

BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

APPLICATION OF PUBLIC SERVICE)
COMPANY OF OKLAHOMA, AN)
OKLAHOMA CORPORATION, FOR AN) CAUSE NO. PUD 201300217
ADJUSTMENT IN ITS RATES, AND)
CHARGES FOR ELECTRIC SERVICE)
IN THE STATE OF OKLAHOMA)

FILED
MAY 29 2014

COURT CLERK'S OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA

REBUTTAL TESTIMONY
OF
MARK E. GARRETT

ON BEHALF
OF
OKLAHOMA INDUSTRIAL ENERGY CONSUMERS
("OIEC")

May 29, 2014

**Rebuttal Testimony of Mark E. Garrett
May 29, 2014**

TABLE OF CONTENTS

I. Witness Identification and Purpose of Testimony	3
II. Rebuttal Issues	
A. PUD’s Incentive Compensation Adjustments	4
B. PUD’s Prepaid Pension Asset Testimony.....	5
C. The Attorney General’s Depreciation Recommendation	8
D. PUD’s Recommendation for Allocation of Transmission Costs.....	9
Exhibit	Attached

I. WITNESS IDENTIFICATION AND PURPOSE OF TESTIMONY

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

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

4

5 **Q: DID YOU PROVIDE DIRECT TESTIMONY IN THIS CAUSE ON APRIL 23, 2014**
6 **AND ON MAY 7, 2014?**

7 A: Yes. I provided direct testimony on revenue requirement issues on April 23, 2014 and I
8 provided direct testimony on rate design issues on May 7, 2014. A description of my
9 qualifications and a list of the proceedings in which I have been involved are included at
10 the end of my revenue requirement direct testimony.

11

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

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

14

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

16 A: The purpose of my rebuttal testimony is to respond to and provide additional information
17 on three recommendations made by the Public Utility Division (PUD) in its revenue
18 requirement testimony in connection with the following issues, (1) short-term incentive
19 compensation, (2) long-term incentive compensation and (3) the prepaid pension asset
20 adjustment. I also address an issue discussed in PUD's rate design testimony, the 4CP
21 Average and Excess recommendation for transmission cost allocation and an issue raised

1 in the Attorney General's rate design testimony regarding depreciation rates.

2 **II. A. INCENTIVE COMPENSATION ADJUSTMENTS**

3 **Q: WHAT IS THE ISSUE CONCERNING PUD'S INCENTIVE COMPENSATION**
4 **ADJUSTMENTS?**

5 A: With respect to short-term incentive compensation, I disagree with the method by which
6 PUD calculated its proposed adjustment. PUD's adjustment disallows 50% of PSO's
7 short-term incentive pay consistent with prior Commission orders,¹ however, PUD's
8 adjustment removes 50% of total short-term incentive test year expense, rather than 50%
9 of the adjusted (normalized) short-term incentive expense target levels.² The
10 Commission's prior treatment of PSO's short-term incentive compensation expense in
11 PSO's last two litigated rate cases, which is the disallowance of 50% of the adjusted
12 target levels, is the proper treatment, I believe.³ From a ratemaking perspective, a
13 normalization adjustment and a disallowance are two separate adjustments. A
14 *normalization adjustment* is made to adjust an expense level to its expected ongoing
15 level for the rate-effective period. A *disallowance adjustment*, however, is made to
16 remove expenses that should not be recovered for ratemaking purposes. In the case of
17 incentive compensation expense, it is necessary to normalize the expense to its expected
18 ongoing level and then remove that portion of the ongoing level that is associated with
financial-performance measures. This is the approach used by the Commission in PSO's

1 Javed Seydoff direct testimony at page 13.

2 Id.

3 Cause Nos. PUD 2006-285 and PUD 2008-144.

1 prior cases, and I believe that it is the proper approach for ratemaking purposes.⁴

2 PUD does not make both adjustments – the normalization adjustment and the
3 disallowance . As a result, PUD’s recommends incentive expense levels in rates which I
4 believe are overstated. The Attorney General and OIEC have recommended an approach
5 to adjusting incentive compensation expense consistent with prior Commission orders.

