers. *Id.* at 21-22. He testified that it is possible that payroll could be reduced for Oklahoma as a result of reducing redundancies within the organization. *Id.*

However, if the Company's application is granted in this proceeding, Oklahoma ratepayers are not going to get the advantage of those cost savings. *Id.* at 23. It would require another rate proceeding for the Oklahoma customers to get those benefits. *Id.* at 24-25. Mr. Swain acknowledged that rate proceedings are lengthy proceedings. *Id.* at 25.

Mr. Swain testified that Empire was a Kansas corporation. *Id.* at 28. All the capital stock of Empire was acquired by Liberty Utilities (Central). *Id.* Liberty acquired Empire and its subsidiaries. *Id.* at 28-29. Empire was a public company, but after the merger it is no longer traded on the exchange. *Id.* at 32. He testified that the transaction will benefit Empire's

customers. *Id.* at 29, 32. Mr. Swain read the following from the Order in the Oklahoma merger case, Order No. 652551, page 11, PUD 201600098:

> The transaction benefits Empire's stakeholders by providing benefits to the customers, shareholders, and employees alike. Specifically the transaction benefits Empire and its customers by providing increased corporate capability in scale by making Empire part of the Algonquin Power and Utilities Corporation, Algonquin family of utility companies. Following the transaction, Empire will maintain the strong investment grade credit rating it will need to address future industry risk and trends.

(5/10/17 a.m. Tr. at 31-32).

According to the testimony in the merger docket, Liberty committed to retain all of Empire's management team. *Id.* at 32-33. Mr. Swain acknowledged that in the merger proceeding, Empire committed to retain its work force, but they have lost people since the merger. *Id.* at 33-34. Mr. Swain testified that Mr. Beecher, the former CEO, is no longer employed by Empire. *Id.* at 33.

Mr. Swain agreed that the merger adds scale for both Empire and Liberty. *Id.* at 34. Mr. Swain read from page 12 of Order No. 6252551 in PUD 201600098, as follows:

> The merger adds scale for both Empire and LU Central thus providing opportunities to pursue efficiencies, share costs across a larger customer base, leverage best practices, and enhance service offerings. The inherent increase in scale and market diversification will also provide increased financial stability and strength, which could not be achieved without the combination of the companies."

(5/10/17 a.m. Tr. at 35).

Mr. Swain testified that he agrees with the testimony of Peter Eichler in the merger case that Liberty Utilities and its subsidiaries operate under a shared services model. *Id.* at 36. Pursuant to that model, certain services are provided to the operating businesses from affiliates and shared based on either a direct charge or defined cost allocation methodology. *Id.* at 36. Mr. Swain read from page 16 of Order No. 62551 in PUD 20160098 as follows:

> Mr. Eichler testified that there were several reasons why the costs borne by Empire will be lower under the Liberty Utilities allocation methodology. One of the prevailing strategic rationales for the transaction is gaining efficacy of sale. And LU Central will be approximately 120,000 more customers that Empire serves today, allowing for the distribution of costs over a larger number of customers.

(5/10/17 a.m. Tr. at 37).

Mr. Swain testified that the revenue requirement increase being sought by the Company in this proceeding has changed. *Id.* at 38. This is reflected in Hearing Exhibit 130, Schedule M-1, Rebuttal Errata, Empire District Electric Company Oklahoma Jurisdictional Pro Forma Revenue Summary. *Id.* at 38-39. Exhibit 130 is the errata schedule M-1 reflecting the increase for each of Empire's customer classes. *Id.* at 39. It shows the base rate increase that the Company is requesting is $3.025 million. The left-hand column lists the customer classes of Empire. *Id.* at 39-40. It shows that the residential customer increase sought is a 32.08% increase. It shows the Residential Total Electric is 29.90%; Commercial is 15.71%; General Power is 11.36%; and Power Transmission is 23.31%. *Id.* at 40.

Mr. Swain did not know if the Power Transmission customer class consisted of industrial customers. *Id.* at 40-41. He does not know who the customers are in the customer classes. *Id.* at 41. When asked if he could have done an analysis of the impact of the rate increase sought on these customer classes, he said the percentage increase numbers is the analysis. *Id.* at 43-44. Mr. Swain testified that it would not surprise him to learn that the Company's requested rates would be, for industrial customers, approximately twice as much as the rates that OG&E and PSO charge their industrial customers. *Id.* at 45. When asked what kind of impact a 23.31% increase would have on the Power Transmission class, in the Northeastern corner of Oklahoma, he testified that it would ensure reliability so they could better serve their customers. *Id.* at 46.

Mr. Swain testified that about $300 million of the capital investment costs sought in this proceeding relate to environmental compliance investments. *Id.* at 50. The remaining are various other capital investments. *Id.* Mr. Swain testified that Oklahoma gets allocated a portion of those capital investment costs pursuant to a cost-of-service study. *Id.* Each jurisdiction that Empire operates in gets allocated a portion of those costs. *Id.*

Mr. Swain testified that the investments other than environmental total $360 million. *Id.* at 51. The Company is asking Oklahoma ratepayers to pay for those investments, but it is not recovering those investments in Kansas. *Id.* at 51-52. Empire agreed in Kansas that it would not file a rate case in Kansas until May 1, 2018. *Id.* Outside of the rider, the rates in Kansas are effectively frozen for 2017 and 2018. *Id.* at 52-53.

Mr. Swain testified that Kansas, Oklahoma, and Arkansas are all small pieces of Empire's service territory and load. *Id.* at 53-54. The Arkansas ratepayers are not paying for the capital investments that are being sought for cost recovery in this case, other than the environmental compliance. *Id.* at 54. The Arkansas Public Service Commission approved a settlement in which Empire agreed to refrain from filing a rate case until there was 12 months of data available for the new entity Liberty Utilities (Central). That means that the rates of Arkansas customers are not going to change in 2017, outside of energy costs. *Id.*

Hearing Exhibit 131 is the Arkansas Public Service Commission Order approving the merger in Arkansas in Docket No. 16-013-U, Order No. 4. *Id.* at 55-56. Hearing Exhibit 132 is the Order Granting Joint Motion to Approve the Unanimous Settlement Agreement and Approval of Joint Application in the Empire Liberty merger in Docket 16-EPDE-410-ACQ before the State Corporation Commission of Kansas. *Id.* Both orders approved settlement

agreements. *Id.* at 57. Mr. Swain testified that Empire voluntarily agreed to the terms of those settlements and agreed that they were just and reasonable and in the public interest. *Id.*

Mr. Swain testified that one of the terms of Hearing Exhibit 131, Order No. 4, is that Empire would not bring a rate case before the Arkansas Public Service Commission until after January 1, 2018. *Id.* at 57-58. Part of the settlement agreement was to ensure there would be no increase in rates for customers and no recovery of costs related to the transactions, including the acquisition premium. *Id.* at 57-58. The Order also sets forth the staff witnesses' testimony about the ratepayer protections and assurances made in the settlement agreement. *Id.* at 58. The staff witness acknowledges the Company's commitment, in Section 31 of the Settlement Agreement is to not file a notice of intent to file a rate case until 12 months of actual, historical information is available following the closing of the acquisition on January 31, 2017. *Id.* at 58.

The Order also states the requirement of a 60-day notice before a rate application is filed and the 10 months of statutory suspension period. Mr. Swain testified that the Company's commitment in Arkansas will result in approximately two years of rate certainty and stability for ratepayers. *Id.* at 59. Mr. Swain testified that this means that the Company will not raise rates for the years 2017 and 2018. *Id.*

Mr. Swain acknowledged that it is possible that Oklahoma businesses could compete with Arkansas businesses and businesses located in southeastern Kansas. *Id.* at 59-60. He testified that the Company would be collecting cost increases if approved in Oklahoma, but it was not going to be collecting those costs in Arkansas and Kansas. *Id.* at 61.

Mr. Swain testified that he wasn't at the Company when it evaluated the options available to it for environmental compliance *Id.* at 62. He adopted Mr. Beecher's testimony based on his conversations with Mr. Beecher and other employees who were involved in those activities. *Id.* at 62-63.

Mr. Swain testified that there is no direct testimony of the various options that were available to the Company for meeting capacity requirements related to environmental investments. *Id.* at 63. He is not an integrated resource planner and has never performed one. *Id.*

Mr. Swain testified that he does not know if there is any testimony that the Company provided an integrated resource plan that evaluated the available environmental options. Empire's position is that it typically engages in least cost planning for ratepayers. *Id.* at 64. His direct testimony does not address least-cost planning or provide support that the environmental compliance plan is the least-cost option. *Id.*

Mr. Swain testified that there was an acquisition premium paid by Algonquin to Empire in connection with the acquisition and merger. *Id.* at 65. The merger approvals that were given by the various jurisdictions all say that the acquisition premium is not to be passed on to ratepayers. *Id.*

Mr. Swain said he had read the testimony of Empire's witness, Mr. Eichler, in the merger proceedings that there will be no rate increase as a result of the Liberty Empire merger. *Id.* at 66.

Mr. Swain testified that this application seeking a rate increase is based on a test year prior to the merger. *Id.* Liberty testified in the merger proceeding that the merger will strengthen Liberty Utility's investment grade, credit rating, financial profile, and overall business operating environment. *Id.* The Company testified that strengthening the Liberty Utilities' credit rating will provide prudent access to capital. *Id.* at 66-67. One of the prevailing rationales for the transaction is gaining efficacy of scale. *Id.* at 67. He would assume that there will be cost savings, such as the costs Empire incurred to remain a public company and for public reporting. *Id.* He believes it is correct that Empire testified that there are approximately $2.3 million in costs saved by not requiring Empire to comply with the requirements of being a public company. *Id.* He recalls reading testimony that through natural attrition, an additional $2.24 million in labor savings will emerge. *Id.* at 67-68.

Mr. Swain testified that the agreement for the merger was entered into about a year prior to the closing of the merger. This case was filed in December, 2016 after the merger agreement was signed. *Id.* at 68. He doesn't know whether Liberty advised the Oklahoma Corporation Commission before the Commission approved the merger that Liberty would be seeking a 24% increase in rates. *Id.*

Empire's current rates have been in effect since 2012. *Id.* at 73. The Company could have filed rate cases in 2013 or 2014 if it wanted to recover investments then. *Id.* at 73-74. The Company could have filed a rate case in 2015 to recover investments, without waiting on Missouri, but it did not. *Id.* at 74. The Company waited until December, 2016 to file this rate case, and is seeking $3.024 or $.3.025 million annual revenue requirement. *Id.*

Mr. Swain acknowledged that in February, 2017, he authorized the Company to make a $1.5 million donation to certain nonprofits in Missouri. *Id.*

Mr. Swain testified that the Company has a rider in Kansas that recovers the Asbury environmental project. *Id.* at 78-79. The Company applied for a rider in Kansas to recover the Riverton 12 capital investment, but he doesn't know if it has been approved yet. *Id.* at 79. *Id.* The Company has a rider in Arkansas for Asbury and the Riverton. *Id.* He doesn't know any specifics, but has heard that there has been discussion about a rider in this case for Empire to recover its environmental compliance investment costs. *Id.*

He doesn't know the size of the acquisition premium paid by Algonquin. *Id.* at 80. Liberty paid in excess of book value. *Id. Id.* at 82.

He doesn't know how much, for example, a senior citizen in the Miami area would pay per kilowatt-hour if the rate increase is authorized compared to the same senior citizen across the border in Kansas. *Id.* at 83.

8. Robert Sager

(a) Robert Sager Rebuttal Testimony filed on April 03, 2017

(b) Robert Sager Cross -Examination (from Transcript of May 10, 2017 A.M. Proceedings, beginning on page 95)

Mr. Sager is Vice-President of Finance and Administration for Empire District Electric Company. *Id.* at 95. His testimony responds to the PUD's proposal for implementing Empire's requested revenue increase over four years. *Id.* He did not rebut any testimony of any OIEC witness. *Id.* He did not file Direct Testimony in this proceeding. *Id.*

Empire's last rate case in Oklahoma was filed in 2011. *Id.* at 95-96. The Company has incurred regulatory lag. *Id.* at 96. The Company could have filed a rate case in 2012, 2013, or 2014. *Id.* Mr. Sager testified that the Company's agreement in the merger case in Arkansas and the agreement in Kansas will result in regulatory lag. *Id.* The Company agreed to a rate freeze in Kansas and Arkansas, which will result in regulatory lag. *Id.* at 98. *Id.* The Company testified that the settlements were in the public interest and acceptable. *Id.* at 99.

Mr. Sager admitted that none of the portions of his testimony that were redacted as confidential addressed information that was confidential. *Id.* at 99-102, 104-105, and 109-110. The ALJ granted OIEC's motion that all of Mr. Sanger's testimony be deemed public and no longer subject to any redactions. *Id.*

Mr. Sager testified that the agreement Empire made in Kansas and Arkansas did not require Empire to write off the asset. *Id.* at 102. Under his proposal, Empire is not only going to phase-in the rate increase, but it is also going to recover interest and carrying charges. *Id.* at 105. The rate increase being requested at this time is the updated revenue requirement number of $3.024 million. *Id.* at 105-106. The total amount of money that would be collected under Empire's plan, the expected revenue requirement would indicate approximately $12.1 million. *Id.* at 106. Staff witness Ms. Champion's proposal provides that the Company would collect $7,743,523.80 over years 1 through 4. *Id.* at 108. The net present value of Ms. Champion's proposed plan is $6,253,377.92. *Id.*

9. Blake Mertens

(a) Blake A. Mertens Direct Testimony filed December 21, 2016

(b) Blake Mertens – Rebuttal Testimony filed on April 03, 2017

(c) Blake Mertens Cross-Examination (from Transcript of May 10, 2017 A.M. Proceedings, beginning on page 124)

Mr. Mertens testified that prior to the merger, he was Vice President of Energy Supply and Delivery Operations for Empire. (5/10/17 a.m. Tr. at 124.) He is now Vice-President of Operations Electric for Liberty Central. *Id.* He filed Direct Testimony in December, 2016. *Id.* at 124-125. In his Direct Testimony he described the regulatory factors that led to the construction of the Asbury Air Quality Control System and he described the investment that Empire made in the Riverton 12 combined cycle natural gas-fired generating unit. *Id.* at 125. He did not address in his Direct Testimony Empire's other capital investments. *Id.* His Direct Testimony discussed the various alternatives to the two environmental control projects, and discussed the ultimate decision made. *Id.*

The Asbury unit has roughly 195 megawatts of generating capacity. *Id.* Several options were evaluated to replace the Asbury capacity, but he did not refer in his testimony to the other options that were considered by Empire in connection with the Asbury AQCS. *Id.* at 126. He did not provide in his Direct Testimony Empire's IRP or the various options considered or the discounted cost of those options. *Id.* at 127. Empire's environmental compliance plan has not received Commission approval. *Id.* Mr. Mertens testified that he believes this is the first proceeding involving the Asbury AQCS and Riverton 12 in Oklahoma. *Id.* at 127-128. Empire is asking for recovery of the costs related to the Asbury and Riverton 12 in this case. *Id.* at 128.

He is aware that regulatory commissions typically have a prudence review to determine whether a plan is in the best interest of the utility and its ratepayers. *Id.* He thinks what occurred here is that they provided the information in D.R.'s and the Staff came on site to review those. *Id.* at 129. He doesn't know if the data requests are in the official record in this cause. *Id.*

Mr. Mertens is generally familiar with the Commission's Rules on integrated resource planning. Mr. Merten agrees that the Company should comply with the Commission rules. *Id.* at 137. Rule 165:35-37-4, Hearing Exhibit 133, addresses procedures for integrated resource plans. *Id.* at 136. He believes that the Company prepared a proposed update to its IRP at least 60 days prior to submission pursuant to 165:35-37-4. *Id.*

Subparagraph (b) of the Rule provides that the utility is to conduct at least one technical conference for all stakeholders in order to allow all stakeholders the opportunity to review and provide input regarding utility objectives, assumptions, planning scenarios and other information after giving notice and prior to submitting the final integrated resource plan. *Id.* at 137-138. Mr. Mertens testified that this was not done. *Id.* at 138. Under 35-37-5(d), the utility is to take into account any comments received prior to or at the technical conference and make changes to the plan as seem reasonable. *Id.* at 138-139. Mr. Mertens acknowledges that Empire did not do this. The utility is to provide a facilitator to coordinate and assist the stakeholders in their discussions at the technical conference. *Id.* This was not done. The Commission's IRP rule also provides that the Commission Staff or the Attorney General may retain third-party consultants and/or expert witnesses to review the proposed plan. *Id.* This was not done in Oklahoma. *Id.* at 139-140.

Rule 35-37-5(h) provides that after the stakeholder process has occurred, the utility is to present its final integrated resource plan at a public meeting held at the Commission. *Id.* at 140. He could not say if this was done. He is not aware of any request by Empire for a waiver of the rules. *Id.* Mr. Mertens testified that the Company did not go through a competitive bidding process for the capacity when it was reviewing Asbury for renovation. *Id.* at 142.

Mr. Mertens testified that Empire met the minimum requirements of reliability, but it is one of the worst two as far as reliability ratings for an electric utility in Oklahoma. *Id.* at 144.

Mr. Mertens testified that Empire does not subscribe to J.D. Powers customer satisfaction surveys. *Id.* He is aware that J.D. Powers surveys measure customer satisfaction. *Id.* at 144-145. Mr. Mertens testified that it would surprise him to know that of 16 utilities surveyed by

J.D. Powers in 2016, Empire ranked fourteenth out of sixteen in customer satisfaction and that in 2015 Empire ranted 17 out of 19 utilities surveyed. *Id.* at 147.

He is familiar with the Corporation Commission's rules on reliability of service. *Id.* It would not surprise him to learn that in its review of a utility's cost of service and rate of return, the Commission may consider, in general rate cases, the utility's reliability reporting and levels for SAIDI, SAIFI, customer average, interruption duration index, and MAIFI. *Id.* at 148.

He doesn't know for certain where in the Company's Direct Testimony the Company provides information regarding plant additions since the last rate case, other than environmental investment. *Id.* Empire invested $16 million to $17 million in a new service center in Joplin. *Id.* He doesn't believe that specific investment was discussed in any Direct Testimony. *Id.* at 149. Empire invested $19.5 million in new enterprise support systems. *Id.* Empire is seeking to recover those costs in this case. *Id.* He's not aware that Empire supported that investment in its Direct Testimony. *Id.*

10. Tim Lyons

(a) Timothy Lyons Adoption of Testimony of Bryon Owens filed on April 03, 2017

(b) Timothy Lyons Rebuttal Testimony filed on April 03, 2017

(c) Tim Lyons Cross-Examination (from Transcript of May 10, 2017 Afternoon Proceedings, beginning on page 40)

Mr. Lyons adopted the testimony of Bryan S. Owens. (5/10/17 p.m. Tr. at 40). Mr. Owens was the Assistant Director of Planning and Regulatory at Empire. *Id.* Mr. Lyons testified that Mr. Owens is still with the Company, but Mr. Lyons does not know why Mr. Owens is not providing testimony at this hearing. *Id.* Mr. Lyons is a consultant for Scott Madden. *Id.* at 41. He testified that how much he is being paid for his testimony is confidential. *Id.*

Mr. Lyons testified that Mr. Owens was the lead accounting witness for Empire in this case. *Id.* at 42. Mr. Owens references the recovery of Asbury and Riverton 12 investment costs in Missouri. *Id.* Mr. Lyons did not testify in Missouri. Mr. Lyons did not do any of the resource planning associated with those environmental compliance investments. *Id.* He does not know why Mr. Owens did not reference the rulings of the Arkansas Public Service Commission and the Kansas Corporation Commission regarding recovery of those costs in those jurisdictions. *Id.* at 43.

Mr. Lyons testified that he is responsible for the revenue requirements associated with this case and presenting the schedules and ultimately, the proposed increase for the company. *Id.* at 43. He is not sponsoring testimony regarding the prudency of the capital investments. *Id.* at 44. Mr. Owens' Direct Testimony did not provide support for the prudency of the capital investments, other than referencing other jurisdictions and their treatment of those investments. *Id.* at 44-45.

Mr. Lyons testified that the Company's supporting schedules are based on a 12-month period, ending on June 30, 2016. *Id.* at 45. There are updates to those numbers through December 31, 2016. *Id.* Mr. Lyons testified that he only learned that morning that the merger with Algonquin became effective in January, 2017. *Id.*

Mr. Lyons testified that he did not have anything to do with Empire's resource planning for the environmental compliance investments. *Id.* at 46. In his Rebuttal Testimony, p. 9, lines 4-5, he acknowledged that the proposed revenue increase is measurable. *Id.* By measurable, he means noticeable by people. *Id.* He would not characterize a 24.3 rate increase as excessive. *Id.* He doesn't know that he would characterize such an increase as rate shock. *Id.* at 47. When asked what is rate shock, Mr. Lyons testified that to the extent there is a large percentage increase applied to a large dollar amount, there could be rate shock. *Id.* He couldn't say if a 24.3% increase would have a considerable impact on a customer. *Id.* He testified that the Company knows there has been a significant impact when the call volumes spike after introducing a large increase. *Id.*

Mr. Lyons testified that the Company proposes to recover the full increase in three years, rather than adopt the Staff's plan for recovery over four years. *Id.* at 48. The Company also proposes to recover interest and a carrying charge on the uncollected balance. *Id.* He did not run the numbers to show what the full amount of Empire's proposal would be if it were granted. *Id.* at 48. It would be $3 million each year, plus carrying costs. *Id.* at 49. Figure RWS-1 sets forth the Commission's Staff's proposed plan for recovery. *Id.* at 52. The total amount over years 1, 2, 3, and 4 amounts to $7,743,523.80. *Id.* Mr. Lyons could not say what the total amount would be using Empire's proposal. *Id.* at 53.

Mr. Lyons had testified regarding a multi-year plan tied to the company's cost of service. *Id.* at 54. That multi-year rate plan would not result in utility rate cases for Empire. *Id.* Mr. Lyons is not aware of how formula rates have worked so far in Arkansas. *Id* at 57.

He agree it would be a good idea to look at what the results are from formula rate plan filings, not only for utilities, but for ratepayers. *Id.* However, Empire is not recommending implementation of a formulate rate plan in this proceeding, but is just introducing the concept. *Id.* at 58.

Mr. Lyons testified that the Company is asking for 100% of its short term and long term incentive compensation. *Id.* at 58-59. Mr. Lyons testified that he reviewed Mr. Garrett's testimony about incentive compensation and saw his survey regarding recovery of incentive compensation, which showed that in most instances, recovery of 100% of short term incentive compensation was not granted; it was closer to 50%, and recovery was typically not authorized for incentives tied to financial performance. *Id.* at 59. Mr. Lyons testified that he read the OG&E Order in PUD 201500273, where the Commission did not allow recovery of 100% of short term incentive compensation. *Id.* at 60. Mr. Lyons testified that his view was that the OG&E order was limited to the facts of that case. *Id.* at 60-62. He did not look at other Corporation Commission orders to see how the Commission addressed the issue of recovery of incentive compensation. *Id.* at 61.

Mr. Lyons testified that there are a number of metrics that make up incentive compensation. *Id.* at 62. One is earnings per share. *Id.* at 62-63. Another is reliability of service and also customer satisfaction. *Id.* at 63.

Mr. Lyons said that he did not know if the Commission's score card is a metric of reliability. *Id.* at 65-66. Mr. Lyons admitted that the score card measures performance in terms of outages and reliability. *Id.* at 66. He also agreed that it is an objective measure, based on outages. *Id.* He testified that the SAIDI and SAIFI are industry-wide measures for the electric industry. *Id.*

Mr. Lyons testified on page 5 of his rebuttal testimony that the plant additions were fully supported in the original testimony. *Id.* at 66-67. However, Mr. Lyons acknowledged that there was no testimony in Mr. Owen's Direct Testimony filed on December 21, 2016, that addressed the prudence of the $669.5 million of capital investments. *Id.* at 69. Mr. Lyon's rebuttal testimony was filed on April 3, 2017, which was more than three months after the Direct Testimony had been filed. *Id.* at 69-70. Mr. Lyons had one and a half pages in his rebuttal testimony to support the $669.5 million in capital investments made by the Company. *Id.* at 70.

Mr. Lyons acknowledged that he referred to Mr. Mertens' testimony and also that of Staff witness Tonya Hinex-Ford and her on-site audit of Empire in his Rebuttal Testimony. *Id.* at 75. Yet, he was not there when she did her audit and he did not review the work papers associated with her audit. *Id.* at 76. Mr. Lyons did not know if Ms. Hinex-Ford conducted a physical inspection of the assets. *Id.* He doesn't know if the results of her audit were placed in the record in this case. *Id.* He doesn't know of Ms. Hinex-Ford is a resource planner. *Id.* He doesn't know if the results of her audit were presented in her testimony. *Id.* at 76-77. He doesn't know who Ms. Hinex-Ford met with at Empire when she audited the Company. *Id.* at 77. He does not know how she determined that it was beneficial to discuss the expenses and investments with the company representatives. *Id.*

Mr. Lyons does not know how much rate case expense Empire has incurred. *Id.* at 77. Mr. Lyons agrees that the Commission has broad discretion in determining the amount of expenses a utility may recover from ratepayers. *Id.* at 78. Mr. Lyons acknowledged that the Missouri Public Service Commission, in KCPL's 2014 rate case, determined that KCPL was not entitled to recover 100% of its rate case expenses. *Id.* at 78. Exhibit 135 is the portions of the Missouri's Commission's order addressing rate case expense in ER-2014-0370; issued September 2 2015. *Id.* at 80-81.

Mr. Lyons testified that Empire is requesting recovery of all costs and expenses associated with legal representation, consultants, and expert witnesses in its increased revenue requirement. *Id.* at 83. He cannot say the amount of those expenses. *Id.* The amount stated in PUD SDO 1-10 was $283,000. *Id.*

Mr. Lyons testified that the Missouri Commission found that one way to incentivize the utility to limit its rate case expenses is to tie a utility's percentage recovery of rate case expense to the percentage of its rate increase request that the Commission finds to be just and reasonable. *Id.* at 85. That was the determination by the Missouri Public Service Commission. (Exhibit

135). The Missouri Commission said that use of this approach would directly tie a utility's recovery of rate case expense to both the reasonableness of its issue positions and the dollar value sought from customers in a rate case. *Id.* The Missouri Commission also found that prudence is not only the consideration in determining what costs should be included in rates, but the benefit to customers should also be considered when deciding what costs are reasonable for customer rates. *Id.* at 86.

Mr. Lyons testified that he agrees that benefit to customers must be considered when deciding what costs are reasonable. *Id.* at 87.

11. Chris Krygier

(a) Christopher Krygier Rebuttal Testimony filed on April 03, 2017

(b) Chris Krygier Cross-Examination (from Transcript of May 10, 2017 Afternoon Proceedings, beginning on page 131)

Mr. Krygier testified that each state has different legal standards for merger acquisitions. 5/10/17 p.m. Tr. at 131. He is not an attorney. *Id.* at 131-132. Mr. Krygier testified that Kansas and Arkansas are net benefit states. Tr. at 132-133. Missouri is a no net harm state. *Id.* Mr. Krygier said that he could not go through the Arkansas order, Exhibit 131, to find where it talks about the net benefits rule. *Id.* at 133. He's not sure if that standard is in the Arkansas order or any of the Commission orders. *Id.* at 134. Mr. Krygier testified that another circumstance that is unique to Oklahoma is the length of time that Empire has been in need of an Oklahoma rate increase. *Id.* at 135-136.

Mr. Krygier could not give a specific example of how the standards regarding merger differed between Arkansas, Kansas and Oklahoma. *Id.* at 137-138. He testified that the Direct Testimony filed in Arkansas, Missouri, and Oklahoma were very similar, if not identical. *Id.* at 139.

Mr. Krygier testified that, generally speaking, the capital investments of Empire are operated as an integrated electric utility, and then allocated to various jurisdictions. *Id.* at 144. For example, the Asbury plant is located in Kansas, but it is not paid for only by Kansas rate papers. *Id.* at 144-145. Empire is asking for recovery of capital investments of $369 million in Oklahoma; but the Company has agreed, in Kansas, to not ask for recovery of those same investments until May 1, of 2018. *Id.* at 145.

He testified that in Arkansas, Empire has recovered a portion of the $369 million. The remainder of that amount will not be recovered from Arkansas ratepayers until the beginning of 2019, at the earliest. *Id.* at 147.

Chris Krygier Cross-Examination (from Transcript of May 11, 2017, Vol. I, Morning Session, beginning on page 6)

Mr. Krygier testified that his criticism of Mr. Garrett's recommendation as constituting single-issue ratemaking is referring to the lack of inclusion of property taxes that is handled and being recovered in Kansas and Arkansas. That is not included in the recommendation of the parties that were proposing implementation of the Kansas Plan. (5/11/17 a.m. Tr. at 7). Mr. Krygier testified that he did not mention property taxes in his testimony and provide the amount of the property tax. *Id.*

The outside consultants retained by the Company are Mr. Sullivan, on depreciation; Mr. Overcast, on cost of service; Mr. Lyons on revenue requirement; and Dr. Vander Weide on cost of capital. *Id.* at 10-11. Mr. Krygier testified that the Company can provide the information about how much they are paying the outside experts. *Id.* at 11-12.

Mr. Owens is still with the Company but did not testify in this proceeding because he was working on other projects for the Company relating to financial modeling and other priorities. *Id.* at 12-13. Ms. Schwartz took over his responsibility in the company, but she did not testify because of her responsibilities and the Company's short staff. *Id.* at 13-14.

12. James H. Vander Weide

(a) James H. Vander Weide Direct Testimony filed December 21, 2016

(b) James H. Vander Weide Rebuttal Testimony filed on April 03, 2017

(c) James H. Vander Weide Cross-Examination (from Transcript of May 11, 2017, Vol. I, Morning Session, beginning on page 130)

Dr. Vander Weide testified that has only provided testimony on behalf of public utilities. (5/11/17 a.m. Tr. at 130-131). He has never testified on behalf of an attorney general's office, a commission staff, or a consumer group. *Id.* He believes he testified in the Empire rate case before the Arkansas Public Service Commission, Docket No. 13-111-U. *Id.* t 131. He cannot recall the outcome of the case. *Id.* He doesn't recall if he recommended a return on equity in that case of 10.5%. *Id.*

Dr. Vander Weide provided testimony but did not physically appear before the Kansas Corporation Commission. *Id.* at 132. He does not recall what the numbers in that testimony were. *Id.* When told that it was a 2016 rate proceeding, Dr. Vander Weide testified that he was not surprised that he could not remember his testimony. *Id.* at 132-133. He doesn't recall that the case was ultimately dismissed by Empire. *Id.* at 133.

Dr. Vander Weide agrees that the correct level of economic activity or growth rate of the economy is one of many factors in determining the cost of capital for a public utility. *Id.* at 134. He did not examine the level of economic activity in the Empire service territory. *Id.* He estimates the cost of equity by applying his cost of equity estimation methods to a group of proxy companies. *Id.*

Dr. Vander Weide testified that he does not know the amount of customer growth and revenue that Empire has experienced from its Oklahoma jurisdictional customers or its Kansas and Arkansas customers. *Id.* at 135. He testified that it is true that the level of interest rates is a factor in determining the cost of capital of a public utility. *Id.* He does not know if there has been a reduction since the 2008-2009 Great Recession in actual and expected investment returns. *Id.* at 136. He does not believe that there has been a reduction since the 2008-2009 recession in cost of capital. *Id.*

Dr. Vander Weide testified that he doesn't know if, since the Great Recession of 2008-2009, the cost of capital has increased or decreased. *Id.* at 137-138. It is not relevant to his model. *Id.* at 138.

He does not know whether investors have seen smaller gains since the great recession. *Id.* at 138-139. He doesn't know whether, since the great recession, there have been lower interest rates on bank deposits. *Id.* at 139. He doesn't know if there are lower rates on U.S. Treasury and corporate bonds since the Great Recession. He doesn't know if there have been lower increases in Social Security cost of living benefits as a result of the Great Depression. *Id.* Regulatory ROEs have gone down slightly over the last several years. *Id.* at 139-140.

He believes that utility bond interest rates are low compared to the average over the last 35 years. *Id.* at 140-141. Interest costs that utility's pay on new debt are near the lowest in several decades. *Id.* at 141.

Dr. Vander Weide testified that he used the DCF model in his approach to determine return on equity. He used the CAPM approach as well to determine appropriate return on equity.

(d) <u>James H. Vander Weide Cross-Examination (from Transcript of May 11, 2017, Vol. II, Afternoon Portion, beginning on page 4)</u>

Dr. Vander Weide testified that he is aware that Empire has regulatory mechanisms in place, such as riders, that have the effect of enhancing the recovery of Empire's investment and expenses. (5/11/17 p.m. Tr. at 4). He doesn't know if Empire has a rider to recover Southwest Power Pool costs. *Id.* He just knows that Empire has riders. *Id.* at 4-5. He does not know about Empire's riders that the Company obtained in Arkansas and Kansas to recover environmental compliance costs. *Id.* at 5. He does not know what percentage of Empire's total revenues are collected through riders. *Id.*

Dr. Vander Weide testified that ratings agencies view automatic adjustment clauses, such as Fuel Adjustment Clauses as supportive of utility credit quality and as important in reducing utility cash flow volatility. *Id.* at 5-6. Dr. Vander Weide testified that consistently low interest rates do not ensure a lower business risk profile for utilities. *Id.* at 8. They help. *Id.* Riders also help, but don't eliminate risk. *Id.* at 8-9.

Dr. Vander Weide testified that Empire's return on equity should equal the investors' required return. *Id.* at 9. In other words, the ROE awarded by the Commission should reflect Empire's cost of equity. *Id.* Dr. Vander Weide has proposed a cost of equity in this proceeding of 9.9%. *Id.*

Dr. Vander Weide testified that he does not know if the Discounted Cash Flow model and the Capital Asset Pricing model are the two most widely accepted financial models for calculating cost of equity in utility rate proceedings. *Id.* at 9-10. He testified that the Risk Premium approach is also used. *Id.* at 10. He then testified that all three are widely used. *Id.*

Dr. Vander Weide testified that both he and Mr. Garrett used the Discounted Cash Flow model and the Capital Asset Pricing model. *Id.* at 10-11. Dr. Vander Weide arrived at a cost of equity for Empire of 9.9% while Mr. Garrett arrived at a cost of equity of 7.5%. *Id.* at 11. Mr. Garrett has recommended a 9.0% ROE within his range of reasonableness. *Id.*

Dr. Vander Weide agreed that when the awarded ROE is set above the utility's true cost of equity, in a proceeding such as this, it results in an inappropriate and excess transfer of wealth from ratepayers to shareholders. *Id.* at 11-12. If this transfer of wealth occurs from ratepayers to shareholders, that impacts, in a negative way, Oklahoma's business and its citizens. *Id.* at 12.

Dr. Vander Weide agreed that utility stocks are less risky than the average stock in the market. *Id.* at 13. As a general matter, he agrees that the utility's cost of equity must be less than the market cost of equity. *Id.* Betas is one of the commonly-used measures of risk. *Id.* Utility betas are typically less than one. *Id.* at 14. He agrees that regulatory agencies, such as this Commission, should strive to determine a return on equity in line with the Company's actual, market-derived cost of capital. *Id.* at 14.

Dr. Vander Weide testified that he and Mr. Garrett used a different proxy group to conduct their cost of capital analyses. *Id.* at 15. He testified that Mr. Garrett also estimated the cost of equity using the proxy group selected by Dr. Vander Weide. *Id.* The results of Mr. Garrett's calculations, using Dr. Vander Weide's proximity group, closely resemble the results of the models that Mr. Garrett used using his own proxy group. *Id.*

Dr. Vander Weide testified that he relied on data dating back to 1926 to estimate his equity risk premium as one of his two methods. *Id.* at 16. Beta is one of the inputs into the CAPM model. *Id.* It measures volatility relative to the market. *Id.* As part of his beta estimate, he considered betas published by Value Line. *Id.* He also did his own estimates of betas for some of the companies in his proxy group for an average utility beta. *Id.* His estimated betas are higher, generally, than the betas published by Value Line. *Id.* He testified that if all else is held constant, a higher beta will provide a higher cost of equity estimate in the CAPM model. *Id.* at 16-17. The result of his CAPM model is as high as 10.2%. *Id.* at 17. In their application of the CAPM models, PUD witness, Mr. Rush, arrived at a cost of equity of 6.79%, and OIEC witness, Mr. Garrett arrived at a cost of equity of 7.4%. *Id.*

Dr. Vander Weide testified that he also used the DCF model. *Id.* at 17. One of the inputs for that model is long-term growth rate, which represents a long-term growth rate and dividends earnings and book value per share. *Id.* The experts are not in agreement on the long-term growth rate. *Id.* All else held constant, a higher growth rate estimate in the DCF model will result in a higher cost of equity estimate produced by the DCF model. *Id.* at 18. His average growth rate was 9%. *Id.* at 19.

Dr. Vander Weide testified that he provided several sources for estimated long-term growth rate in the U.S. gross domestic product in his rebuttal testimony. *Id.* at 19. Gross domestic product represents the total value of good produced and services provided in the U.S. in a year. *Id.* In his rebuttal testimony, he testified that the highest long-term GDP growth estimate he provided is 4.6% as estimated by the Social Security Administration. *Id.* at 1.

Dr. Vander Weide stated that he is not testifying that he believes that dividends and/or earnings of one of his proxy utility companies will grow at a rate that is about twice as high as the long-term growth estimate of the entire U.S. economy. *Id.* at 19. The growth rate to be used in the DCF model is the growth rate that investors use when they're estimating the cost of equity. *Id.,* at 19-20. His study and other studies have shown that investors rely on analysts' growth rates to estimate the growth rate for individual securities. *Id.* at 20.

Dr. Vander Weide testified that he is not saying that a utility's stock can continuously, year after year, outgrow the long-term GDP growth rate. *Id.* at 21. He is not recommending using the long-term growth rate in his DCF model. *Id.* at 23. He recommends using the growth rate investor's use when they buy and sell stocks to evaluate the price. *Id.* The result of his DCF model is 9.3%. *Id.* at 24. He acknowledged that Mr. Rush and Mr. Garrett came up with significantly lower ROE results than he did. *Id.*

13. Thomas Sullivan

(a) Thomas J. Sullivan Direct Testimony filed December 21, 2016

(b) Thomas Sullivan Rebuttal Testimony filed on April 03, 2017

(c) Thomas Sullivan Cross-Examination (from Transcript of May 11, 2017, Vol. I, Afternoon Portion, beginning on page 51)

Mr. Sullivan testified that he is not suggesting that Empire collect dollars for the future interim activity, but it's in the calculation of the depreciation rate. (5/11/17 Tr. at 51-52). Empire is requesting approval of depreciation rates. *Id.* at 52.

Mr. Sullivan testified that the inclusion of the interim retirements in his study results in an increase to his proposed depreciation rates. *Id.* at 53. Mr. Sullivan agreed that collectively, for the production units, Mr. Garrett's proposed depreciation rates are lower than his proposed rates. *Id.* at 53-54. Mr. Sullivan testified that as part of his interim retirement proposal, he estimated future plant additions and retirements for each year in the future until the plant's estimated retirement date. *Id.* at 54. Some of them go for more than 50 years into the future. *Id.* The interim retirements are not based on Iowa Curves and he did not do any Iowa Curve Analysis. *Id.* They are based on historical experience. *Id.*

Empire's response to OIEC's Data Request 9.1 was marked as Exhibit 141. *Id.* at 55. Mr. Sullivan testified that he provided the answer to Data Request 9.1. *Id.* at 56. Empire was asked to provide all justification and support for the proposed net salvage rates for the Company's production accounts. His response was:

> For steam and hydroelectric plants, we used a gross salvage of 5 percent and a cost removal of 10 percent for a net salvage of negative 5 percent. For the prime movers and generators for combustion turbine and combined cycle plants, we used a gross salvage of 10 percent and a cost for removal of 5 percent, for a net salvage value of positive 5 percent. For the other accounts, for combustion, turbine and combined cycle plants, we used a gross salvage of 8 percent and a cost of removal of 10 percent, for a net salvage of negative 2 percent. These amounts represents minimal allowances that we deem reasonable absent any specific demolition studies.

(5/11/17 p.m. Tr. at 56-57.)

Mr. Sullivan testified that the company name on the report is Black & Veatch, which is the company he used to work for. *Id.* at 58. The team he worked with on the depreciation study were the employees there. *Id.* He now works for himself. *Id.* The percentages he provided for the net salvage value were not based on a study; they were a very nominal, minimal analysis. *Id.* at 59.

Mr. Sullivan testified that he estimated future plant additions for the Iatan 2 each year until 2069. *Id.* at 63. His schedule A-28, A-29 shows plant additions estimated each year, until 2069, with an average of over $1 million each year. *Id.* The total amount of his estimated future plant additions is about $65 million. *Id.* at 64. Mr. Sullivan testified that he incorporated all of these future plant additions in developing his depreciation rates. *Id.* at 64.

Mr. Sullivan testified that the test year concept does not apply to the determination of depreciation rates. *Id.* at 65. It's his understanding that as far as cost recovery for a plant, the utility has to have the plant in service within the test year or six months after the test year to get the plant in rate base. *Id.*

Mr. Sullivan testified that his future plant additions were based on two pieces, one that were "Major Additions," that is based on the five-year Capital Investment Plan, which was provided by the Company. *Id.* at 67. The other were interim additions and retirements that are based on the historical experience for that particular account for that particular plant. *Id.* He did not do any independent due diligence regarding those plants and whether they had been approved by the Commission in advance for prudence. *Id.* His calculation of depreciation rates include rates based on plants that will be built and in service in the future. *Id.* at 69.