6 With respect to long-term incentives, PUD disallows 100% of long-term
7 incentive pay, consistent with prior Commission orders, however I disagree with PUD’s
8 calculation of that disallowance. According to PSO, the amount of long-term incentive
9 costs from AEPSC included in pro forma operating expense was \$2,907,210⁵ and the
10 amount of long-term incentive costs from PSO included in pro forma operating expense
11 was \$646,907, for a total of \$3,554,117. PUD’s total disallowance for long-term
12 incentive costs is \$2,893,003,⁶ which is \$661,114 short of the total amount included in
13 pro forma operating expense.

14
15 **II. B. PREPAID PENSION ASSET ADJUSTMENTS**

16 **Q: WHAT IS THE ISSUE CONCERNING THE PREPAID PENSION ASSET?**

17 A: PUD’s recommendation is that no adjustment is necessary to PSO’s proposed prepaid
18 pension asset in rate base. PUD also asserts that inclusion of the prepaid pension asset in
19 rate base derives the same result as the Commission’s treatment in PSO’s 2006 rate case,
20 Cause No. PUD 2006-285. In that case, the Commission (1) removed the pension asset

4 For example, in Docket No. 11-06006, the Nevada commission found that Nevada Power’s short-term incentive expense must be adjusted to a normalized ongoing level before the amounts related to financial performance were removed.

5 See PSO’s response to AG 3.11, Attachment 2.

1 from rate base, (2) provided a cost of debt return on the pension asset balance but then
 2 (3) made a capital structure debt adjustment that had the effect of wiping out the first two
 3 adjustments.⁷ PUD's assertion, however, fails to take into account the fact that the
 4 capital structure adjustment issue was litigated in PSO's next rate case, the 2008 rate
 5 case (Cause No. PUD 2008-144), and the Commission chose **not** to make the capital
 6 structure adjustment again. PSO appealed that decision and, in response to that appeal,
 7 the Oklahoma Court of Civil Appeals upheld the Commission's decision on that issue.^{8/}

8 In Oklahoma, the Commission's treatment of Prepaid Pension Assets is well
 9 established. The issue has been addressed by the Commission in four separate
 10 proceedings and in each proceeding, the Commission has authorized the removal of the
 11 prepaid asset from rate base and a cost of money return on the balance. The cost of
 12 money return in each case was set at the utility's cost of long-term debt. In one case,
 13 PSO's 2006 rate case (PUD 200600285), the Commission made a capital structure
 14 adjustment for debt allegedly assigned to the asset, however, the Commission chose not
 15 to follow that approach in the Company's next rate case (PUD 200800144).

Table 1: OCC Treatment of Prepaid Pension Asset			
Company	Cause No.	Cost of Money (Debt) Return	Capital Structure Adjustment
ONG 1992 Rate Case	92-1190	Yes	No
OG&E 2005 Rate Case	05-0151	Yes	No
PSO 2006 Rate Case	06-0285	Yes	Yes
PSO 2008 Rate Case	08-0144	Yes	No

6 Derived from Javed Seydoff direct testimony at page 5, lines 15-18 and page 31, lines 8-12.
 7 See Direct Testimony of Robert Thompson at page 23.
 8 Court of Civil Appeals - Case No. CU-106778

1 Q: ARE YOU RECOMMENDING THE SAME TREATMENT IN THIS CASE?

2 A: Yes. I am recommending that the prepaid asset balance be removed from rate base and
3 that PSO be provided a cost of money return instead. In this case, though, I am
4 recommending that the cost of money return be set at the “expected return” on pension
5 fund assets, which is higher than a cost of debt return but lower than a full rate base
6 return. This treatment has the added benefit of setting the return level for the utility at
7 the same benefit level ratepayers receive from the excess contributions. In other words,
8 PSO will receive the same benefit ratepayers receive from the excess contributions.

9
10 Q: WHAT IS THE IMPACT OF THESE ADJUSTMENTS TO PUD’S
11 RECOMMENDED REVENUE REQUIREMENT?

12 A: The impact of these adjustments is calculated at Exhibit MG-Rebuttal1 and set forth in
13 the table below.

Description	Rate Base Amount	ROR w/Tax	Revenue Requirement Impact
PUD’s Filed Rate Decrease			(\$7,294,274)
Short-term Incentives			(\$3,597,456)
Long-term Incentives			(\$661,114)
Prepaid Pension Rate Base Adj	\$67,741,716	11.206%	(\$7,591,809)
Prepaid Pension Return Adj			\$4,403,602
Total Additional Decrease			(\$7,447,777)
PUD’s Rate Decrease – Adjusted			(\$14,742,051)

14 Table 2 above is intended to show the impact that these adjustments (if adopted by PUD

1 or the Commission), would have on PUD's original filed rate decrease recommendation.