Mr. Sullivan testified that the Company's transmission and distribution depreciation accounts are known as mass property accounts. *Id.* at 70. Both he and Mr. David Garrett used Iowa Curves to estimate service lives for Empire's mass property accounts. *Id.*

On his Iowa Curve application, he analyzed Empire's property was placed in service as early as 1900 for some accounts. *Id.* at 71. Mr. Garrett started with 1960 for his analysis. *Id.*

Mr. Sullivan testified that he has not read the Integrated Resource Plan of Empire. *Id.* at 79. He does not know if the capacity and generation of the Riverton units were replaced by converting Riverton 12 to a combined cycle. *Id.* at 80. Mr. Sullivan testified that his estimated retirement date of the Riverton 12 unit is 2057. *Id.*

Mr. Sullivan acknowledged that the retirement of the Riverton 7 and 8 were part and parcel of the same Environmental Compliance Plan that allowed for the conversion of the Riverton 12. *Id.* at 82. He testified that the Riverton 12 unit has an estimated total service life of 50 years and a remaining life of 42 years as of the depreciation study date. *Id* at 83. Empire is proposing to recover the undepreciated balance of the Riverton 7 and 8 over five years. *Id.* at 80-81.Mr. Garrett has recommended the amortization of the undepreciated portion of the Riverton unit 7 and 8 over 42 years. *Id.* at 83-84.

14. H. Edwin Overcast

(a) H. Edwin Overcast Direct Testimony filed December 21, 2016

(b) H. Edwin Overcast Rebuttal Testimony filed on April 03, 2017

(c) H. Edwin Overcast Cross-Examination (from Transcript of May 12, 2017, beginning on page 21).

Mr. Overcast testified that he did not prepare, but has reviewed the Company's rebuttal errata Schedule M1, Ex. 130. (5/12/17 Tr. at 21-22). Column H shows percentage increases sought, which are relatively large for this company. *Id.* at 22. This would be within his definition of rate shock. *Id.* at 22-23. The power transmission, industrial class, is allocated 23.31% of this increase. *Id.* at 23.

Mr. Overcast testified that Exhibit 30 does not identify the rate of return that the Company is going to earn on each of these classes. *Id.* That information is not provided to the Commission for this revenue requirement. *Id.* The Commission does not know the rate of return that the Company is going to earn from the various classes. *Id.* No cost of service study was filed using these revenue requirements. *Id.* at 23-24.

Mr. Overcast testified that under the Company is earning a rate of return from the general power class of 3.8 times the system average return. *Id.* at 24. He testified that the general principle followed to arrive at the revenue spread is that for classes with the large deficiencies have approximately 125% of the increase. *Id.* at 25-27. They are trying to move all the classes toward the full cost of service, but you can't get there in one move. *Id.* at 27-29. Mr. Overcast testified that you will always have some cross-subsidy because you have to produce a total revenue requirement. *Id.* at 29.

Mr. Overcast testified that the Commission has defined equalized rate of return using a bandwidth, and it could do that here. *Id.* at 31. A bandwidth of 1.25 to 0.75 provides bounds of relative rates of return. *Id.* at 35.

Mr. Overcast recommends a proposed cost of service study using an Average and Excess demand, AED method, with a 12 CP allocator for production plant. Mr. Garrett recommends that Empire's cost of service study be modified to utilize the 4 CP Average and Excess demand methodology for allocation of its production costs. *Id.* OIEC also recommends that transmission costs be allocated using the 4 CP methodology. *Id.* at 36.

Mr. Overcast testified that he is aware that the Commission has addressed cost of service studies many times, and that the Commission recently addressed it in PSO and OG&E's recent rate cases. *Id.* He is aware that the Commission determined that the appropriate cost of allocation for retail customers for transmission was a 4 CP allocation. *Id.*

Mr. Overcast testified that the four months with the most system demand requirements are January, July, February, and August. *Id.* at 38. Mr. Garrett has recommended his 4 CP average and Excess based on these four peak months. *Id.* Mr. Overcast testified that January's peak demand is almost twice the peak demand of April. *Id.* He included April in his cost of service proposal as if it's a peaking month because he doesn't just use load demand. He uses total demand on capacity, which includes scheduled maintenance. *Id.* April is the month when utilities with this load pattern typically pull their large units out for maintenance, which increases demand on capacity. *Id.* at 38-39.

Mr. Overcast acknowledged that peak demands in January, February, July and August are substantially in excess of peak demands in May, October, and November, but that is when they pull maintenance on the units as well. *Id.* at 40. He testified that the cost of service guide is the guide to allocating costs among customer classes. *Id.* at 40-41. He testified that cost causation is the key element in allocating costs among customer classes. *Id.* at 41. A 4 CP Average and Excess is one of many forms recommended in a NARUC cost allocation manual. *Id.* at 41.

Mr. Overcast acknowledged that Staff witness Schwartz did not say anything about Mr. Garrett's proposed allocation factor. *Id.* at 42. He does not speak for Staff. *Id.* at 43.

B. Public Utility Division (Staff)

1. Kathy Champion

(a) Kathy Champion Responsive Testimony filed March 13, 2017

(b) Kathy Champion Responsive Rate Design Testimony filed March 22, 2017

2. Kiran Patel

(a) Kiran Patel Responsive Testimony filed March 13, 2017

3. Tonya Hinex-Ford

(a) Tonya Hinex-Ford Responsive Testimony filed March 13, 2017

4. McKlein Aguirre

(a) McKlein Aguirre Responsive Testimony filed March 13, 2017

5. Elbert D. Thomas

(a) Elbert D. Thomas Responsive Testimony filed March 13, 2017

6. David Melvin

(a) David Melvin Rebuttal Testimony filed on April 03, 2017

7. Robert C. Thompson

(a) Robert C. Thompson Responsive Testimony filed March 13, 2017

(b) Robert C. Thompson Cross-Examination (from Transcript of May 11, 2017, Vol. I, Morning Session, beginning on page 32)

Mr. Thompson testified that the change to Accounting Exhibit 138, PUD Revised accounting exhibit, is that the Company has accepted the six-month post-test year adjustment to plant in service, which Staff shows on Colum G, to the accumulated appreciation, which is in Column H. Staff then updated the beginning number, the accumulated deferred income tax, to the six-month post-test year number as well. (5/11/17 a.m. Tr. at 32).

Mr. Thompson testified that the only adjustments that the Company did not accept is Staff's $50,000 adjustment in Column C in H-2, which is payroll incentives; and the Staff's adjustment to depreciation expenses, which is Column E. *Id.* at 33.

Currently, Staff's revenue requirement recommendation is a proposed increase of $2,844,138. That appears on p. 3 of 16, Section A, Schedule 1, Line 7. *Id.* Much of that revenue increase is related to capital investments. *Id.* at 33-34. The Company is seeking around $669 million of capital investments to be recovered in rate base in this case. *Id.* at 34.

His responsive testimony does not provide any details regarding or supporting the Company's plant in service. That testimony is by PUD witness David Melvin. *Id.* Mr. Melvin did not provide responsive testimony. *Id.*

Mr. Thompson testified that in PSO's last rate case, PSO filed the testimony of numerous witnesses supporting the prudence of transmission, distribution, and generation additions. *Id.* at 35. It would be correct that PSO, in its environmental compliance proceeding, had a number of witnesses that testified to the prudence of the environmental compliance plan. *Id.* The extensive amount of testimony in the PSO case was not present in this case. *Id.* at 35-36.

Mr. Thompson testified that the 6-month post-test year period ends December 31, 2016, which pre-dates the effective date of the merger. *Id.* at 36. The rates that are being reviewed are associated with expenses, investments, capital structure, and corporate overhead, associated with

the former Empire District Electric Company. *Id.* Some rate orders remain in effect over long periods of time. *Id.* For example, Empire's current rates were set back in 2011 or 2012. *Id.* at 36-37. Mr. Thompson agreed that it is important to have the proper, correct, and best information possible when determining rates. *Id.* at 37. Mr. Thompson said he understood that Empire has testified that there will be benefits from the merger. *Id.* The Company was talking about corporate savings in the way of overhead, etc., and did not include the cost that could be saved as a result of the lower cost of capital. *Id.*

Mr. Thompson was not sure if a comprehensive list of O&M expenses were included. *Id.* at 38. Mr. Thompson agrees that you really never know what the costs savings are going to be until you operate for a year and look and see what the appropriate cost savings have been. *Id.*

He was involved in ONG's performance based rate calculation proceedings. *Id.* Every year the rates and costs of ONG are reviewed, pursuant to a Performance Based Rate Plan. *Id.* Mr. Thompson was aware that ONG was at one time a division of ONEOK. *Id.* A few years ago, ONEOK Corporation spun off ONG into a separate, stand-alone entity called ONEGas. *Id.* Mr. Thompson is aware that under the terms of ONG's previous rate orders and PBRC plans, ONG was scheduled to file a rate case before the Commission around 2014. *Id.* at 39.

Mr. Thompson acknowledged that ONEGas, the new entity, and the Staff filed an application seeking deferral of the rate case requirements, he believes, until ONG had four quarters of operating and financial information as a stand-alone company. *Id.* at 39. Ex. 139 is the final order for the Joint Stipulation and Settlement Agreement in ONG matter, Order NO. 620407, PUD 201300815. *Id.* at 40. Applicants were ONG and the PUD. *Id.* t 40-41. The Order addresses the elimination of ONG/ONEOK's filing of a 2014 general rate review and the filing of a 2015 a general rate review, utilizing a test year that includes the first four complete quarters of ONEGas, with ONEGas filing in 2015 general rate review application on or before five months following the fourth quarter's end. *Id.* at 41. The Order further states that PUD witness Fairo Mitchell supported the Joint Stipulation and the elimination of the 2014 rate case as there would not be sufficient historical data to support a rate case initiated during that year. *Id.* at 42.

Mr. Thompson understands that OIEC and the Attorney General have in their testimony put forth the concept of a rider to recover the environmental compliance costs in Oklahoma. *Id.* at 43-44. Mr. Thompson testified that the Company has agreed to not pursue recovery of all other investments in Kansas and Arkansas. *Id.* at 44. Mr. Thompson testified that there are different timings involved, different test years, and different merger agreements and statutes. *Id.* at 44. As far as different timing, Mr. Thompson acknowledged that the investments were made for the benefit of all the Empire jurisdictions. *Id.*

When asked why Oklahoma should pay for the investments now, while other jurisdictions are not going to pay for them until 2019, at the earliest, Mr. Thompson said: "Somebody has to be first." *Id.* at 45. He testified that Staff has looked at the impact of the rate request on Oklahoma consumers. *Id.* For example, Staff has done an analysis of what impact it will have on senior citizens and it is extreme. *Id.* He admitted that he has never testified in response to a 24.5% rate increase. *Id.* This is an extraordinary situation. *Id.* at 45-46.

Mr. Thompson testified that the Company needs to support their capital costs and their O&M expenses. *Id.* at 46. He agrees that it's the Company's burden to respond to question and support their case. *Id.* The Company has all the information. *Id.* at 47.

(c) Robert C. Thompson Cross-Examination (from Transcript of May 11, 2017, Vol. II, Afternoon Portion, beginning on page 103)

Mr. Thompson testified that he is aware that David Garrett did a comprehensive depreciation analysis of Empire's proposed depreciation expenses. (5/1/17 p.m. Tr. at 104). Other than the amortization of Riverton 7, 8 and 9, he does not have any issue with what Mr. Garrett says in his testimony. *Id.*

Mr. Thompson testified that he did not know whether the Riverton 7, 8, and 9 units are mentioned in Empire's Environmental Compliance Plan. *Id.* at 105. Mr. Thompson said that he did not review IRPs of Empire for 2014 or 2015. *Id.* at 105-106.

8. Jeremy K. Schwartz

(a) Jeremy K. Schwartz Responsive Testimony filed March 22, 2017

(b) Jeremy Schwartz Rebuttal Testimony filed on April 03, 2017

(c) Jeremy K. Schwartz Cross-Examination (from Transcript of May 11, 2017, Vol. I, Morning Session, beginning on page 59)

Mr. Schwartz testified that he did not provide any responsive testimony regarding Empire's reliability issue, but did provide rebuttal testimony on this issue. (5/11/17 a.m. tr. at 60). He agrees that the Commission should consider reliability reporting of the Company and the results in this case, within the bounds of the Commission's rules. *Id.*

Mr. Schwartz testified that one of the requirements of the utility is to provide reliable service. *Id.* at 61. He does not have any issues with the Commission's 2016 reliability scorecard. *Id.* Mr. Schwartz testified that he now recommends that the Commission require the Company to provide an in-depth analysis of its system reliability plan in its next rate case proceeding. *Id.* at 61. He does not know when that will be. *Id.* at 61-62.

Mr. Schwartz testified that the Commission should defer consideration of reliability, even though it has not looked at it in over six years, because of the Company's declining expenses for vegetation management. *Id.* at 62-63. This could be the result of the Company not having sufficient funds, but if it is not, they need to re-evaluate their spending. *Id.* at 63. Mr. Schwartz testified that vegetation management expense is not an issue in this proceeding. *Id.* at 63-64.

Mr. Schwartz testified that he agreed that Commission Rule 35-25-18(d) provides that the Commission can consider changes to a Company's return, return on investment or rate of return, as a result of reliability results. *Id.* at 64.

(d) Jeremy K. Schwartz Cross-Examination (from Transcript of May 12, 2017, beginning on page 91)

Mr. Schwartz testified that regarding cost of service allocators, the Staff is not choosing one side or the other. Staff is not opposed to other recommendations regarding cost of service allocators. (5/12/17 Tr. at 91). The 4 CP allocator could be reasonable for both production plant and transmission. *Id.* at 91-92.

Mr. Schwartz testified that when the revenue requirement keeps changing, then the schedules have to be updated to reflect a new revenue distribution. *Id.* at 92. Mr. Schwartz testified that Mr. Garrett's proposed revenue distribution formula, with a band of 1.25 to .75, could be used, but it would not be appropriate, primarily because of the impact it would have on other customer classes. *Id.* at 93. Also, it sets an arbitrary level for all classes and doesn't take into consideration the impacts of individual classes and what shifts need to be made. *Id.* at 93.

Figure 3 in his testimony, page 13, sets forth PUD's proposed revenue distribution. *Id.* at 94. In his recommended revenue distribution at his previous revenue requirement, the Company would earn a relative rate of return from the general power class of close to 1.9. *Id.* at 95. The reason PUD did not shift them any lower is because of the impacts to other classes. *Id.* Mr. Schwartz could not say whether it would be fair to the general power class that the company earn an almost 200% rate of return from that class. *Id.* at 95.

9. Geoffrey M. Rush

(a) Geoffrey M. Rush Responsive Testimony filed March 13, 2017

(b) Geoffrey M. Rush Surrebuttal Testimony filed on April 17, 2017

(c) Geoffrey M. Rush Cross-Examination (from Transcript of May 11, 2017, Vol. I, Morning Session, beginning on page 69)

Mr. Rush testified that he is recommending a disallowance of 75% of Empire's long-term incentive compensation. (5/11/17 a.m. Tr. at 69) He testified that in OG&E and PSO's recently concluded rate cases, the Commission decided that 100% of the long-term incentive compensation should be excluded from rates. *Id.* That is the position of OIEC and the Attorney General in this case. *Id.* at 69-70. He did not examine other litigated cases before the Commission in major rate case proceedings, such as earlier PSO rate cases or OG&E rate cases. *Id.* at 70. He read Mr. Garrett's testimony, where he provided information on the rate case orders of PSO in 2006 and 2008 regarding this issue. *Id.* The Commission disallowed 100% of long-term incentive compensation in those cases. *Id.* Mr. Rush testified that he is aware that most of the long-term incentive compensation is stock based. *Id.*

Mr. Rush is recommending 50% recovery of short-term investments in rates. *Id.* He has heard the testimony today about the Commission rules that allow the Commission to consider reliability in connection with developing rates and determining ROE. *Id.* at 70-71. The Commission can in this case consider reliability in determining recovery of incentive compensation. *Id.* at 71. He has not heard or read in testimony anyone challenge the fact that

Empire is having service issues and has been providing poor quality service. *Id.* The Commission could disallow 100% of short-term incentive compensation recovery based on poor reliability and other factors. *Id.* at 72.

Mr. Rush testified that he is aware that Empire's incentive compensation plan is in part based on the service and reliability quality that it provides. *Id.* at 73. Mr. Rush is recommending disallowance of incentive compensation related to financial performance measures. *Id.* The other 50% of incentive compensation is based on factors such as service, quality, reliability, and customer satisfaction. *Id.* at 74-75.

(d) Geoffrey M. Rush Cross-Examination (from Transcript of May 12, 2017, beginning on page 57)

Mr. Rush testified that in his cost of capital analysis, he used the DCF model, the CAPM model, and one other model. (5/12/17 Tr. at 57). His DCF model produced a result of 7.2%. *Id.* at 57-58. That is a very similar to the result that Mr. David Garrett's DCF model produced. *Id.* at 58. Mr. Rush agrees that the DCF model is one of the widely used models to determine ROE. *Id.* His use of a CAPM model produced a result of 6.79%. *Id.* That result is also similar to the result reached by Mr. David Garrett with his use of the CAPM Model. *Id.*

Mr. Rush testified that he made a comparable earnings study, and his analysis looks at the earned returns of other utility companies. *Id.* at 58-59. Mr. Rush agreed that the comparable earnings method is somewhat circular in that you never really get a true cost of equity from that model because you are basing it on other utilities' returns. *Id.* at 59.

Mr. Rush testified that regulators such as the Commission have a duty to stand in place of competition and that duty cannot be adequately accomplished by simply awarding returns on equity based on the earned returns of other utilities. *Id.* at 59. Mr. Rush testified that the comparable earnings model is the weakest of the three models presented in this case and should be considered with caution. *Id.*

Mr. Rush testified that his recommended return on equity is 9.9%. *Id.* at 59-60. That 9.9% is more than 250 basis points above his DCF model result and more than 300 basis points above his CAPM model result. *Id.* at 60. Mr. Rush testified that the Company would want to go gradually to a return on equity based on the Company's cost of equity. *Id.* Mr. Rush testified that he does not believe that the Commission has, in the past, awarded a return based on the company's true cost of equity. *Id.* at 60-61.

Mr. Rush testified that there had to be a gap to allow for a competitive return. *Id.* at 61. Mr. Rush disagreed that the concept of "gradualism" is not used so much with cost of equity. *Id.* Mr. Rush testified that if the Commission chose to gradually move towards cost of equity that would result in ratepayers paying more than the true cost of equity. *Id.* at 62. It would result in a transfer of wealth from utility ratepayers to company shareholders. *Id.*

Mr. Rush testified that the current ROE for Empire is 10.19%. *Id.* at 62. Mr. Rush testified that the average return on equity from his models is 7.91%. *Id.* at 62-63. In moving toward the current cost of equity, he is going from 10.19% to 9.9%. *Id.* at 63. The witness

testified that he's moving 0.29% towards cost of equity when the difference between the current ROE and his models, which produce the true cost of equity, is 2.8%. *Id.* at 64. If you moved halfway, it would result in an ROE of 9.05%. *Id.* at 65. Mr. Garrett has recommended, as the high end of his range, a 9.0% ROE. *Id.* Mr. Rush testified that he can see the rationale for moving halfway. *Id.*

Mr. Rush is aware that Empire has a beta from ValueLine and others that is below 1. *Id.* at 66. The beta is 0.7. *Id.*

C. Attorney General

1. Edwin C. Farrar

(a) Edwin C. Farrar Responsive Testimony filed March 13, 2017

(b) Edwin C. Farrar Responsive Rate Design Testimony filed March 22, 2017

(c) Edwin C. Farrar Rebuttal Testimony filed on April 3, 2017

(d) Edwin C. Farrar Cross-Examination (from Transcript of May 12, 2017, beginning on page 85)

Mr. Farrar testified that he recommends a rate design rider like the one implemented in Kansas as a means to moderate any rate increase the Commission may approve in this case. (5/12/17 Tr. at 85-86). The rate increase associated with that rider would be around $868,000. *Id.* at 86. He recommends that the environmental compliance rider be recovered on a cost per kilowatt hour basis for jurisdictional costs, as it is recovered in Kansas. *Id.* Mr. Farrar testified that the environmental compliance costs are really production plant costs. *Id.* at 86-87. The Commission typically allocates production plant using a production demand allocator rather than a kWh allocation. *Id.* at 87. Mr. Farrar acknowledged that Mr. Garrett proposed an equal increase to each class. *Id.* Mr. Farrar testified that an equal increase is a reasonable approach. *Id.*

D. OIEC

1. Mark Garrett

(a) Responsive Testimony of Mark E. Garrett – Revenue Requirement Issues, filed on March 13, 2017

He is the President of The Garrett Group, LLC, a firm specializing in public utility regulation, litigation and consulting services. He is an attorney and CPA with more than 25 years of experience testifying as an expert witness in gas and electric utility rate cases. He is appearing in these proceedings on behalf of Oklahoma Industrial Energy Consumers ("OIEC"). OIEC represents the interests of industrial companies and other large energy consumers. Electric power costs can constitute a significant percentage of industrial and other large consumers'

operating costs. Industries served by the Empire District Electric Company, ("Empire" or the "Company"), operate in competitive business environments and are interested in the Commission setting rates that result in the delivery of reliable power at the lowest reasonable cost.