2
3 **II. C. THE ATTORNEY GENERAL'S DEPRECIATION RECOMMENDATION**

4 **Q: DO YOU HAVE ANY COMMENTS REGARDING THE ATTORNEY**
5 **GENERAL'S DEPRECIATION RECOMMENDATION AS SET FORTH IN MR.**
6 **FARRAR'S RATE DESIGN TESTIMONY FILED ON MAY 7, 2014?**

7 A: Yes I do. In his rate design testimony, Mr. Farrar states that he cannot accept PSO's
8 recommended increases to depreciation rates. Mr. Farrar's position is consistent with the
9 positions taken by both PUD and OIEC. However, Mr. Farrar's Testimony does not
10 quantify the impact of this recommendation on the Attorney General's revenue
11 requirement recommendation which was previously made in testimony filed on April 23,
12 2014. I have quantified that impact which is set forth in the table below and at Exhibit
13 MG-Rebuttal 1.

Table 3: Revenue Requirement Impact of Keeping Current Depreciation Rates	
Description	Amount
AG's Original Filed Rate Increase	\$16,345,663
Depreciation Expense Adjustment (OIEC Exhibit MG-2)	(\$26,625,314)
AG Revenue Requirement - Adjusted (Decrease)	(\$10,279,651)

14 This table is not intended to reflect the Attorney General's actual recommendation, but is
15 intended to reflect the rate impact on the Attorney General's recommended revenue
16 requirement of not including PSO's proposed depreciation rate increase in the revenue
17 requirement.

1

2 **Q: WHY IS THIS IMPORTANT?**

3 A: If the AG revenue requirement set forth in Table 2 above is an appropriate representation
4 of the Attorney General's position, then PUD, OIEC and the Attorney General are ALL
5 recommending substantial rate decreases, which certainly underscores the importance
6 that a rate decrease result from these proceedings. That being the case, it is also
7 important for ratepayers and the economy of Oklahoma that the rate decrease be
8 implemented as soon as possible.

9 **II. D. 4CP AVERAGE AND EXCESS ALLOCATION OF TRANSMISSION COSTS**

10 **Q: PLEASE COMMENT ON PUD'S RECOMMENDATION MADE IN ITS RATE**
11 **DESIGN TESTIMONY TO USE A 4 COINCIDENT PEAK AVERAGE AND**
12 **EXCESS ("4CP/A&E") ALLOCATION FOR TRANSMISSION COSTS?**

13 A: On pages 19 and 20 of his direct testimony, Mr. Saenz disagrees with PSO's
14 recommendation to change the allocation method for transmission plant from a 4CP to a
15 12CP method and recommends instead using a 4CP A&E method. OIEC also disagreed
16 with PSO's recommendation to change from a 4CP to a 12CP allocation for transmission
17 plant and recommended no change to the current utilized transmission allocation which
18 is a straight 4CP method.

19

20 **Q: DO YOU OPPOSE PUD'S RECOMMENDATION TO CHANGE TO A**
21 **4CP/A&E?**

1 A: No. While I believe a straight CP method is more-commonly used to allocate
2 transmission plant, a 4CP/A&E method would also be acceptable. The 4CP/A&E
3 method would result in allocations to the various customer classes similar to the straight
4 4CP method. Both methods are consistent with the rate structure proposed by PSO both
5 historically and in the current case. Mr. Saenz is correct in stating in his testimony that
6 the PSO requested 12CP allocation for transmission is inconsistent with pricing signals
7 of PSO's current and proposed rate structures. Mr. Saenz is also correct when he points
8 out that PSO's response to PUDLS-03-10 shows that the transmission system was
9 planned to avoid thermal and voltage violations under peak loading conditions. Mr.
10 Saenz's testimony correctly recognizes that the transmission allocation method should
11 reflect the fact that PSO's system is a summer peaking system.
12

13 **Q: DO YOU RECOMMEND ANY CHANGES TO THE TRANSMISSION**
14 **ALLOCATION METHOD RECOMMENDED BY MR. SAENZ?**

15 A: Yes. Mr. Saenz used the PSO-supported four summer month demands in developing his
16 cost of service. In my direct rate design testimony beginning on page 10, I pointed out
17 that there are problems with PSO's proposed demand units for the summer months used
18 to develop cost allocations to the LPL1 and LPL2 classes. My recommendation remains
19 the same, that the average demands for the four summer peak months be reduced for
20 these classes from that supported by PSO to more realistic levels.