A. Empire's proposed increase is unconscionable and constitutes rate shock.

Empire is recommending an approximate $3.8 million increase in Oklahoma. This represents a 45.26% increase in base rates and a 27.58% increase in overall rates. According to the Company, the requested increase is primarily driven by new capital investment to comply with Environmental Protection Agency ("EPA") air quality regulations at its Asbury and Riverton 12 plants.

Empire's last rate case was Cause No. PUD 201100082. Since its last rate case in 2011, Empire has been investing large amounts in new rate base with no notice to the Commission or to the Company's customers. It is irresponsible for a utility to incur such costs for five years before informing its customers that it intends to nearly double their base rates. Empire's requested base rate increase of 45.26% increase is unconscionable. Generally, a base rate increase of even 10% would constitute rate shock. Empire has proposed an increase here nearly five times as large. A 27.58% increase in overall rates over a 5-year period is also unreasonable. This amounts to an average annual increase of 5.5%. In comparison, the Consumer Price Index ("CPI") rose by an annual average increase of 1.32% over the period 2012 to 2016. Empire's requested increase is more than 4 times the CPI average.

B. Empire's rate increase in Oklahoma should be in line with its Kansas Settlement.

Empire's requested increase is inequitable compared to its last Kansas rate case. Last year Empire sought a similar rate increase (25.64%) in Kansas, a jurisdiction like Oklahoma, in which Empire had not filed a rate case since 2011. The increase in Kansas was driven by the same two factors: the Asbury and Riverton 12 environmental costs; and Empire's failure to timely file rate cases. However in Kansas, Empire withdrew its rate case and settled for a much more reasonable increase.

Pursuant to a Unanimous Settlement Agreement in Docket No. 16-EPDE-410-ACQ ("410 Docket") involving Empire's application for approval of a merger with Liberty Utilities (Central) Co., the Kansas Corporation Commission ("KCC") authorized the following: (1) Empire's withdrawal of the Kansas rate case, (2) a moratorium on another rate case filing until May 1, 2018, (3) collection of the Asbury and Riverton 12 capital costs through an environmental compliance rider, subject to refund and annual true-up. The settlement reached in Kansas, and approved by the KCC, was that Empire would recover its Asbury and Riverton 12 capital cost increases, and nothing more.

By its agreement to the Kansas settlement, Empire has indicated that these terms would result in just and reasonable rates. The KCC in the 410 Docket also determined that the Kansas settlement terms resulted in just and reasonable rates. In my view, before this Commission considers Empire's requested increase, the Company should address the appropriateness of

asking that Oklahoma ratepayers incur significantly higher rate increases than the rate increases received by Kansas ratepayers.

It is appropriate to consider the Kansas settlement purposes of showing the utility agreed to terms it found just and reasonable. Moreover, the Kansas settlement is particularly relevant to this case because of its close proximity in time and similarity of jurisdictional impact. In other words, Empire's Oklahoma ratepayers comprise an even smaller jurisdictional percentage of its overall service territory than its Kansas ratepayers do. Thus, the impact of implementing the same terms in Oklahoma as in the Kansas settlement will have no greater financial impact on Empire. The converse, however, is not true. If the Commission were to approve Empire's requested rate increase, the Oklahoma ratepayers in Empire's service territory would suffer tremendous detrimental financial impact.

He recommends that the Commission should establish rates in this case based on the same terms in the Kansas settlement. The Commission should authorize a rider for Empire's collcction of the capital costs of the Asbury and Riverton 12 projects, subject to refund and subject to a Commission review for prudence of these investments in Empire's next Oklahoma rate case.

The Net Plant in Service for the Asbury and Riverton 12 additions, after deductions for accumulated depreciation and ADIT, is $233,325,825. The Oklahoma jurisdictional amount of Net Plant in Service is $6,421,127. Assuming a pre-tax rate of return of 9.79%, which is OIEC's recommended rate of return, the annual return and depreciation expense on the Asbury and Riverton 12 net plant balances would be $804,205. These costs should be distributed to the rate classes based on the current revenues in each class and collected then on a kWh basis.

C. Traditional ratemaking requires significant adjustments and disallowances.

In his testimony he discusses the inequities and insufficiencies in Empire's application that lead him to strongly recommend the Commission adopt the Kansas settlement approach. However, if the Commission decides to take another approach, numerous adjustments and disallowances are required to reduce Empire's proposed rate increase.

1. 6-Month Rate Base Updates. In Oklahoma, the Commission is required by law (Title 17 § 284) to give effect to known and measurable changes that occur within six months of test year end. As a result of this requirement, he made following adjustments to update rate base balances to December 31, 2016:

OIEC Adjustment to Actual Balance at 12/31/2016	OK Jurisdictional Amount
Plant in Service	$99,489
Accumulated Depreciation	$(134,465)
Accumulated Deferred Income Tax	$(73,619)
Customer Deposits	$(250)
Prepayments	$2,352

Materials & Supplies $(4,162)

2. Annual Incentive Compensation Expense Adjustment. He propose that the Commission exclude 100% of the annual incentive plan expense. This treatment removes all of the incentive-plan costs associated with financial performance measures, because incentive plan costs associated with financial performance are traditionally removed from rates. It also removes all of the incentive-plan costs associated with customer satisfaction and reliability, because Empire has performed so poorly in these areas over the past several years. The adjustment to remove 100% of Empire's annual plan expense and applicable payroll taxes is $49,048.

As a general rule, regulatory commissions exclude incentive compensation associated with financial performance. When the costs associated with these plans are excluded, the rationale is generally based on one or more of the following reasons:

1) Payment is uncertain;
2) Some factors affecting earnings are not in the control of employees;
3) Earnings-based incentive plans can discourage conservation;
4) The utility assumes no risk associated with incentive payments;
5) Financial incentives should be paid out of increased earnings;
6) Incentive payments embedded in rates shelter the utility against the risk of earnings erosion through attrition.

Although regulators routinely exclude financial-based incentive compensation payments based on one or more of the reasons outlined above, this does not mean that companies cannot offer financial-based incentives. However, when a financial-based incentive package is properly constructed, there will be ample additional earnings to fund these payments. Thus, ratepayers do not need to subsidize incentive

The Garrett Group, LLC conducted an Incentive Compensation Survey of the 24 Western States in 2007, and updated it in 2015, which shows that a clear majority of the states follow the financial-performance rule, in which incentive payments associated with financial performance are excluded from rates. Some states disallow incentive pay using other criteria. None of the jurisdictions surveyed allow full recovery of incentive compensation through rates as a general rule. The survey shows that the vast majority of the states surveyed follow the financial-performance rule, in which incentive payments associated with financial performance are excluded from rates. None of the jurisdictions surveyed allow full recovery of incentive compensation through rates as a general rule.

The argument that incentives should be included in rates because the amount is reasonable when compared with amounts paid by other utilities misses the point. The question for regulators is not whether the amount paid for incentives is reasonable, but whether the incentives are necessary for the provision of service. The utility is free to offer whatever compensation package it wants to offer, but most commissions agree that ratepayers should not pay the costs of plans designed to increase corporate earnings.

Although Empire's plan includes operational factors, he is recommending that all of the costs associated with Empire's operational measures such as safety, reliability and customer satisfaction should be disallowed because the Company has performed poorly in these areas in recent years. Empire's JD Power Customer Satisfaction ratings were far below average in 2016. The Company's Reliability Scorecard filed annually with the Commission was also poor in 2016. In fact, Empire's SAIFI scores were the worst in the state. On average, Empire's customers experienced 2.5 outages per customer in 2015. This was 2½ times the state average.

In his testimony, he referenced several examples in which this Commission has denied recovery of incentive compensation. For instance, in PUD 91-1190, at page 145, this Commission disallowed the entire cost of both of ONG's plans, finding that the incentive plans were designed to increase corporate earnings. In PUD 04-610, the Commission ordered the disallowance of the entire cost of ONG's incentive compensation payments. In OG&E's 2005 rate case, PUD 200500151, the Commission's final order disallowed 60% of the Company's Teamshare expense.

3. Long-Term Stock Incentive Plan Adjustment. The Company is proposing to include $37,574 in rates for its long-term incentive plan for officers, directors and selected senior management of the Company. Long-term incentive compensation payments to officers, executives and key employees are generally excluded for ratemaking purposes. Since officers of any corporation have a duty of loyalty to the corporation and not to the customers, these individuals typically put the interests of the company first. The interests of the company and its customers are not always the same, and at times, can be quite divergent. Since compensation is tied over a long period of time to the company's stock price, it motivates employees to make business decisions from the perspective of long-term shareholders. This intentional alignment of employee and shareholder interests means the costs of these plans should be borne solely by the shareholders.

On a number of occasions this Commission has addressed the issue of whether to include long-term incentive compensation in rates. The Commission excluded the entire amount of long-term incentive compensation in Cause Nos. PUD 91-1190; PUD 04-610; PUD 200600285; PUD 200800144; and PUD 201500208.

Garrett Group, LLC's Incentive Compensation Survey, discussed in the previous section of this testimony, also shows that most states disallow recovery of long-term incentives. In keeping with Oklahoma's long-standing regulatory treatment of this issue, he recommends an adjustment to remove 100% of Empire's long-term incentives payroll taxes of $37,574.

4. Supplemental Employee Retirement Plan (SERP) Adjustment. The Company provides supplemental retirement plan benefits to certain highly-compensated employees. These supplemental retirement plans for highly compensated individuals are provided because benefits under the general retirement plans are subject to limitations under the Internal Revenue Code. Benefits payable under these plans are typically equivalent to the amounts that would have been paid but for the limitations imposed by the Code. In general, the limitations imposed by the Code allow for the computation of benefits on annual compensation levels of up to $265,000 for 2016.

He recommended that SERP costs be disallowed as a matter of principle. If SERP costs are disallowed, ratepayers will pay for all of the executive benefits included in the Company's regular pension plans, and shareholders will pay for the additional executive benefits included in the supplemental plan. For ratemaking purposes, shareholders should bear the additional costs associated with supplemental benefits to highly compensated executives, since these costs are not necessary for the provision of utility service, but are instead discretionary costs of the shareholders designed to attract, retain and reward highly compensated employees.

The Oklahoma Commission has disallowed 100% of SERP expense in Cause Nos. PUD 200600285; PUD 200800144; and PUD 201500208. Similarly, the Texas commission disallowed Entergy's SERP costs in Docket No. 39896. The Nevada commission disallowed NVE's SERP costs in Docket Nos. 01-10001, 03-10001, 06-11022, 08-12002, and 11-06006.

The Arkansas Commission disallowed SERP costs in Entergy Arkansas's last litigated rate case in that state, Docket No. 13-028-U. SERP costs are excluded in numerous other states as well.

Because officers of any corporation have a duty of loyalty to the corporation, these individuals are required to put the interests of the company first. This creates a situation where not every cost associated with executive compensation is should be passed on to ratepayers. Many regulators are inclined to exclude executive bonuses, incentive compensation and supplemental benefits from utility rates, understanding that these costs are more appropriately borne by shareholders. The impact of disallowing 100% of SERP cost in this docket is $(2,061).

5. Payroll Expense 6-Month Update. Empire made two adjustments to increase its annualized payroll expense levels for future pay raises and unfilled positions. Empire provided no testimony to support these adjustments. Typically, unsupported pay increases after the test period are inappropriate. Unfilled positions do not represent actual expenditures of the utility and thus, should not be included in rates. He proposes to reverse these improper adjustments, resulting in an Oklahoma jurisdictional adjustments of a $72,205 decrease to payroll expense, and a related $4,693 decrease for payroll tax.

6. Revenue 6-Month Update. In response to AG 3-3, Empire provided revenues updated for customer growth through December 31, 2016. The adjustment for updated revenues is $78,817.

7. Depreciation Adjustment. OIEC witness David Garrett proposes adjustments to the Company's depreciation study resulting in new proposed depreciation rates for many of the Company's plant accounts. The impact of his adjustments on the revenue requirement of Empire is a reduction in depreciation expense of $(439,856).

8. Cost of Capital Adjustment. With respect to cost of capital, OIEC witness David Garrett recommends a Return on Equity ("ROE") of 9.0%. The impact of his recommended ROE on the Oklahoma revenue requirement is a reduction of $(396,953).

9. Unsupported Plant Addition Costs. The Company identifies $669.5M of plant additions since the Company's last rate case in Oklahoma, for which Empire seeks cost

recovery. Empire provides minimal testimony in support of $304M of these additions. Specifically, Empire provides very limited testimony in support of its environmental upgrades at Asbury and Riverton 12, but provides virtually no testimony in support of the remaining additions in the amount of $365.5M, which is about $10.1M to the Oklahoma jurisdiction.

In every rate case the applicant has the burden of proving the reasonableness of the rates it seeks. He does not believe that Empire has met its burden with respect to its plant additions. The Commission has not been provided with sufficient evidence to determine whether these plant additions are prudent, or whether the costs are just and reasonable.

Empire has requested an unprecedented 45.26% increase in base rates with virtually no support for the majority of its asset additions, and with very minimal support for Asbury and Riverton 12 additions. The Commission would be justified in rejecting Empire's entire requested rate increase based on the fact that Empire failed to provide adequate support for the asset additions it claims are causing the increase.

He recommends that, at a minimum, the Commission should reject all of the requested increase related to the $365.5 million of unsupported plant, along with all of the costs associated with that plant, such as depreciation, property tax, O&M expenses and administrative costs, with a finding that the Company would be eligible to resubmit these costs for consideration in rates in the Company's next rate case proceeding.

D. Conclusion

In the conclusion of his revenue requirement testimony he recommended that the Commission authorize an environmental compliance rider for Empire's recovery of the capital costs of the two environmental compliance projects, Asbury and Riverton 12, similar to what was authorized in Kansas by the Kansas Corporation Commission, but nothing more. This is a more equitable treatment and would mitigate the rate shock that Oklahoma ratepayers would otherwise experience as result of Empire's irresponsible handling of regulatory matters in Oklahoma.

Based upon the insufficiencies in Empire's filing, he does not recommend that the Commission adopt a traditional approach in this rate case. If the Commission decides to follow a traditional ratemaking approach, it should adopt all of the adjustments outlined in my testimony, including an adjustment to reject recovery in this proceeding of the unsupported plant, and costs associated with that plant, such as depreciation, property tax, O&M expenses and administrative costs.

(b) <u>Responsive Testimony of Mark E. Garrett – Rate Design Issues, filed on March 22, 2017</u>

A. ECP Rider Cost Recovery and Allocation Recommendations

In his revenue requirement testimony, he recommended that the Environmental Compliance Plan ("ECP") rider be approved by this Commission. The cost of that rider should

be allocated on an equal percentage basis to all customer classes. This allocation method ensures that all customers share equally in these additional environmental compliance costs.

B. Alternative Class Cost of Service and Rate Design Recommendations

If the Commission does not accept the recommendation in my Revenue Requirement testimony to implement an ECP rider with no other rate changes, and instead implements on some other basis, the Commission should make two modifications to the Company's cost of service study:

1. Transmission Plant Allocation. Empire's class cost of service study should be modified to utilize the 4 Coincident Peak ("4CP") methodology for allocation of its transmission costs, rather than Empire's proposed 12 Coincident Peak ("12CP") methodology. A 4CP methodology reflects how the transmission system is actually used in Oklahoma. It is also the methodology approved by this Commission regarding allocation of transmission costs for both Oklahoma Gas and Electric Company ("OG&E") and Public Service Company of Oklahoma ("PSO").

2. Production Plant Allocation. Empire's class cost of service study should be modified to utilize the 4 Coincident Peak Average and Excess ("4CP AED") methodology for allocation of its production costs, rather than Empire's proposed 12 Coincident Peak Average and Excess ("12CP AED") methodology. A 4CP AED methodology reflects how Empire's production plant is actually used in Oklahoma. It is also the methodology approved by this Commission regarding allocation of production costs for both OG&E and PSO.

(c) Rebuttal Testimony of Mark E. Garrett filed on April 3, 2017

He testified that Empire identified $669.5M of plant additions, but only supported $304M of these additions. Specifically, Empire provided limited testimony to support its environmental upgrades at Asbury and Riverton 12, but provided no testimony to support the remaining additions in the amount of $365.5M. As a result, the Commission has not been provided with sufficient evidence to determine that the plant additions were prudent investments. He testified that Empire has the burden of proving the reasonableness of the rates it seeks, and that Empire has not met its burden with respect to recovery of the unsupported Plant additions. Finally, he testified that the Commission should reject all of the requested increase related to the $365.5 million of unsupported plant, and allow the Company to resubmit these costs for inclusion in rates in the Company's next rate case proceeding. In my rebuttal testimony, he addressed the responsive testimony filed by Staff and the Attorney General ("AG") in this proceeding.

A. Rebuttal to Staff's Recommendations

1. Lack of Evidence for Plant Additions. Staff did not address the fact that Empire provided no evidence to support the prudence of its plant additions. Instead, Staff included all of the plant in the Company's pro forma rate base in its recommended revenue requirement, despite Empire's failure to show that the new plant additions were prudent or that the costs were just and reasonable.

2. Rate treatment for Empire in Kansas and Arkansas jurisdictions. Staff's recommendations for Oklahoma ratepayers are not consistent with the ratemaking treatment Empire received in Kansas or Arkansas.

In Kansas, Empire requested a comparable increase (25.64%) last year, a jurisdiction in which, like Oklahoma, Empire had not filed a rate case since 2011. The increase in Kansas was driven by the same two factors as in Oklahoma: the large increase for the Asbury and Riverton 12 environmental costs; and Empire's failure to timely file rate cases. In Kansas, however, Empire withdrew that rate case, and pursuant to a Settlement Agreement, Empire agreed to the following terms: (1) Empire's withdrawal of its Kansas rate case, (2) a moratorium on another rate case filing until May 1, 2018, and (3) collection of the Asbury and Riverton 12 capital costs through an environmental compliance rider, subject to refund and an annual true-up. Staff acknowledged the rate treatment approved for ratepayers in Empire's Kansas jurisdiction but did not recommend such treatment for Oklahoma ratepayers.

Staff failed to consider the rate treatment received by Empire's ratepayers in Arkansas. In Arkansas, ratepayers are receiving virtually the same rate treatment ratepayers in Kansas are receiving. Arkansas ratepayers are paying for the Asbury and Riverton 12 environmental compliance costs through an Environmental Compliance Cost Recovery (ECP) rider, and Empire has a rate case stay-out provision effectively through 2018. Empire is required to have 12 months of post-merger actual accounting data before it files its notice of intent for its next rate case. The merger became effective at the end of January 2017, which means Empire cannot file its notice of a rate case until early 2018. With a 60-day notice period and a 10-month processing period for rate cases in Arkansas, Arkansas ratepayers will not see a rate change until early 2019. This provides ratepayers with two years of rate stability after the merger.

He testified that to be constitutionally valid, utility rates must be just, reasonable and non-discriminatory. In my opinion, the Oklahoma Commission should protect Oklahoma ratepayers by affording them the similar treatment that was afforded to Kansas and Arkansas ratepayers under similar circumstances.

Based on Empire's rate treatment in Kansas and Arkansas, which effectively requires a 2-year rate stabilization plan after the Liberty-Empire merger, a similar rate-freeze period is appropriate for Oklahoma. He recommends that the Commission require that Empire provide to the Commission at least twelve months of actual post-merger accounting data to include in its next rate case application, so that the historical test year in Empire's next rate case application is a 12-month period that includes all post-merger cost data. This will result in rate treatment in Oklahoma that is consistent with the rate treatment in both Kansas and Arkansas.

3. Staff's overstated 9.9% ROE. Staff does not explain why it is recommending a 9.9% ROE for Empire when the Commission in two recent litigated rate cases awarded 9.5% returns to both Oklahoma Gas and Electric Company ("OG&E") and Public Service Company of Oklahoma ("PSO"). Staff failed to distinguish Empire in any way that would justify the higher rate of return. Since the top end of Staff's range for Empire is 8.0%, it cannot show a financial basis for its higher recommended return. Moreover, from an operational standpoint, Empire's allowed return should be much lower than the returns of OG&E and PSO,

because Empire's quality of service and reliability are so much lower. He testified that awarding Empire a higher return is tantamount to rewarding the Company for poor operational performance. He recommended instead that the Commission award an ROE of 9.0% consistent with the recommendation of OIEC witness David Garrett.

4. Staff's Treatment of Long-Term Incentive Compensation. Staff recommended a disallowance of only 75% of Empire's long-term incentive compensation. He testified that this recommendation is misguided for all of the reasons he included in his responsive testimony. This Commission has consistently excluded the stock-based incentives for electric utilities. In fact, this Commission recently deliberated this issue in OG&E's and PSO's recently-concluded rate cases, Cause No. PUD 201500273 and Cause No. PUD 201500208. In the Final Orders in these causes, the Commission decided that 100% of long-term incentive compensation should be excluded from rates.

B. Rebuttal to the Attorney General's Recommendations

1. The Attorney General's Energy Allocation. The Attorney General, like OIEC, recommended that Empire should be allowed to recover only the capital costs associated with Asbury and Riverton 12 environmental compliance upgrades through a rider mechanism. However, the Attorney General recommended that these costs be allocated to and collected from the customers on an energy (kWh) basis, which is not a cost-based allocation.

He testified that since the Asbury and Riverton 12 capital costs are production plant costs, they should be allocated using a production plant allocator. In Oklahoma, capital costs associated with production assets have always been allocated on a demand basis, not on an energy basis, and this is the appropriate allocation of these costs.

An energy based allocation of these costs would create a significant subsidy to the residential class from the industrial classes. In essence, it would unfairly penalize the high load factor commercial and industrial customers. Since the residential class already has a significant subsidy that needs to be reduced, not increased, the AG's recommendation should not be accepted.

(d) Mark Garrett Surrebuttal Testimony (from Transcript of May 11, 2017, Vol. I, Morning Session, beginning on page 82)

Mr. Garrett's testimonies were admitted. (5/11/17 a.m. Tr. at 82-83). His surrebuttal issues list provided on April 17, 2017 was also admitted. *Id.* at 83-84. Mr. Garrett prepared a surrebuttal exhibit, MG-2, alternate proposal, Hearing Exhibit 40. *Id.* at 84-85. It is the revenue requirement calculations, similar to the one he provided with his responsive testimony, but it is updated to include all of the six-month plant and other rate base updates provided by PUD that the Company and PUD agreed upon, as does OIEC; they are all working with the same numbers. *Id.* at 84-85. It has also been updated to quantify the impact of the $369 million of unsupported plant expense, i.e., the plant that is not environmental compliance related. *Id.* at 85. It quantifies those adjustments on Lines 15 through 21, and it includes amounts on lines 48, 49, and 50 for

depreciation and property tax on O&M and administrative general expenses related to those assets. *Id.* On Lines 32 through 40, it takes out the adjustments that the Company has agreed to, and leaves in the adjustments that the Company has not agreed to. *Id.* Line 1 starts with the Company's revised position. *Id.* That number should tie to the revenue requirement that you find in Staff's accounting exhibit for the Company's position. *Id.* It is an alternative proposal. *Id.* at 86. OIEC's primary proposal is the environmental compliance plan rider, so that the Company would be allowed to collect Asbury and Riverton 12 costs until such time as they can file a rate case with proper support for these additional assets that were unsupported in this case. Ex. 140 is an alternate position if the Commission does not approve the rider; it shows the adjustments that would need to be made. *Id.* It also quantified the value of the unsupported plant additions. *Id.* Mr. Garrett testified that one additional correction needs to be made. Line 11, accumulated for income tax, still has Mr. Garrett's adjustment because he thought the Company had not corrected its accumulated deferred income tax. *Id.* However, Mr. Garrett saw an exhibit at trial where the Company has corrected the accumulated deferred income tax, so that the line item would come out. It would add $73,000 to the bottom line. *Id.* at 86-87.

Once the correction is made, Mr. Garrett's traditional rate case approach results in a rate increase to the Company of a little under $600,000. *Id.* at 87-88. OIEC is not suggesting that any of the plant is disallowed. *Id.* at 88. OIEC is saying it is not deemed used and useful at this point until it is properly supported in the next rate proceeding. *Id.* at 88. Then it will come into rate base as used and useful plant. *Id.* The specifics about the unsupported plant adjustments are on Ex. 140 at Lines 15 through 21 and 48 through 50. *Id.*

Mr. Garrett testified that Mr. Krygier gave three reasons to reject the Kansas Plan, which are that it would be kicking the can down the road; it would be cherry-picking; and it would be single-issue ratemaking. *Id.* at 89. Mr. Garrett testified that it would be putting off some of these increases for later. *Id.* That is what the Company agreed to in Kansas and Arkansas. *Id.* Also, it is important in this case that so much of the rate request is new rate base that had no testimony at all as to why it was needed or why it was added, or if the costs were prudent. *Id.* at 89. For the used and useful determination, there has to be testimony supporting that request. *Id.* Mr. Garrett testified that it is important that the Commission not set a standard where a Company can get a rate increase with no support for most of the assets that are going into the rate base. *Id.* at 89-90.

Mr. Garrett testified that OIEC is not cherry-picking, but is relying on the results in both Kansas and Arkansas. *Id.* at 90. Further, without the support for these other assets, we are left with either a $600,000 a year rate increase, or we have offered $800-$900,000 rate increase to cover the environmental compliance costs. *Id.*

Mr. Garrett testified that he agrees that the rider is single-issue ratemaking. *Id.* at 90. Mr. Garrett testified that this has disadvantages, but it is all we are left with. *Id.* It is consistent with the statute that allows a rider for environmental compliance costs. *Id.* It is temporary until the Company files its next rate case. *Id.* at 90-91.

Mr. Garrett testified, with regard to Mr. Lyons' rebuttal testimony regarding delaying a rate increase, that OIEC is not suggesting that there be a delay for all costs. *Id.* at 91. OIEC is

suggesting that the Company recover its an environmental compliance costs now because they supported those, and that we delay the rest until they bring in proper support for those assets as well. *Id.*

Mr. Lyons says the Company believes its payroll expense and aggregate are necessary to attract and retain qualified employees. Mr. Garrett testified that Mr. Lyon's argument has been raised at the Commission for 25 years and it has been rejected in all the cases. *Id.* at 92. Financial based incentives are not allowed. *Id.* Mr. Garrett testified that this case is rare, but the rest of the incentives that aren't financial are related to reliability and customer satisfaction. *Id.* The Company is doing a really poor job in those areas right now. *Id.* Poor performance should not be rewarded, and that is what the incentives are doing. *Id.* at 92. If they improve, the incentives could be included in rates at that time. *Id.*

OIEC omitted vacant positions from the payroll adjustment because those are not employees of the company. *Id.* at 92. They are just vacant positions. *Id.* The Commission has addressed this issue a couple of times before when OG&E asked for vacant positions and they were not allowed. *Id.* at 92-93. Mr. Lyons admitted that the 27 has grown to 30, so the vacant positions are getting bigger, not smaller. *Id.* t 93.

With respect to Plant additions, Mr. Garrett testified that there was no direct testimony provided as to what the additions were and why they were needed. That is a requirement in every rate case for a new plant. *Id.* at 94.

Mr. Garrett testified that he agrees that rate case expenses are necessary and should be included, in an appropriate and proper amount. *Id.* at 95. Tying recovery of rate case expense to the success of the utility in the final order would be a way of sharing those costs with the Company so that they don't all fall on ratepayers. *Id.*

Mr. Garrett testified that witness Mertens said that the testimony of Mark Garrett and Edwin Farrar suggest that Empire's performance in other states has a higher reliability than Oklahoma. That was not Mr. Garrett's testimony. Mr. Garrett's testimony compared Empire's reliability performance with other utilities in Oklahoma. *Id.* at 95-96. Mr. Garrett used the reliability report to show that we should not be paying incentives for reliability because you don't reward poor performance. *Id.* at 96.

Mr. Garrett's surrebuttal regarding Mr. Mertens' testimony about plant additions is the same as his surrebuttal to Mr. Lyons. The additions, other than environmental compliance, were not supported. *Id.* at 96.

In response to Schwartz, Mr. Garrett testified that the reliability report that OIEC used was the correct report. *Id.* at 96-97. It was a complete report. *Id.* at 97.

As for incentive comparison, i.e., incentives that were paid in 2016, it needs to be based upon actual data at the time and not what we hope the Company will do in the future. *Id.* at 97. The ratepayers should be charged for actual performance of the Company. The J.D. Powers report measures customer satisfaction. The Company is at the bottom of both reports. *Id.*

(e) Mark Garrett Surrebuttal Testimony (from Transcript of May 12, 2017, beginning on page 72)

Mr. Garrett testified that in his Rebuttal Testimony, Mr. Overcast talks about the differences he has with Mr. Garrett in the allocation of transmission plant and generation plant, where Mr. Garrett recommends a 4 CP for both and Mr. Overcast recommends a 12 CP. (5/12/17 Tr. at 72-73). Mr. Overcast's statement that Mr. Garrett relies on Commission precedent for other utilities in developing his cost of service allocation recommendations is partially right. *Id.* at 73. The Commission has consistently authorized a 4 CP for production costs for PSO and OG&E. *Id.* But that is not all he relied on. *Id.* Mr. Garrett also looked at the peak load each month and developed a little different 4 CP because Empire has a winter peaking system and a summer peaking system. *Id.* Mr. Garrett testified that he used two summer months and two winter months. *Id.*

In response to Mr. Overcast's testimony that it was incorrect for Mr. Garrett to only consider peak load, Mr. Garrett testified that the Commission has always relied on peak load. *Id.* at 73-74. Mr. Overcast wants to take peak load and then layer on other things, like forced outages and scheduled maintenances. *Id.* at 74. You will always have scheduled maintenance. That just waters down the peaks to make them all come out to a 12-peak system. *Id.* FERC allocations are for something totally different than retail so the FERC standards do not apply to retail allocation. *Id.*

Mr. Garrett testified that Mr. Overcast's testimony that Mr. Garret's argument for a 4 CP allocation factor for transmission plant does not reflect cost causation is wrong. The whole point in looking at the peaks is to reflect why the system was built and how it was built. *Id.* at 76. Mr. Overcast says that Empire's transmission costs are allocated to the Oklahoma jurisdiction on a 12 CP basis. *Id.* That is a jurisdictional allocation; it has nothing to do with how you allocate to the retail classes. *Id.* For example, PSO allocates jurisdictionally with a 12 CP, but allocates in Oklahoma with a 4 CP. *Id.* This is important especially for the large customers, the industrial customers because they compete with the surrounding states for market share. *Id.* at 76-77. It puts Empire customers at a huge disadvantage if you have surrounding states and other companies in Oklahoma using a 4 CP and Empire allocates with a 12 CP.

Mr. Garrett testified that Mr. Schwartz's Responsive Testimony, p. 13, figure 3, is PUD's proposed revenue distribution. *Id.* at 80. It is the rate design piece after we do cost of service allocations. This is how the revenue is going to be spread to the classes. *Id.* If we really go to cost of service, it is going to put too much costs on the residential class. *Id.* at 80. When you look at the relative rate of return basis, this class is almost at 1.9, so the return on that class is almost double what it should be. *Id.* at 80-81. The transmission class is fine. *Id.* at 81. Commercial is close. *Id.* All the rest of the classes are getting towards cost of service. *Id.* The GP class is not close enough. Mr. Garrett suggests that the Commission set a band width of 1.25 to 0.75 and that everyone moves into that band. *Id.* Mr. Garrett testified that his band width recommendation would apply to Staff's recommended revenue requirement and to that recommended by OIEC. *Id.* at 82.

Mr. Garrett testified that his revenue distribution recommendation applies to the traditional rate-case approach. *Id.* at 82-83. If the Commission decides instead to go with a rider, the Kansas-Arkansas approach, and just implement the environmental compliance rider, this discussion goes away. *Id.* at 83. Under OIEC's recommendation, if the Commission approves a rider, would spread the costs equally to all classes on an equal percentage. *Id.* at 83.

(f) Mark Garrett Redirect (from Transcript of May 12, 2017, beginning on page 112)

Mr. Garrett testified that Hearing Exhibit 140 is a revised version of his Surrebuttal MG-2 alternative proposal. (5/12/17 Tr. at 113). This is the alternative proposal that calculates the revenue requirement based upon OIEC's recommendations that include depreciation, return on equity, and all of the accounting adjustments. Mr. Garrett testified that he changed one number, which affected three different lines. *Id.* He took out the accumulated deferred income tax adjustment on Line 11, which was the OIEC recommendation. *Id.* The Company corrected its accumulated deferred income tax number in its revised exhibits, so the adjustment is no longer needed. *Id.* This exhibit represents OIEC's revised accounting exhibit and reflects the recommended rate revenue requirement increase for OIEC's alternative proposal. *Id.* at 114.

2. David Garrett

(a) David Garrett Direct Testimony, Part I – Cost of Capital, filed on March 13, 2017

David J. Garrett is the managing member of Resolve Utility Consulting, PLLC. On March 13, 2017, Mr. Garrett filed two separate responsive testimony documents on behalf of OIEC. Part I of his responsive testimony addressed the cost of capital and related issues, and Part II of his responsive testimony included depreciation expense and related issues.

In formulating his recommendation, Mr. Garrett conducted a Discounted Cash Flow ("DCF") Model and a Capital Asset Pricing Model ("CAPM") on a proxy group of utility companies to estimate the cost of equity for Empire District Electric Company ("Empire" or the "Company"). Applying reasonable inputs and assumptions to these models reveals that Empire's estimated cost of equity is about 7.5%. Pursuant to the legal and technical standards guiding this issue, the awarded rate of return on equity should be based on, or reflective of the cost of equity of 7.5%. However, these legal standards also provide that the "end result" be fair and reasonable under the circumstances. If the Commission were to award a return on equity reflective of Empire's actual cost of equity of 7.5%, it would be technically correct under the rate base rate of return model, and it would not violate any legal standards. However, if the Commission were to set the awarded return at 7.5%, it would represent an abrupt change in Empire's awarded return, and could increase the Company's market risk. For this reason, Mr. Garrett recommends an awarded return on equity of 9.0%, which is the highest point in a reasonable range of 7.5% - 9.0%. In addition, Mr. Garrett recommends the Commission adopt Empire's proposed capital structure consisting of 50.32% debt and 49.68% equity. Mr. Garrett's overall weighted average cost of capital recommendation is 7.14%.

In responding to Company witness Dr. James H. Vander Weide, Mr. Garrett found that several of Dr. Vander Weide's key assumptions and inputs to the DCF Model and CAPM violate fundamental, widely-accepted tenants in finance and valuation. Specifically, Mr. Garrett identified the following areas of concern in Dr. Vander Weide's testimony:

1. In his DCF Model, Dr. Vander Weide's long-term growth rate applied to Empire exceeds the long-term growth rate for the entire U.S. economy. It is a fundamental concept in finance that, in the long run, a company cannot grow at a faster rate than the aggregate economy in which it operates; this is especially true for a regulated utility with a defined service territory. Thus, the results of Dr. Vander Weide's DCF Model are based on unrealistic assumptions and are not reflective of market conditions.

2. Dr. Vander Weide's estimate for the equity risk premium ("ERP"), the single most important factor in estimating the cost of equity, is significantly higher than the estimates reported by thousands of experts across the country. This is because Dr. Vander Weide has inappropriately considered the arithmetic mean total market returns dating as far back as 1926. It is widely-accepted in the finance community that the current and forward-looking equity risk premium is lower than the historical risk premium (especially when calculated through the arithmetic mean).

3. Dr. Vander Weide's estimates for beta for the proxy companies in the CAPM are significantly higher than the betas reported by institutional financial analysts, and are overstated due to faulty assumptions.

4. Dr. Vander Weide's own risk premium is also unrealistic, as it produces cost of equity results for a utility that exceeds any reasonable estimate of the required return on the market portfolio.

In short, the assumptions employed by Dr. Vander Weide skew the results of his financial models such that they do not reflect the economic realities of the market upon which cost of equity recommendation should be based.

Mr. Garrett also testified that when the awarded return is set significantly above the true cost of equity, it results in an inappropriate and excess transfer of wealth from ratepayers to shareholders beyond that which is required by law. This outflow of funds from Oklahoma's economy would not benefit its businesses or citizens. Instead, Oklahoma businesses, such as OIEC member companies, would be less competitive with businesses in surrounding states, and individual ratepayers will receive inflated costs for basic goods and services, along with higher utility bills.

(b) <u>David Garrett Responsive Testimony, Part II – Depreciation, filed on March 13, 2017</u>

In his depreciation testimony, Mr. Garrett testified that there are several primary factors driving OIEC's adjustment of $439,856 to Empire's proposed depreciation expense in the Oklahoma jurisdiction. These factors, along with their estimated dollar impact on the final adjustment are as follows: (1) removing proposed terminal net salvage on production plants,

removing future, unapproved plant additions from the Company's calculated depreciation rates on the production accounts, and leaving the current lifespan estimates for the production units unchanged – $229,806; (2) proposing different Iowa curve shapes and average lives for various transmission, distribution, and general accounts – $154,303; and (3) amortizing the unrecovered costs of Riverton Units 7, 8, and 9 over the estimated remaining life of Riverton 12 – $55,748. Mr. Garrett testified that according to the Supreme Court, Empire bears the burden to make a convincing showing that its proposed depreciation rates are not excessive, and that Empire has not met that burden regarding several issues related to depreciation.

Regarding Empire's production accounts, Mr. Garrett recommended that any proposed terminal and net salvage be removed due to lack of support by the Company. Mr. Garrett also stated that Company witness Thomas J. Sullivan incorporated unapproved future plant additions in the calculation of his proposed depreciation rates, and that this is not an appropriate way to calculate depreciation rates for production accounts.

Regarding Empire's transmission and distribution accounts, Mr. Garrett testified that he made adjustments to the proposed service lives for several accounts based on mathematically better-fitting Iowa curves.

Regarding Empire's proposed amortization of the Riverton Units 7, 8, and 9, Mr. Garrett testified that the undepreciated balance of $7.5 million for these units should be amortized over the estimated remaining life of the new Riverton 12 plant, because the approval of this plant was part of the same environmental compliance plan that called for the retirement of Riverton Units 7, 8, and 9. Thus, Mr. Garrett proposes that the undepreciated portion of the retired Riverton Units 7, 8, and 9 be amortized over 42 years.

(c) David Garrett Rebuttal Testimony filed on April 3, 2017

Mr. Garrett also filed rebuttal testimony on April 3, 2017 in response to PUD witness Geoffrey Rush's responsive testimony regarding Empire's cost of capital and the awarded return. In his rebuttal testimony, Mr. Garrett stated that he did not disagree with the majority of Mr. Rush's cost of equity analysis, as conducted through the CAPM and DCF Model. Mr. Garrett also agreed with Mr. Rush that Empire's cost of equity is well below 8.0%. However, Mr. Garrett disputed Mr. Rush's decision to accept Empire's requested ROE of 9.9% because this recommendation did not comport with Mr. Rush's analysis.

(d) David Garrett Surrebuttal Testimony (from Transcript of May 11, 2017, Vol. II, Afternoon Portion, beginning on page 116)

Mr. Garrett testified that he disagrees with Mr. Sullivan's characterization of his depreciation testimony as "cherry-picking." Mr. Garrett testified that he simply accepted some of Mr. Sullivan's recommendations regarding lifespan and didn't accept others, which is done with any witness in any case. (5/11/17 p.m. Tr. at 117-118). It's rare to just adopt or reject all of a company's testimony. *Id.*

Mr. Sullivan testified in his rebuttal testimony regarding interim retirements. Mr. Garrett testified that Mr. Sullivan clarified that the Company did not include any terminal net salvage recovery in this case, and Mr. Garrett does not take issue with this. *Id.* at 118. However, Mr. Garrett recommends that recovery of interim retirement should be disallowed due to lack of support. *Id.*

Mr. Garrett testified that Mr. Sullivan's calculation of depreciation rates for production facilities in his rebuttal testimony is unusual. *Id.* at 118-119. The vast majority of depreciation studies do not calculate production rates in this manner because it requires estimating future, unapproved plant additions for many years into the future; in this case more than 50 years for some plants. *Id.* at 119. That is problematic. They should be calculated in the normally-accepted way, which would not include future estimated plant additions and requirements. *Id.* Mr. Garrett testified that the rates he proposes would not include future estimated plant additions and retirements. *Id.*

Mr. Garrett testified that Mr. Sullivan, in his rebuttal testimony, is suggesting that if you don't include interim retirements, you should shorten the life spans of the plants. *Id.* at 119-120. Mr. Garrett testified that where interim rates are excluded, they are excluded without any adjustment to life span. *Id.* at 120.

As far as placement bands, Mr. Garrett testified that he relied on placements that began in 1960, which provided a sufficient amount of time to get an adequate retirement experience to apply Iowa curves to the historical observations. *Id.* Mr. Sullivan included the total banding period, which goes back as far as 1900 for some accounts. *Id.* at 121. As a result, Mr. Sullivan's Iowa Curve that he developed indicate shorter service lives whereas the Iowa Curve that Mr. Garrett developed using the more recent data indicate longer service lives. *Id.* For many accounts and many assets, more recent property tends to last longer. *Id.* Mr. Garrett testified that his data is based on more recent data, but still goes back far enough to give adequate retirement experience. *Id.*

Regarding the issue of cost of capital, Mr. Garrett testified that Dr. Vander Weide used surveys of the average hurdle rate or the average cost of equity in the country. Mr. Garrett testified that it is not instructive to consider the average hurdle rate or average cost of equity because utilities are less risky than the average firm in the market. *Id.* at 122.