21 In my rate design testimony I recommended reducing the LPL1 average summer
22 demand units used to develop the 4CP allocator from PSO's proposed 82,204 kW to a

1 more normal 73,318 kW. I also recommended reducing the LPL2 average summer
2 demand units from PSO's proposed 357,221 kW to a more normal 347,367 kW.

3
4 **Q: IS IT YOUR RECOMMENDATION THAT PUD SHOULD REVISE ITS COST**
5 **OF SERVICE BASED UPON THESE CHANGES?**

6 A: Yes. Making these changes would result in a more reasonable cost assignment of
7 transmission assets and expenses to the industrial classes. The resulting impact on the
8 other classes from this change would be minimal, but the impact to the LPL1 and LPL2
9 classes would be significant.

10
11 **Q: WOULD THIS CHANGE ALSO AFFECT THE ALLOCATION OF**
12 **PRODUCTION COSTS TO THE CLASSES?**

13 A: Yes. The kW units I recommend should also be used to revise the production costs
14 allocations. Again, the resulting impact from this change would be minimal to the other
15 classes but significant to the LPL1 and LPL2 classes.

16
17 **Q: DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

18 A: Yes, it does.

OIEC REVENUE REQUIREMENT REBUTTAL TESTIMONY CALCULATIONS
PSO Rate Case Cause No. PUD 201300217
Test Year Ended July 31, 2013

Incentive Adjustment Comparison

PSO 2014 Rate Case - Cause No. PUD 20013-217, Test Year End 7/31/13

	AG	OIEC	Staff	Difference
	[Ed Farrar Exhibits]	[Exhibit MG-2]	[Staff Accounting Exhibit] [Seydoff pp.5 and 18]	
1 Remove 50% of annual incentives	\$ (4,118,444)	\$ (4,118,445)	\$ (519,989)	FN1 \$ (3,598,456)
2 Remove long term incentives	(3,554,118)	(3,554,117)	(2,893,003)	FN2 (661,114)
3 Total Adjustments for Incentives	\$ (7,672,562)	\$ (7,672,562)	\$ (3,412,992)	<u>\$ (4,259,570)</u>

FN1 My understanding is that staff started with the total amount paid in the test year, not the normalized target amounts.

FN2 Staff correctly recommends excluding 100% of long-term incentives, but picked up the wrong amounts for its adjustments.

Prepaid Pension Asset Adjustment Comparison

PSO 2014 Rate Case - Cause No. PUD 20013-217, Test Year End 7/31/13

	Rate Base Amt.	ROR w/Tax	Rev Req Impact
4 Remove Prepaid Pension Asset from Rate Base (Exhibit MG-2)	\$ (67,747,716)	11.206%	\$ (7,591,809)
5 Provide Cost of Money Return (Expected Pension Fund Return) (Exhibit MG-2)			<u>4,403,602</u>
6 Net Revenue Requirement Impact of Pension Asset Adjustments			<u>\$ (3,188,207)</u>

Staff's Filed Position Adjusted for Incentive Calculation Correction and Prepaid Pension Asset

PSO 2014 Rate Case - Cause No. PUD 20013-217, Test Year End 7/31/13

7 Staff's Original Filed Revenue Requirement Decrease (Staff Accounting Exhibit)	\$ (7,294,274)
8 Add Incentive Calculation Corrections (above)	(4,259,570)
9 Add Prepaid Pension Asset Adjustments (above)	<u>(3,188,207)</u>
10 Staff's Original Filed Revenue Requirement Decrease Adjusted for Incentives and Prepaid Pensions	<u>\$ (14,742,051)</u>

AG's Filed Position Adjusted for Adoption of Depreciation Recommendation

PSO 2014 Rate Case - Cause No. PUD 20013-217, Test Year End 7/31/13

11 AG's Original Filed Revenue Requirement Increase (Ed Farrar Exhibits)	\$ 16,345,663
12 Depreciation Expense Adjustment (OIEC Exhibit MG-2)	<u>(26,625,314)</u>
13 AG Effective Revenue Requirement Decrease Recommendation	<u>\$ (10,279,651)</u>