Dr. Vander Weide's testimony regarding the assumption that investors' growth expectations are rational is especially problematic. *Id.* at 122-123. By and large, investors do act rationally, and in financial modeling you assume investors act rationally. *Id.* at 123. However, Dr. Vander Weide's testimony seems to suggest that we also should expect that investors act irrationally and somehow incorporate that into the model. *Id.* Mr. Garrett strongly disagrees with that and has never seen anyone suggest that. *Id.*

Mr. Garrett testified that growth rate is one of the most important issue in this case. It is a fundamental concept of finance that over the long-term, no company can grow its earnings and/or dividends at a greater rate than the growth rate of the aggregate economy in which it operates. *Id.* Therefore, it is concerning that Dr. Vander Weide and others use analysts' growth

rates which are short-term growth rates, for the long-term growth rate in the DCF model. *Id.* at 123-124. That is inappropriate. Long-term growth rate should be capped at a reasonable projection of nominal GDP growth, which is what Mr. Garrett did. *Id.* at 124. By using nominal growth GDP, as Mr. Garrett's long-term growth rate for each company in the proxy group, he is suggesting that a regulated utility can match the growth of the entire U.S. economy, which is very optimistic. *Id.* It would be easy to argue that the long-term growth rate of a regulated utility would be less than projected nominal GDP growth, maybe around 3%. *Id.* at 124. Mr. Garrett testified that he is using 4% in his model, in the interest of being conservative and reasonable. *Id.*

Mr. Garrett testified that Dr. Vander Weide suggests that Mr. Garrett did not acknowledge that the CAPM tends to underestimate beta. *Id.* at 124-125. Mr. Garrett agrees that there's some research that suggests that the CAPM can underestimate betas that are less than one. *Id.* at 125. However, the betas published by Value Line and Bloomberg and similar sources account for that by adjusting the raw betas upward. *Id.* They are already adjusted. *Id.* Mr. Garrett testified that the problem with what Dr. Vander Weide did is he took the beta, which was already adjusted higher to account for this research, and then he adjusted even further higher to .9. *Id.* Mr. Garrett can't recall a utility witness that has done that. *Id.*

In Mr. Garrett's opinion, the Equity Risk Premium in the CAPM mode is the single most important factor in estimating the cost of equity for any company. *Id.* at 125-126. To get to the cost equity estimate, the equity risk premium is probably the most important number, along with the growth rate and the DCF model. *Id.* at 126. Mr. Garrett testified that he didn't use the results of his calculation, but actually used a higher equity risk premium result that was published by a respected professor who publishes his Equity Risk Premium results each month. *Id.* He chose the higher result, again, in the interest of being conservative. *Id.* Mr. Garrett testified that he presents his Equity Risk Premium calculation, along with several others, on page 69 of his Testimony, Figure 12. *Id.* The results of this chart were not rebutted. *Id.* at 127.

At page 29, lines 5 to 9, regarding depreciation rates, Dr. Vander Weide misstates that Garret said it is best to overestimate depreciation lives. *Id.* Mr. Garrett said that he never said that. *Id.*

III. Findings of Fact and Conclusions of Law

A. Jurisdiction

The Commission finds that the Applicant is a public utility with plant, property, and other assets dedicated to the generation, production, transmission, distribution, and sale of electricity, power and energy at wholesale and retail levels within the State of Oklahoma. This Commission has jurisdiction over the cause by virtue of the provisions of Okla. Const. Art. 9, § 18, 17 Okla. Stat. § 151 *et seq.*, and the rules and regulations of the Commission. Due and proper notice of these proceedings was given as required by law and the orders of the Commission, and Empire is in substantial compliance therewith.

B. Burden of Proof

A public utility's rates must be reasonable and just, and the lowest reasonable rates. Okla. Const. Art. 9, § 18 (rates must be "reasonable and just"); *State v. Oklahoma Gas & Electric Co.,* 1975 OK 40, ¶ 20, 536 P.2d 887, 891 (Commission has a duty to safeguard the public's interest with regard to utility rates and to ensure that the rates charged by the utility are the lowest reasonable rates); *Public Service Co. v. Oklahoma Corporation Commission,* 1983 OK 124. ¶ 11, 688 P.2d 1274, 1277 (the Commission may determine the effect of the utility's capital investments "'upon the public rights and approve, modify or reject such effect if found to be unreasonable, unfair, or prejudicial.'"); *Valliant Tel. Co. v. Corporation Commission,* 1982 OK 159, 656 P.2d 273, 275 (The Commission has the power to prevent a utility from passing on to ratepayers unreasonable costs).

To be included in rate base, a utility's capital investment must serve the public and be necessary, used and useful. *Southwestern Public Service Co. v. State,* 1981 OK 136, ¶ 13, 637 P.2d 92, 97. The Commission may exclude expenses if "'they are excessive, unwarranted, unreasonable, or incurred in bad faith.'" *Public Service Co.,* 688 P.2d at 1281, quoting *State v. Oklahoma Gas & Electric Co.,* 1975 OK 15, 543 P.2d 546. A utility cannot "exhibit improvident expenditures to justify a rate increase." *State v. Oklahoma Gas & Electric Co.*1975 OK 40, ¶ 24, 536 P.2d 887.

Empire, as the applicant seeking relief, has the burden of proving the reasonableness of the rates it seeks. *Southeastern Oklahoma Dev. & Gas Auth. v. Oklahoma Corporation Commission*, 1980 OK 16, 606 P.2d 574, 577-578.

Empire asserts that the Corporation Commission has the burden of proving that the rates sought by Empire are unreasonable, relying on *Turpen v. Oklahoma Corporation Commission,* 1988 OK 126, 769 P.2d 1309. The Court in *Turpen,* citing only cases from other jurisdictions, and discussing payments to affiliates for services rendered by the affiliates, stated: "It is generally held that, while the regulatory agency bears the burden of proving that expenses incurred in transactions with nonaffiliates are unreasonable, the utility shall bear the onus of proving that expenses incurred in transactions with affiliates are reasonable. *Id.,* ¶ *25*, 769 P.2d at 1320-1321. The rate case investments at issue in this cause do not involve payments to affiliates. Moreover, the statements in *Turpen* were made in connection with operating expenses and not made in connection with capital costs sought to be included in rate base. The Court made this important distinction abundantly clear in paragraph 33 of its opinion, 769 P.2d at 1320, when it stated: "While the Commission must closely monitor SWBT's costs and revenues, the term 'used and useful" is misplaced in such an examination; that concept is only applied when determining the firm's rate base."

Further, the court's discussion of burden of proof was made in addressing a utility's payments to an affiliate. The Court's statement pertaining to nonaffiliates that it is "generally held" is *dicta*. The Court did not cite any Oklahoma law for this proposition and no Oklahoma cases were found holding that the Corporation Commission has the burden of proving that a utilities' expenses are unreasonable.

Empire also relied on another portion of the *Turpen* decision, in which the Court did not mention burden of proof, but stated: "Since good faith is presumed on the part of public utility managers, their judgment about prudent outlays, including outlays for capital, should not be overruled unless inefficiency or improvidence on their part is shown." *Id.*, ¶ 63, 769 P.2d at 1330. The Court's statements in this portion of its opinion likewise did not apply to capital expenditures for plant investment to be included in rate base. Instead, the capital costs the court was addressing in the *Turpen* case were the capital costs for debt and equity included in the capital structure of the utility and the "practice of imputing a hypothetical debt-equity ratio". *Id.*, ¶ 62, 769 P.2d at 1329.

Moreover, in 2006, subsequent to *Turpen*, the Oklahoma Corporation Commission adopted a rule requiring prudence reviews "on all generation, purchased power and fuel procurement processes and costs." OAC 165:35-35-1(a). That rule provides: "The utility shall bear the burden of proof as to prudence." OAC 165:35-35-1(b). Also subsequent to *Turpen,* the Commission adopted stringent Integrated Resource Plan rules, which the Company admitted that it did not comply with in this case. OAC 165:35-37-1 through 35-37-4; Hearing Exhibit 133; 5/10/17 a.m. Tr. at 137-142 (Mertens).[1]

More importantly, decisions of the Oklahoma Supreme Court, as well as of the United States Supreme Court, make it clear that the general rule is that the public utility, if it is requesting a rate increase, has the burden of proof. *Southeastern Okla. Dev. & Gas Auth. v. Oklahoma Corporation Commission,* 1980 OK 16, ¶ 12, 606 P.2d 574, 577-578 (The Court, in affirming an order refusing to approve new rates, stated: "The trust did not attempt to show that the purchase price for the physical plant was reasonably related to its market value, nor did it justify various expenses which the evidence tended to establish to be unreasonable. In the absence of such evidence the Commission determined that there was insufficient evidence to allow it to determine a rate base and a fair rate of return under the procedure outlined in *Tecumseh Gas System, Inc. v. State of Oklahoma*, Okl., 537 P.2d 421 (1975)"); *In re Application of Valliant Tel. Co.* , 1982 OK 159, ¶¶ 10-11, 656 P.2d 273, 276 (The Court affirmed the disallowance of certain expenses because the utility "failed to meet its burden of showing these salaries were necessary and proper business expenses for rate-making purposes."); *United Fuel Gas Co. v. Railroad Commission of Kentucky,* 278 U.S. 300, 313 (1929) ("The burden of proving

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[1] Rule 165:35-37-1(a) provides, in part:

> The purpose of this Subchapter is to establish fair, just, and reasonable rules and procedures for Commission review of the resource plans of utilities. The utility resource plans establish additional bases for substantial investment and expenses incurred by utilities to provide electric supply to retail consumers . . . Recognizing the significance of the costs incurred based on resource plans, the Commission believes it is in the best interest of retail ratepayers and the utilities providing regulated retail electric supply to establish regular review of the utilities resource plans to ensure that the utilities' resource planning and resulting investment are reasonably and prudently conducted and that overall cost of power supply to retail ratepayers is fair, just, and reasonable.

the value of property on which they are constitutionally entitled to earn a fair return rests upon the [public utility] . . . .").

Imposing the burden of proof on the utility seeking a rate increase is fair and reasonable. As testified to by Staff witness Thompson, the Company has the burden to support its capital costs and O&M expenses; it has all the information. (5/11/17 a.m. Tr. at 47). Further, the Commission rules of practice provide that "no applicant will by default of an adverse party respondent be relieved from the burden of proving the material allegations of fact upon which his claim for relief is based." OAC 165:5-9-1(e). The Rules further provide that if a respondent fails to deny an allegation of an application, that failure "will not relieve the person making the allegation of the burden of proving it." OAC 165:5-9-1(b)(2)(B)(iii). The rules also recognize that the burden of proof is on the applicant by providing that: "The applicant or complainant who institutes a cause may open and close the proof." OAC 165:5-13-3(f). The above rules are in accord with the general law that the burden of proof is on the party seeking relief. *State ex rel. State Insurance Fund v. Great Plains Care Center, Inc.,* 2003 OK 79, ¶ 29, 78 P.3d 83, 92.

Finally, the Commission recently found that the utility bears the burden of proof in rate proceedings. *See, e.g.,* Order No. 662059 entered in Cause No. PUD 201500273 (in a general rate case, the Commission adopted Judge Jackson's finding that "As the applicant seeking relief, OG&E has the burden of persuasion about whether its proposed rates and charges are necessary as well as reasonable and just."); Order No. 647346, p. 15, entered in Cause PUD 201400229 (finding that the applicant in a proceeding for pre-approval of environmental compliance investment has the burden of proving its entitled to the relief requested).[2]

C. Rejection of Rate Increase and Authorization for Environmental Compliance Rider

Empire is requesting an overall rate increase in excess of 24%, which would result in rate shock to its ratepayers, as testified to by Empire's witness, Mr. Overcast, and by OIEC witness Mark Garrett. (5/12/17 Tr. at 22-23; M. Garrett Responsive Testimony on Revenue Requirement Issues at 6-7.) Granting Empire's application would result in rates charged by Empire that are approximately twice that charged by Oklahoma's other investor-owned utilities, PSO and OG&E.[3] Empire did not study the impact its rates would have on it various customer classes. (5/10/17 a.m. Tr. at 41-45).

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[2] The Corporation Commission may take judicial notice of its own records, *Mistletoe Express Service v. Corporation Commission,* 1957 OK 164, ¶ 12, 316 P.2d 865; *Cotner v. Golden,* 2006 OK 25, ¶ 10, 136 P.3d 630, 633; and of documents that are of public record. 12 O.S. § 2202; *Van Woudenberg v. Gibson,* 211 F.3d 560, 568 (10th 2000), *cert. denied,* 531 U.S. 1161 (2001) ("[T]he court is permitted to take judicial notice of . . . facts which are a matter of public record").

[3] This is shown by PSO's and OG&E's tariffs, which the Commission may take judicial notice of under the authorities cited in footnote 2, *supra.*

1. Rejection Because of Changed Circumstances

The test year used by Empire ended June 30, 2016, and the six-month post-test year period ended December 30, 2016. Empire filed its application in this cause in December, 2016. The merger agreement was entered into about a year prior to that, but did not close until January, 2017. (5/10/17 a.m. Tr. at 67-68). All of the capital stock of Empire was acquired by Liberty Utilities (Central). (5/10/17 a.m. Tr. at 28-29, 49). As a result of the merger, Empire is one of several operating public utilities that are owned by a parent company. Empire previously was a publicly traded company. Subsequent to the merger, Empire is no longer a publicly traded company. *Id.* at 32. The costs sought to be imposed in this case are to be allocated to Oklahoma and the other states in which Empire operates, including Kansas and Arkansas.

All of Empire's evidence pertains solely to pre-merger information, expenses, and revenues. However, in obtaining approval of its merger, the Company presented testimony in Oklahoma, Arkansas, and Kansas that the merger would result in economies of scale and benefits to its ratepayers. In Arkansas and Kansas, in obtaining approval of the merger, Empire entered into a settlement agreement, under which it agreed to freeze its rates, except for an environmental rider to recover the costs of its environmental compliance plan investments, until there was at least one year's worth of data and information as to the effect of the merger on the Company's rates. (Hearing Exhibits 131 and 132). Due to the application requirements and the time necessary to process a rate application in those states, Empire's rates in Arkansas and Kansas are effectively frozen for 2017 and 2018, as testified to by its witnesses.

Empire's witnesses testified that Liberty Utilities and its subsidiaries operate under a shared services model under which costs are shared. (5/10/17 a.m. Tr. at 36). The capital investments of Empire are operated as an integrated public utility, and then the costs are allocated to the various jurisdictions. (5/10/17 p.m. Tr. at 144-145). Empire's President of Central Region testified that savings could occur as a result of the merger, but that if the Company's application is granted in this proceeding, Oklahoma ratepayers are not going to get the advantage of any cost savings. (5/10/17 a.m. Tr. at 23-25). Empire is seeking recovery of $369 million in capital investments in Oklahoma, but has agreed to defer asking for recovery for those same investments in Kansas and Arkansas and will not begin recovering for such capital investments in those states until 2019. (5/10/17 p.m. Tr. at 144-147; 5/10/17 a.m. Tr. at 53-57).

Liberty Utility represented to the Corporation Commission in the merger proceedings that the merger was expected to result in savings to Empire's Oklahoma ratepayers. In approving the merger, this Commission found at page 5 of Order No. 652551, Cause No. PUD 201600098:

> Empire's customers will also benefit from becoming part of a larger and more diversified utility business group with the support of a larger balance sheet to meet the capital demands of its customers; and there is also potential for lower costs for Empire's customers.

The Commission attached to its Order No. 652551 a summary of the evidence supporting its approval of the merger. That summary includes the following testimony:

> According to Mr. Eichler, Liberty Utilities and its subsidiaries operate under a shared services model pursuant to which certain services are provided to the operating businesses from affiliates and charged to these utilities based on either a direct charge or defined cost allocation methodology . . . .
>
> Mr. Eichler testified that there are several reasons why the costs borne by Empire will be lower under the Liberty Utilities methodology. One of the prevailing strategic rationales for the transaction is gaining efficacy of scale. In LU Central, there will be approximately 120,000 more customers than Empire serves today, allowing for the distribution of costs over a larger number of customers.
>
> Certain costs will be saved by the business combination, such as the costs Empire currently incurs to remain a public reporting issuer. Liberty Utilities anticipates there are approximately $2.3 million in costs saved by not requiring Empire to comply with all the requirements of being a public reporting issuer.
>
> While there will be no involuntary job losses within the Empire group, it is anticipated that, through natural attrition, an additional $2.2 million in labor savings will emerge. . . .

Order No. 652551, Attachment B, pp. 15, 16 (emphasis added).

Further, Liberty's witness, Mr. Krygier testified in the merger proceedings:

> Mr. Krygier further testified that the proposed transaction will not result in any change in the rates currently charged to Empire's retail customers. Empire will continue to utilize the rates, rules, regulations and other tariff provisions on file with and approved by the Commission, and will continue to provide service to their customers under those rates, rules and regulations and other tariff provisions until such time as they may be modified according to applicable law. Further, LU Central committed not to seek any merger related adjustments for acquisition costs or any premiums paid above book value.

Id. at 21.

Moreover, both Mr. Eichler and Mr. Krygier committed to providing the Commission with a revised or modified current cost allocation manual to reflect the acquisition of Empire within six months following the closing of the transaction. *Id.* at 16, 22. Therefore, the Commission will be receiving additional information about the effect of the merger on Empire's costs within the next couple of months.

If the Company is allowed to obtain a rate increase in Oklahoma, its Oklahoma ratepayers will be paying higher rates than are being paid by Empire's Kansas and Arkansas ratepayers for the similar services provided by the same facilities. This will harm Empire's customers, particularly its industrial and other business customers, who may operate in Kansas and Arkansas, as well as Oklahoma, and could relocate their Oklahoma business to those states, or who could even relocate to parts of Oklahoma served by PSO or OG&E, whose rates are much lower than those sought by Empire in this proceeding.

In Kansas, as in Oklahoma, Empire had not filed a rate case since 2011, until it filed a rate case in Kansas in 2016. (M. Garrett Responsive Revenue Requirement Issues Testimony at 7). Empire withdrew its application pursuant to a settlement agreement entered in the merger proceedings, Docket No. 16-EPDE-410-ACQ before the Kansas Corporation Commission. The Kansas Corporation Commission authorized Empire to withdraw its rate case in Kansas, imposed a moratorium on any rate case filing until May 1, 2018, and authorized the collection of the Asbury and Riverton 12 capital costs through an environmental compliance rider, subject to refund and an annual true-up. (M. Garrett Responsive Revenue Requirement Issues Testimony at 8; Kansas Order Granting Joint Motion to Approve Unanimous Settlement Agreement and Approval of Joint Application in Docket No. 16-EPDE-410-ACQ, Hearing Exhibit 132.)

Similarly, in Arkansas, Empire entered into a settlement agreement in the proceeding in which it sought approval of its merger. The Arkansas Public Service Commission entered an order approving the settlement, prohibiting the filing of another rate case until it has 12 months of post-merger actual accounting data. (M. Garrett Rebuttal Testimony, pp. 6-7; Arkansas Order, Order No. 4 in Docket No. 16-013-U, Hearing Exhibit 131). Further, a rider like the one in Kansas was implemented, under which the Arkansas ratepayers are paying for the Asbury and Riverton 12 environmental compliance costs. *Id.*

Empire's witnesses in the Kansas and Arkansas proceedings testified that the terms of the settlement were fair, just and reasonable. A two-year rate stabilization plan, as Empire has agreed to in Kansas and Arkansas, is appropriate for Oklahoma. After a merger or acquisition, cost levels can shift considerably under new management. (M. Garrett Rebuttal Testimony, p. 8.). Empire's witness testified that after the merger with Empire, Liberty announced several department head changes of Empire. (5/10/17 a.m. Tr. at 49-50). This Commission has previously entered an order after a company's structure has changed, which provides that at least twelve months of new data must be gathered before new rates may be considered. (Order No. 620407, Cause PUD 201300185, Hearing Exhibit 139; 5/11/17 a.m. Tr. at 38-42).

Empire's witness, Chris Krygier, testified that the laws regarding approval of utility mergers in Kansas and Arkansas are substantially different from that of Oklahoma and that is why the rates were frozen in Kansas and Arkansas, but that the rate proceedings in Oklahoma should not be held in abeyance awaiting further information. Mr. Krygier testified that Arkansas and Kansas require a finding that the merger will result in a net benefit to ratepayers, in order for the merger to be approved; whereas Oklahoma only requires a showing of no net harm from the merger to ratepayers. This testimony is contrary to the merger laws of Oklahoma, Arkansas, and Kansas. Oklahoma, like Arkansas and Kansas, does not require a finding that a merger will benefit a ratepayer; only that a merger will not harm a ratepayer. *See* 17 O.S. § 191.3; Ark. Code

Ann. § 23-3-310; *In re Anadarko Natural Gas Co.,* 2013 WL 6096364 (Kan. Oct. 3, 2013); *In re Application of Kansas City Power & Light Co.,* Docket Nos. 172, 174-U and 174.155-U at p. 32-34 (Kansas Corporation Commission, Nov. 15, 1991). Thus, Mr. Krygier's testimony is not credible and should be disregarded.

The ALJ recommends that the Commission reject Empire's requested rate increase for the reason that the Company's filing is based on information relating to the period of time before the merger became effective and rates determined pursuant to the Company's application will not reflect the effect of the merger on the Company's rates. The Commission should further find that the Company would be eligible to resubmit a rate application after the Company has at least twelve months of data post-merger to present to this Commission for its review, as the Company has not provided substantial evidence, including post-merger expenses, to support cost recovery in this proceeding.

2. Rejection Due to Unsupported Capital Investments

In addition to not providing post-merger information for this Commission to evaluate in establishing new rates for Empire, Empire failed to meet its burden of establishing the prudence, necessity, or reasonableness of over one-half of the capital investments that Empire seeks to add to its rate base in this proceeding. It is unrefuted that Empire presented no Direct Testimony or other evidence in its case-in-chief to support $365.5M of plant additions which Empire alleges that it added since Empire's last rate case. Empire's witnesses admitted that no direct testimony about those plant additions was presented by it. (5/10/17 a.m. Tr. at 125, 148; 5/10/17 p.m. Tr. at 44-45, 69-70).

Those plant additions are identified in Mark Garrett's Responsive Testimony on Revenue Requirement Issues, pp. 37-38, filed on March 13, 2017. Empire first attempted to provide support, in the record, for such additional costs in its Rebuttal testimony, which was filed shortly before the hearing, and which was based on hearsay testimony regarding onsite audits, which were not made a part of the record. Thus, this testimony came too late and was insufficient to support the recovery of the requested capital costs. A party is required to present evidence to support its requested relief in its case in chief. *See, e.g., Middlebrook v. Imler, Tenny & Kugler, M.D.'s,* 1985 OK 66, ¶ 24, 713 P.2d 572, 582; *Caughlin v. Sheets,* 1952 OK 97, 242 P.2d 724. A plaintiff does not meet its burden of proof if it does not present its evidence in its case in chief. *Irwin v. SWO Acquisition Corp.*, 1992 OK CIV APP 48, ¶ 13, 830 P.2d 857. In *Caughlin,* in affirming the trial court's refusal to allow rebuttal testimony on matters required to be raised in a party's case in chief, stated:

> It was an essential part of the plaintiff's petition and proof that he allege and establish that there was no natural drainage from the west basin . . . . If he had failed to do so, it would have been incumbent upon the court to sustain a demurrer to the evidence.

242 P.2d at 726. *See also Kinkead v. Western Atlas Int'l, Inc.,* 1993 OK CIV APP 132, ¶ 16, 894 P.2d 1123 ("Rebuttal evidence is properly deemed to be evidence which is relevant only by virtue of evidence introduced by the adverse party.").

The ALJ recommends that the Commission reject Empire's requested increase as the Company has not provided substantial evidence to support most of the capital investments it seeks to recover in this proceeding. The Commission should further find that the Company is eligible to resubmit these capital investment costs for consideration in the Company's next rate proceeding, along with at least twelve months of post-merger expense and financial information supporting such filing.

3. ECP Rider

The ALJ recommends that the Commission authorize an environmental compliance plan (ECP) rider that allows Empire to collect the capital costs of its Asbury and Riverton 12 environmental compliance investments. The rider shall be subject to refund and a prudence review in Empire's next rate case. No prudence review has yet been conducted of such investments. Further, at the hearing, the Company's witnesses admitted that it did not comply with the Commission's rules for integrated resource plans (IRPs) regarding such investments. OAC 165:35-37-5 (Hearing Exhibit 133), requires the utility to allow stakeholders the opportunity to review and provide input regarding the proposed updated integrated resource plan; that the utility is to conduct at least one technical conference for all stakeholders to discuss the plan and to get the input of the stakeholders; the utility is to provide a facilitator to coordinate and assist the stake holders in their discussions at the technical conference; the Attorney General and the Commission may retain third party consultants and/or expert witnesses to review the plan and participate in the technical conference, and the utility is to then presents its final integrated resource plan at a public meeting held at the Commission. OAC 165:35-37-5. None of these requirements were complied with by the Company in connection with Empire's environmental compliance plan or its IRP.

Both the Attorney General and OIEC recommend approval of an ECP rider. The difference between the Attorney General's recommendation and OIEC's recommendation is (1) OIEC's rider authorizes a return on equity of 9.0% consistent with the recommendation of OIEC witness David Garrett in this proceeding while the AG's rider authorizes a return on equity of 9.3%, consistent with the rider approved by the Kansas Commission; and (2) the Attorney General recommends that the costs collected pursuant to the ECP Rider be allocated to Empire's customers on an energy, or per kilowatt, basis while OIEC recommends that the ECP rider costs be allocated to the customer classes based on existing revenues in each class, as a middle ground to allocating the costs on a demand basis. OIEC's recommendation would result in all customers receiving an equal percentage increase of the added ECP costs. (M. Garrett Rebuttal Testimony, p. 11). Attorney General witness, Mr. Farrar, testified that OIEC's approach of an equal allocation of rider costs was a reasonable one. (5/12/17 Tr. at 856).

The ALJ recommends that the ECP rider include a return for the Company based on a return on equity of 9%, rather than the 9.3% ROE recommended by the Attorney General. The Commission finds that the ROE most suitable for the rider is the ROE supported by Mr. Garrett's testimony on behalf of OIEC, rather than the ROE awarded to Empire in its Kansas jurisdiction for rider recovery.

Regarding allocation of costs to customers pursuant to the rider, the Commission recommends adopting OIEC's allocation which provides that all customer classes receive an equal percentage increase of the environmental compliance costs. (M. Garrett Rebuttal Testimony, p. 11). The Commission finds that an energy based allocation of these costs as recommended by the AG would create a significant subsidy to the residential class. *Id* at 10. The residential class already receives a significant subsidy that should not be further increased.

The Oklahoma jurisdictional portion of the Asbury and Riverton 12 environmental compliance capital expenditures is set forth in Exhibit MG-2 attached to Mark Garrett's Responsive Revenue Requirements Testimony. A copy of Exhibit MG-2 is attached hereto as Exhibit "A". The Oklahoma jurisdictional amount of the Net Plant in Service is $6,421,127. Assuming a pre-tax return of 9.79%, the annual return and depreciation expense on the Asbury and Riverton12 net plant balances would be $804,205.

For these reasons, the ALJ recommends that the Commission deny Empire's application, except to allow an ECP rider under which Empire may begin to recover the capital costs for the Asbury and Riverton 12 environmental compliance costs until the next general rate case, subject to a prudence review in Empire's next general rate case and subject to refund and true-up requirements. The ALJ further recommends that the Commission authorize Empire to file a new rate proceeding, after it has at least twelve months of information subsequent to the effective date of its merger with Liberty Utilities.

The ALJ recommends that the Commission approve the ECP Rider attached hereto as Exhibit "B" and reject all other rate increases proposed by the Company. The ECP Rider was recommended by OIEC and is Attachment 1 to Mark Garrett's Responsive Rate Design Testimony.

D. ALTERNATIVE RECOMMENDATION

If the above recommendation is not adopted, the ALJ recommends that the Commission adopt the revenue requirement increase and adjustments shown in the accounting exhibit attached hereto as Exhibit "C". That accounting Exhibit is Revised Hearing Exhibit 140, surrebuttal MG-2, alternative proposal. The remainder of these findings address OIEC's alternative recommendation.

1. Unsupported Plant Additions

As discussed in Section C.2 above, Empire presented no Direct Testimony or other evidence in its case in chief to support $365.5M of plant investments that Empire alleges it added since Empire's last rate case. Therefore, Empire failed to meet its burden of showing its entitlement to recover the costs of such investments in this proceeding. The ALJ recommends that the Commission find that such investments shall not be recovered in this proceeding and, instead, that Empire may seek recovery of such capital investments in its next rate case upon providing proper support for such recovery.

2. Rate of Return

(a) Capital Structure.

The Commission adopts the recommendation of Empire for a capital structure containing 49.68% common equity and 50.32% debt. The Commission finds that no party opposed Empire's capital structure which reflects the actual capital structure of Empire as of test year-end.

(b) Cost of Capital

(i) Cost of Debt and Preferred Stock.

The Commission finds that Empire had $1,818 million of long-term debt in its test-year capital structure at a cost of 5.3% which is the cost of debt proposed by the Company as part of its weighted cost of capital proposal. The Commission finds that no party disagrees that Empire's embedded cost of long-term debt is 5.3%.

(ii) Return on Equity.

Three witnesses testified to the appropriate ROE for the Company; Dr. Vander Weide for Empire, Mr. David Garrett for OIEC and Mr. Geoffrey Rush for the Public Utility Division Staff (Staff). Mr. Mark Garrett for OIEC and Mr. Ed Farrar for the Oklahoma Attorney General also provided testimony regarding ROE although they did not recommend that a specific ROE be adopted.

Empire argued that an appropriate ROE would be 9.9%, slightly lower than the Company's current ROE of 10.19% established by Commission Order No. 592623 in Cause No. PUD 201100082, which approved a settlement agreement entered into in that Cause. OIEC recommended that an appropriate ROE for Empire would be 9.0%, while Staff argued that the ROE for Empire should be set at 9.9%.

A complete discussion of the various methodologies for determining ROE is referenced in the summary of the testimony of the witnesses set forth above in this Order. For that reason, the Commission will not repeat all of the arguments of the parties regarding an appropriate ROE in this section of the Order, however, based upon all the arguments of the parties and the testimony of the witnesses, the Commission finds that an ROE of 9.0% should be approved for Empire. This ROE is reasonable and is the ROE recommended by OIEC witness David Garrett. A 9.0% ROE is higher than the results of both Staff witness Rush and OIEC witness David Garrett's application of the discounted cash flow (DCF) and capital asset pricing (CAPM) models and is close to the 9.3% ROE result of Dr. Vander Weide's discounted cash flow model.

The Commission finds that Empire failed to provide persuasive evidence to support Dr. Vander Weide's 9.9% recommended ROE. The Commission finds that several of Dr. Vander Weide's key assumptions and inputs to his DCF model and CAPM model are inconsistent with certain fundamental, widely-accepted tenants in finance and evaluation. The Commission notes that Dr. Vander Weide testifies only on behalf of public utilities. On cross-examination, Dr.

Vander Weide could not recall his recommended return on equity in recent proceedings before the Arkansas Public Service Commission or the Kansas Corporation Commission. (5/11/17 TR. at 132). While Dr. Vander Weide agreed that the level of economic activity or growth rate of the economy is one of many factors in determining cost of capital for a public utility, he acknowledges that he did not examine the level of economic activity in the Empire service territory. *Id at 134.* Further, he did not know the amount of customer growth and revenue that Empire has experienced from its Oklahoma jurisdictional customers or its Kansas and Arkansas customers. *Id. at 134.* He testified that it is true that the level of interest rates is a factor in determining the cost of capital of a public utility. *Id.* He further testified that he is aware that Empire has regulatory mechanisms in place, such as riders, which have the effect of enhancing recovery of Empire's investments and expenses, but he does not know specifically what riders the Company has nor what percentage of Empire's total revenues are collected through riders. (5/11/17 TR at 5). Dr. Vander Weide also agreed that when the awarded ROE for a utility is set above the utility's true cost of equity, it results in an inappropriate and excess transfer of wealth from ratepayers to shareholders. *Id at 11-12.* Dr. Vander Weide testified that utility stocks are less risk than the average stock in the market, *Id. at 13* and as a general rule he agrees that the utility's cost of equity must be less than the market cost of equity. *Id.* Dr. Vander Weide testified that this Commission should strive to determine a return on equity in line with the Company's actual market-derived cost of capital. *Id at 14.*

Regarding Empire's DCF model application, the Commission finds that Dr. Vander Weide's long-term growth rate applied to Empire exceeds the long-term growth rate for the entire U.S. economy and his use of investor analyst growth assumptions skew the results of his DCF model. The results of Dr. Vander Weide's DCF model are based on unrealistic assumptions and are not reflective of market conditions. The Commission further finds that Dr. Vander Weide's estimate for the equity risk premium, the single most important factor in estimating the cost of equity for the capital asset pricing model (CAPM), is significantly higher than the estimates reported by thousands of experts across the country. This results from Dr. Vander Weide's consideration of arithmetic means of total market returns dating as far back as 1926. The Commission finds that the current and forward-looking equity risk premium is lower than the historical risk premium, especially when calculated through the arithmetic mean. The Commission also notes that Dr. Vander Weide's estimates for betas for the proxy companies in his CAPM analysis are significantly higher than the betas reported by institutional financial analysts and are overstated. Finally, Dr. Vander Weide's own risk premium is also unrealistic as it produces cost of equity results for a utility that exceeds any reasonable estimate of required return on the market portfolio. In short, the assumptions employed by Dr. Vander Weide skew the results of his financial model such that the results do not reflect the economic reality of the market upon which cost of equity recommendations should be based.

The Commission finds that Staff witness Rush's overall awarded return on equity recommendation of 9.9% does not comport with the rest of his cost of equity analysis and testimony. Mr. Rush presents strong empirical evidence that Empire's cost of equity is below 8%, but his ultimate recommendation is to simply accept the Company's filed position regarding return on equity. The Commission notes that Mr. Rush's DCF model produces a cost of equity result of 7.1%, while his CAPM analysis produces a cost of equity of 6.8%. While Mr. Rush also applies a comparable earnings analysis to yield an ROE recommendation, Mr. Rush

acknowledges that the comparable earnings model is the weakest of the three models presented in this case and that it should be considered with caution. The Commission notes that the average cost of equity resulting from the application of Mr. Rush's three models was 7.9%, yet Mr. Rush recommends an awarded return of 9.9% in the interest of gradualism.

Staff witness Rush testified that regulators such as this Commission have a duty to stand in place of competition and that duty cannot be accomplished by simply awarding returns on equity based on the earned returns of other utilities. (Tr. 5/12/17 at p. 59). Mr. Rush further testified that his recommended return on equity is more than 250 basis points above his DCF model result and more than 300 basis points above his CAPM result. *Id. at 60.* Mr. Rush testified that the current ROE for Empire is 10.19% *Id. at 62*, while the average return on equity from his models is 7.91%. *Id. at 62-63.*

The Commission finds that Staff's recommended ROE of 9.9% does not provide sufficient movement towards Empire's true cost of equity as determined by the model applications of OIEC witness David Garrett and Staff witness Rush. Empire's current ROE is 10.19% and the Commission finds that a 9.9% ROE would result in very little movement towards Empire's true cost of equity. The Commission finds that establishing an ROE of 9% moves halfway from the current ROE of 10.19% to a true cost of equity of approximately 8%, as determined by the model results of Staff.

For these reasons, the Commission adopts the recommendation of OIEC witness David Garrett and determines an ROE for Empire of 9%, which is a return that is consistent with the concept of gradualism and is fair to the Company in all respects.

(iii) Overall Rate of Return.

The overall rate of return that results from the capital structure and cost of capital determined above is 7.14%.

3. Depreciation Expense.

Empire proposes an increase in its revenue requirement to reflect the Company's new depreciation rates from Empire's depreciation study and also to reflect a 5-year amortization of the undepreciated portion of Empire's investment in the recently-retired Riverton steam units 7 and 8 and Riverton combustion unit 9 and the cost of decommissioning those units over a 5-year period.

In response to Empire's proposal for an increase in depreciation expense, Staff witness Thompson recommends that Empire maintain its current depreciation rates in effect while OIEC witness David Garrett recommends a downward adjustment to Empire's proposed depreciation expense in its Oklahoma jurisdiction of $439,856.

The Commission finds that the key differences in Empire and OIEC's proposed depreciation rates are: (1) whether to allow interim net salvage on production plant, (2) whether to allow future unapproved plant additions in the Company's depreciation rates on production accounts, (3) whether to modify the current life-span estimates for the production units, (4) what

Iowa curve shapes and average lives should be utilized for various transmission, distribution and general accounts and (5) whether to amortize the unrecovered costs of Riverton units 7, 8 and 9 over 5 years or over the estimated remaining life of Riverton 12.

The Commission notes that according to the Supreme Court decision of *Lindheimer vs. Illinois Bell Telephone Co.*, [4] Empire bears the burden to make a convincing showing that its proposed depreciation rates are not excessive. The Commission finds that Empire has not met that burden as it relates to the following depreciation expense issues:

(i) Production Accounts. Regarding Empire's production accounts, the Commission finds that proposed interim net salvage should be removed from depreciation rates due to lack of evidence supporting interim net salvage costs. The Commission notes that while Empire did not include any terminal net salvage recovery in its depreciation rates, it does include interim retirements which must be supported with adequate analysis. While the Commission has supported interim retirements in previous causes, such interim retirements were supported by detailed Iowa curve analysis which Empire did not provide in this case. In addition, Empire's proposed depreciation rates for its production accounts, include unapproved future plant additions. The Commission finds that including such unapproved plant additions in rates is inappropriate as future plant additions should not be included at this time.

Regarding Empire's recommended decreased life-spans for some of the Company's production units, the Commission finds that sufficient justification and support was not provided for the proposed life-span decreases.

(ii) Mass Property Accounts. Regarding the Company's mass property accounts, the Commission finds that while the Company and OIEC used similar curve-fitting approaches, in certain instances the Company selected a curve that underestimates the average remaining life of the assets in the account which results in unreasonably high depreciation rates. The Commission notes that the Company's selection of a curve for accounts 353, 362, 364, 369 and 390, understates average life-spans and thus, overstates depreciation expense. The Commission finds that the adjustments recommended by OIEC witness David Garrett for Empire's transmission and distribution accounts should be adopted based on Mr. Garrett's adjustments to the proposed service lives for several accounts which are based on mathematically better-fitting Iowa curves.

(iii) Amortization of Riverton Units 7, 8 and 9. Regarding the amortization of the undepreciated portion of the Riverton units 7, 8 and 9, which the Company proposes to amortize over a 5-year period, the Commission finds that it is appropriate to amortize the unrecovered investment in these Riverton units over a longer period of time as the 5-year amortization period proposed by the Company is arbitrary and will result in excessive costs to Empire's current ratepayers. The Commission notes that the Riverton units 7, 8 and 9 were retired pursuant to Empire's environmental compliance plan and the Riverton 12 unit was installed to replace the capacity of such retired units in accordance with Empire's plan. The Commission finds that future customers, not current customers, will be the primary beneficiaries of the environmental compliance plan and therefore, should share in the costs imposed by such plan. The Commission

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[4] 292 U.S. 151 167 (1934)

finds that the undepreciated portion of the Riverton units 7, 8 and 9 should be amortized over 42 years which results in an adjustment to Empire's depreciation expense of $55,748 for the Oklahoma jurisdiction.

The Commission finds that Empire's depreciation expense should be adjusted downward by $439,856 for its Oklahoma jurisdiction to reflect the findings set forth above.

4. Adjustments to Update Investment Levels to Six-Month Post Year Balances

The Commission finds that the following adjustments are to be made to reflect balances existing as of December 31, 2016, which is the end of the six-month post-test year period, pursuant to 17 O.S. § 284, and as recommended by OIEC witness Mark Garrett:

(a) Plant in Service

The Commission finds that an adjustment should be made to reflect the plant in service balance increase as of December 31, 2016, which is the end of the six-month post-test year period, in the sum of $930,891 for the total company, or $99,489 for the Oklahoma jurisdictional share. (M. Garrett Responsive Revenue Requirement Testimony, p. 14; Hearing Exhibit 141-Revised).

(b) Accumulated Depreciation

The Commission finds that an adjustment should be made to reduce the actual balance of accumulated depreciation as of December 31, 2016, in the amount of $1,255,668 for the total company, or $134,200 for the Oklahoma jurisdictional share. (M. Garrett Responsive Revenue Requirement Testimony, pp. 14-15; Hearing Exhibit 141-Revised).

(c) Customer Deposits and Prepayments

The Commission finds that an adjustment in the Company's Customer Deposits and Prepayments accounts is necessary to give effect to the known and measurable changes that occurred within six months of test year end. The Customer Deposits account should be decreased by $12,893 for the Company total, or $1,378 for the Oklahoma jurisdictional share. The Prepayments account should be adjusted by increasing it by $22,003 for the Company total, or $2,352 for the Oklahoma jurisdictional share. (M. Garrett Responsive Revenue Requirement Testimony, p. 16; Hearing Exhibit 141-Revised).

(d) Materials and Supplies

The Commission finds that the materials and supplies account should be adjusted, based on the updated information provided by the Company through December 31, 2016, by increasing the balance by $21,269 for the company total, or $2,273 for the Oklahoma jurisdictional share. (M. Garrett Responsive Revenue Requirement Testimony, p. 16; Hearing Exhibit 141-Revised).

(e) ADIT

The Commission finds that Accumulated Deferred Income Tax (ADIT) as of December 31, 2016 is correctly reflected in the Company's revised exhibits.

(f) Customer Advances

The Commission finds that a reduction to customer advances to reflect the actual balance as of December 31, 2016 should be made in the amount of $13,346 for the total Company, or $1,426 for the Oklahoma jurisdictional share. (Hearing Exhibit 141-Revised).

(g) Fuel Inventories

The Commission finds that a reduction to fuel inventories to reflect the actual balance as of December 31, 2016 should be made in the amount of $65,768 for total Company or $7,029 for the Oklahoma jurisdictional share. (Hearing Exhibit 141-Revised).

5. Expense Adjustments

(a) Incentive Compensation

The Commission finds that the cost of Empire's long-term incentive compensation plan is tied to financial performance. Therefore, recovery of 100% of those expenses, in the amount of $37,574 for the Oklahoma jurisdictional share, is disallowed. This finding is consistent with the Commission's long-standing practice of disallowing such costs in rates, as reflected in the Commission's two most recent electric utility rate orders, denying 100% of the costs of long-term incentive compensation plans of OG&E and PSO, issued in Cause Nos. PUD 201500208 and 201500273, and as reflected in other Commission Orders, such as Order No. 545168, entered in Cause PUD 200600285 on October 9, 2007. In Order No. 545168, the Commission explained:

> In most jurisdictions, including Oklahoma, the cost of incentive plans tied to financial performance measures are excluded for ratemaking purposes based on one or more of several reasons. Since utilities retain, between rate cases, all of the savings generated from increased efficiencies promoted by these incentives, payment to the employees for these plans should be made from a portion of the savings these plans help to achieve. Thus, a properly designed incentive compensation will pay for itself and does not need to be subsidized by ratepayers. In the
>
> analysis of incentive compensation plans it is important to distinguish between financial performance measures and quality of service measures. However, if the overriding goal of the incentive plan is to increase shareholder earnings, the entire incentive compensation should be funded out of the increased earnings that trigger the payments. Cost of incentive plans were disallowed in

Oklahoma in Cause No. PUD 91-1190, Cause No. PUD 20040010 and Cause No. PUD 200500151.

With respect to Empire's recovery of the costs of its short-term incentive compensation plan, the Commission finds that 100% of the costs of the Short-Term Annual Incentive Compensation Plan, totaling $49,048 for the Oklahoma jurisdictional share, are rejected for cost recovery because (i) approximately 50% of the incentive compensation is tied to financial performance measures which benefit shareholders rather than ratepayers, and (ii) allowing recovery of the balance of incentive compensation, which is based largely on reliability and customer satisfaction measures, would, in this instance, reward Empire for poor performance. The Commission has historically allowed recovery of 50% of the costs of a utility's short-term incentive compensation plan where the plan benefitted both shareholders and ratepayers equally, such as in the rate orders cited above issued in OG&E and PSO's recent rate proceedings. In this case however, the evidence established that Empire has performed poorly in reliability of service and customer satisfaction measures. Therefore, the Commission musts disallow the entire amount ($42,234) of the Oklahoma jurisdiction share of the incentive pay and related payroll taxes ($2,745).

(b) Non-Qualified Employee Retirement Plan

The Commission rejects recovery of SERP in the amount of $2,061 for the Oklahoma jurisdictional share. SERP costs should be disallowed because shareholders should bear the additional costs associated with supplemental benefits to highly compensated executives. These costs are not necessary for the provision of utility service.

(c) Payroll Expense

Empire annualized payroll at test year end and then added $63,037 additional adjustments to increase the expense level: one adjustment increases payroll expense for future pay raises, and the other adjustment increases payroll expense for unfilled positions. These two adjustments are not supported by evidence and are improper adjustments. Pay raises that occur during the test year are captured and quantified in the payroll annualization and it is not proper to add additional pay raises after the test period. Unfilled positions do not represent actual expenditures of the utility and cannot be included in rates. Therefore the payroll expense should be adjusted by reducing the Oklahoma share of the payroll expense by $63,037. (M. Garrett Responsive Revenue Requirement Testimony, pp. 35-36; Hearing Exhibit 141-Revised).

(d) Rate Case Expense

Empire proposes to recover all of its rate case expenses in this Cause. While Empire witness Mr. Lyons testified that he does not know the amount of such expenses, he agrees that the Commission has broad discretion in determining the amount of expenses a utility may recover from ratepayers. (Tr. 5/17/17 pm). Mr. Lyons acknowledged that the Missouri Public Service Commission in the KCPL 2014 rate case, determined that KCPL was not entitled to recover 100% of its rate case expenses and instead, linked the recovery of rate case expense to the percentage of the rate increase request that the Commission finds to be just and reasonable.

(Hearing Exhibit 135 and Tr. 5/17/17 at p. 83). The Missouri Commission said that the use of this approach would directly tie a utility's recovery of rate case expense to both the reasonableness of its issue position and the dollar value sought from customers in a rate case. *Id.* The Missouri Commission also found that prudence is not only the consideration in determining what costs should be included in rates, but benefit to customers should also be considered when deciding what costs are reasonable for customer rates. *Id. at 76.* Mr. Lyons testified that he agrees that benefits to customers must be considered when deciding what costs are reasonable. *Id. at 87.*

The ALJ recommends that under the facts and circumstances of this cause, the Commission allow Empire to recover the prorata share of rate case expenses granted by the Commission compared to the amount of rate increase requested by the Company in its initial application filed in this Cause. This provides an incentive for Empire to control its rate case costs and ensures the reasonableness of its positions. It also allows the rate case expense to be shared by both the utility and its customers. (5/11/17 a.m. Tr. at 95).

6. Cost of Service Study

Empire conducted a cost of service study (COSS) attached as Exhibit HEO-1 through HEO-5 to Empire witness Overcast's direct testimony. In its COSS, Empire proposes an AED-12CP cost allocation methodology for Empire's production costs and a 12CP allocation factor for Empire's transmission plant. The Company proposes the allocation of distribution plant as either demand or customer-related. For distribution costs found in Account Nos. 364 – 374, the Company proposes that either all or a portion of such costs be classified as customer-related.

OIEC witness Mark Garrett recommends modification of Empire's class cost of service study to utilize a 4CP methodology for transmission cost allocation and a 4CP AED methodology for allocation of Empire's production costs. (M. Garrett Responsive Rate Design Testimony, p. 7-10). Staff witness Schwartz on cross-examination, agreed that Mr. Garrett's recommendations could be reasonable and Staff acknowledges that it does not formally take a position regarding Mr. Garrett's cost of service study recommendations.

OIEC witness Mark Garrett testifies that Empire provides little support for a 12CP allocation of transmission plant. While Empire witness Overcast states in his direct testimony at page 17 that the use of a 12CP for transmission plant reflects the use of such transmission plant on a monthly basis, Empire's system has significant differences in monthly loading making a 12CP methodology inappropriate for its system. The monthly demand data as provided in Mr. Overcast's direct testimony in the Tables appearing at Page 17 and 18 demonstrates that Empire is clearly a peaking system with well-defined summer and winter peaks. (*Id. at p. 10*). The Commission finds that transmission costs should be allocated using a 4CP methodology that more accurately reflects how Empire's system is being used.

Regarding Empire's COSS and allocation of the Company's production costs, Mr. Garrett testifies that based upon the information provided by Empire witness Overcast in his direct testimony, the data reflects that Empire's system has well-defined summer and winter peaks and thus, the allocation of production costs between Empire's various customer classes

should be based on the two summer and two winter peak-defined months. (*Id. at p. 12*). The Commission finds that an average and excess model based on those four peak months is more appropriate for the allocation of production costs to Empire's customer classes then Empire's proposed 12CP AED allocation. The Commission also notes that it has utilized the 4CP average and excess method to allocate production costs between customer classes in both OG&E and PSO's most recent rate proceedings. (*Id. at p. 11)*. The Commission finds that Empire, like OG&E and PSO, has well-defined peaks and determines that the 4CP average and excess methodology is the most appropriate production cost allocation method for Empire in this instance.

Regarding distribution cost allocation, the Commission accepts the results of Empire's cost of service study for distribution cost allocation.

7. Revenue Distribution

Revenue distribution involves assigning revenue responsibility to customer classes after the consideration of the cost of service studies and other relevant factors. For this case, Empire proposes to distribute the total system average revenue requirement change in accordance with Hearing Exhibit 131. According to that Exhibit, Empire does not propose an equalized return for all classes, but instead, proposes interclass subsidies to mitigate customer class impacts.

Both Staff and OIEC recommend different methods of revenue responsibility. In his responsive testimony regarding rate design issues, OIEC witness Mark Garrett proposed that rates should be set in accordance with Empire's cost of service study with the COSS modifications recommended by Mr. Garrett for transmission and production plant allocations. (*Id. at p. 12*). In his surrebuttal testimony, Mr. Garrett revised his recommendation regarding revenue distribution by proposing a bandwidth within which Empire will earn a return from customer classes no less than .75 and no greater than 1.25 to ensure that the Company moves toward implementing cost of service based rates. (5/12/17 Tr. at 81).

The Commission finds that the revenue distribution recommended by OIEC, which moves the revenue distribution closer to cost of service based on establishing the bandwidth described above, will help to eliminate inter-class subsidies and allow Empire to recover rates of return from its customer classes that are reasonable and fair for Empire's ratepayers.

8. Reliability Issues

The Commission notes that Empire's electric service reliability has been unsatisfactory as its System Average Interruption Frequency Index (SAIFI) scores were the worst in the state. (M. Garrett Responsive Revenue Requirement Testimony, p. 24). On average Empire's customers experience 2.5 outages per customer in 2015, which was two and one-half times the state average of one outage per customer per year. Empire's safety results can be seen at Page 5 of the Commission's 2016 reliability scorecard attached as Exhibit MG-4 to Mr. Garrett's March 13, 2017 Responsive Testimony. The Commission also notes that Empire ranked poorly in the JD Powers Customer Satisfaction Rating as the Company's ratings were far below average in 2016. (M. Garrett Responsive Revenue Requirement Testimony, p. 24, lines 11-12).

The Commission finds that these reliability rankings must improve. To remedy this, the Commission requires that Empire immediately address reliability issues and the causes of unplanned outages such as unbalanced line voltage issues and remedy such causes. The Commission requires that Empire not only strictly comply with Commission rules and standards regarding reliability, but also conduct more frequent inspections, no less than annually, of its Oklahoma plant and property to ensure reliability to its customers. The Commission also instructs Staff to convene a meeting of Empire and interested stakeholders within 30 days of issuance of this Order for the purpose of discussing and addressing Empire's reliability issues.

The Commission further finds that until Empire's reliability issues are addressed to this Commission's satisfaction, the Commission will reject recovery of any short-term incentive compensation in rates and will consider future downward adjustments to the Company's ROE.

ORDER

A. The ALJ recommends that the Commission enter an Order as follows:

IT IS THEREFORE THE ORDER OF THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA that based on the evidence herein, the above Findings of Fact and Conclusions of Law are hereby adopted as the Order of the Commission, to the extent they are consistent with the following paragraph.

IT IS FURTHER THE ORDER OF THE OKLAHOMA CORPORATION COMMISSION that a Rider providing for the recovery of Empire's capital costs for the Asbury and Riverton 12 in the form attached hereto as Exhibit "B" is adopted, subject to refund and a prudence review in Empire's next rate case. Empire's application is rejected in all other respects and the Company's next rate case filing is to include at least twelve (12) months of post-merger data.

B. In the alternative, the ALJ recommends that the Commission enter an Order as follows:

IT IS IT IS THEREFORE THE ORDER OF THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA that based on the evidence herein, the above Findings of Fact and Conclusions of Law are hereby adopted as the Order of the Commission, insofar as they are consistent with the following paragraph.

IT IS FURTHER THE ORDER OF THE OKLAHOMA CORPORATION COMMISSION that Empire's Oklahoma jurisdictional rates are increased by $576,701, as set forth in the alternative findings of the ALJ and in the Accounting Exhibit attached hereto as Exhibit "C".

IT IS FURTHER THE ORDER OF THE OKLAHOMA CORPORATION COMMISSION that the rates, charges and tariffs reflecting the terms of this Order be and the same are hereby approved and shall become effective the first billing after tariffs conforming to this Order have been submitted to, reviewed by, and approved by the Director of the Public Utility Division.

Ben Jackson, Administrative Law Judge

EXHIBIT "A"

EXHIBIT MG 2.0

EMPIRE DISTRICT ELECTRIC COMPANY
OIEC WORKPAPERS - CAPITAL COST RECOVERY FOR ASBURY AND RIVERTON 12
Test Year Ended June 30, 2016
Cause No. PUD 201600468

Line	Description	Asbury	Riverton 12	Total	Oklahoma
					2.75%
1	Plant in Service	$ 122,292,465	$ 181,640,749	$ 303,933,214	$ 8,364,242
2	Accumulated Depreciation	(11,476,271)	(2,344,710)	(13,820,981)	(380,353)
3	ADIT	(22,144,455)	(34,641,953)	(56,786,408)	(1,562,762)
4	Total	$ 88,671,739	$ 144,654,086	$ 233,325,825	$ 6,421,127
5	Pre-Tax Rate Of Return				9.79%
6	Return				$ 628,406
7	Depreciation Expense	$ 2,283,425	$ 4,104,607	$ 6,388,032	$ 175,799
8	ECP Rider Revenues - Year 1				$ 804,205

Source: AG-EDE-7

EXHIBIT "B"

ATTACHMENT 1

OKLAHOMA CORPORATION COMMISSION

THE EMPIRE DISTRICT ELECTRIC COMPANY

(Name of Issuing Utility)

Index No.

Schedule ECR

Sheet _1 of 2___

OKLAHOMA
(Territory to. which schedule is applicable)

Replacing Schedule _____

which was filed _____

ASBURY/RIVERTON 12 ENVIRONMENTAL
COST RECOVERY RIDER-ECR

Sheet 1 of 2 Sheets

APPLICATION:
To all bills rendered by the Company for utility service, permitting the recovery of such cost.

TERM:
This rider will have a term beginning with the effective date of a Commission Order approving the rider in Cause No. PUD 201600468 and ending with the rate effective date of the general rate case to be filed on or after August 1, 2018, unless modified by the Oklahoma Corporation Commission ("Commission"),

BASIS OF ADJUSTMENT:
Company will collect from customers as an adjustment to the aforementioned bills, an environmental charge equal to the annual capital investment-related revenue requirements associated with the Asbury Environmental Retrofit and Riverton 12 Investment undertaken by Company. The calculation of such revenue requirements will be made in conformity with the formula stated in this Rider, and will not change absent Commission approval.

Company shall provide quarterly reports to the Commission of its collections including a calculation of the total collected under this Rider,

METHOD OF BILLING:
The environmental charge shall be collected by applying the following factor and adding the charge to each applicable customer's bill:

ARECRR Factors	Factors per kWh
Residential [1/]	$.00555
Commercial	$.00767
Total Electric Building	$.00500
General Power	$.00491
Power Transmission	$.00330
Lighting [2/]	$.01422

1/ Includes the Residential and Residential-Total Electric Pricing Plans
2/ includes the Street Light, Private Light and Special Light Pricing Plans

BASIS FOR DETERMINING THE ECR:
The monthly charge shall reflect the recovery of the ECR revenue requirement as approved by the Commission in Cause No. PUD 201600468. The ECR charge shall be implemented on an interim basis subject to refund, and shall remain fixed until otherwise ordered by the Commission.

ANNUAL TRUE-UP:
The revenue collected pursuant to the application of this Rider shall be compared to the estimated revenue approved for collection by the Commission on an annualized basis. The amount of any over{under) recovery Shall be included in any refund calculation that may result from the re-calculation of the revenue requirement to take place during Empire's rate case to .be filed on or after August 1, 2018.

INTERIM SUBJECT TO REFUND:
The revenue collected pursuant to this rider, as approved by the Commission in Cause No. PUD 201600468, shall be collected on an interim basis; subject to refund. For purposes of determining whether a refund is necessary, each component of the ECR revenue requirement will be determined by the Commission during Empire's general rate case (to be filed on or after August 1, 2018). The ARECRR revenue requirement will then be compared against the ECR revenue requirement approved by the Commission in Cause No. PUD 201600468. If the ECR revenue requirement calculated by the Commission in Empire's 2018 general rate case is less than the ECR. revenue requirement approved by the Commission in Cause No. PUD 201600468, then Empire shall refund the difference through a bill credit. The refund rates (bill credits) shall be distributed to customers in the same fashion as the original ARECRR rates contained in this tariff. The components of the ERC revenue

Revenue requirements for ECR = (RB x r) + D

RB = the rate base investment associated with the ECR. Rate base will consist of all prudently incurred gross plant investment associated with the ECR, less Accumulated Depreciation associated with the ECR, less any applicable Accumulated Deferred Income Taxes associated with the ECR investment.

r = the pretax rate of return approved by the Commission to set rates for Empire's operations in Oklahoma, unless otherwise agreed to by the parties and the Commission.

D = the Depreciation Expense, calculated using Commission approved depreciation rates, and the Commission Approved Gross Plant component of ECR Rate Base described above.

DEFINITIONS AND CONDITIONS:

Company for the purposes of this rate schedule or rider is defined as The Empire District Electric Company.

Rate Authorized by: _____

_____

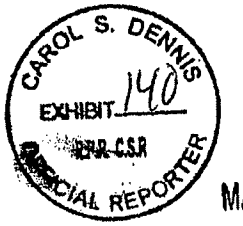
(Order No.) (Cause No.) (Date of Order)

EXHIBIT "C"

EMPIRE DISTRICT ELECTRIC COMPANY
OIEC WORKPAPERS - SUMMARY OF PROPOSED ADJUSTMENTS
Pro Forma Test Year Ended June 30, 2016
Cause No. PUD 201600468

ALTERNATE PROPOSAL

Ln	Descriptions		Ref.	New Adjustments	Oklahoma Rate Base	ROR W/Tax	Oklahoma Impact
1	**Empire Proposed Rate Increase**		Sch. A	Revised			$ 3,071,159
2							
3	**Rate Base**		Sch. A	Revised	$ 43,649,265		
4							
5	**6-Month Update Adjustments**						
6	Plant in Service		PUD		$ 930,891	10.688%	$ 99,489
7	Accumulated Depreciation		PUD		$ (1,255,668)	10.688%	$ (134,200)
8	Materials and Supplies		PUD		$ 21,269	10.688%	$ 2,273
9	Fuel Inventories		PUD		$ (65,768)	10.688%	$ (7,029)
10	Prepayments		PUD		$ 22,003	10.688%	$ 2,352
11	Accumulated Deferred Income Tax		OIEC		$ -	10.688%	$ -
12	Customer Deposits		PUD		$ (12,893)	10.688%	$ (1,378)
13	Customer Advances		PUD		$ (13,346)	10.688%	$ (1,426)
14					$ (373,512)		$ (39,919)
15	**Unsupported Plant Additions**						
16	Ongoing Capital Expenditures		Owens	$ (302,400,000)	$ (8,376,480)	10.688%	$ (895,237)
17	Project Overhaul		Owens	$ (20,600,000)	$ (570,620)	10.688%	$ (60,985)
18	Iatan II and Plum Point True-up		Owens	$ (20,300,000)	$ (562,310)	10.688%	$ (60,097)
19	Kodiak Service Center		Owens	$ (16,400,000)	$ (454,280)	10.688%	$ (48,551)
20	Miscellaneous Additions		Owens	$ (5,800,000)	$ (160,660)	10.688%	$ (17,171)
21	Total Rate Base Adjustments			$ (365,500,000)	$ (10,124,350)		$ (1,082,041)
22							
23	ADIT on Unsupported Plant		M. Garrett		1,771,761	10.688%	$ 189,357
24	Accumulated Depreciation on Unsupported Plant		M. Garrett		759,326	10.688%	$ 81,153
25							
26	**Cost of Capital**						
27							
28	To Adjust Return on Equity	9.000%	MG 2.12		$ 35,682,491	-0.901%	$ (321,486)
29							
30	**Revenue and Expense Adjustments**						
31							
32	Adjust Revenues to December 31, 2016		PUD				-
33	Adjust Fuel Revenues		PUD				-
34	Adjust Payroll		OIEC	Revised			(63,037)
35	Remove STIP		OIEC				(42,234)
36	Remove STIP Payroll Tax		OIEC				(2,745)
37	Remove LTIP		OIEC				(37,574)
38	Remove SERP		OIEC				(2,061)
39	Adjust General Expenses		PUD				-
40	Correct Income Taxes		PUD				-
41							$ (147,651)
42	**Depreciation Adjustments**						
43							
44	Adjust Depreciation Rates		D. Garrett				$ (439,856)
45							
46	**Unsupported Plant Adjustments**						
47							
48	Remove Depreciation on Unsupported Plant		M. Garrett	40			$ (253,109)
49	Remove Property Tax on Unsupported Plant		M. Garrett	1.25%			$ (126,554)
50	Remove O&M / A&G on Unsupported Plant		M. Garrett	3.50%			$ (354,352)
51							$ (734,015)
52							
53	**Total OIEC Adjustments**						$ (2,494,458)
54							
55	**Rate Increase after OIEC Adjustments**						$ 576,701



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