

**BEFORE THE  
CORPORATION COMMISSION OF THE STATE OF OKLAHOMA**

APPLICATION OF PUBLIC SERVICE )  
COMPANY OF OKLAHOMA FOR A )  
DETERMINATION THAT ADDITIONAL ) CAUSE NO. PUD 200500516  
ELECTRIC GENERATING CAPACITY )  
WILL BE USED AND USEFUL )

APPLICATION OF PUBLIC SERVICE )  
COMPANY OF OKLAHOMA FOR A )  
DETERMINATION THAT ADDITIONAL ) CAUSE NO. PUD 200600030  
BASELOAD ELECTRIC GENERATING )  
CAPACITY WILL BE USED AND USEFUL )

IN THE MATTER OF THE APPLICATION OF )  
OKLAHOMA GAS AND ELECTRIC COMPANY )  
FOR AN ORDER OF THE COMMISSION ) CAUSE NO. PUD 200700012  
GRANTING PRE-APPROVAL TO CONSTRUCT )  
RED ROCK GENERATING FACILITY AND ) (CONSOLIDATED)  
AUTHORIZING A RECOVERY RIDER )

Rebuttal Testimony

of

James R. Hatfield

on behalf of

Oklahoma Gas and Electric Company

June 18, 2007

James R. Hatfield  
*Rebuttal Testimony*

1 Q. **Please state your name.**

2 A. James R. Hatfield.

3

4 Q. **Are you the same James R. Hatfield who submitted direct testimony on January 17,**  
5 **2007 in this cause?**

6 A. Yes.

7

8 Q. **What is the purpose of your rebuttal testimony?**

9 A. The purpose of my testimony is to address the contentions of witnesses for the Oklahoma  
10 Industrial Energy Consumers (OIEC) and the Attorney General's Office (AG). I will  
11 address the appropriate use of "preapproval", the necessity for OG&E's proposed Red  
12 Rock Construction Rider (RRCR), the financial stress of the Company's 6-Year  
13 Construction Initiative and the integrity of the planned level of capital expenditures.

14

15 Q. **Before you address specific comments by other parties, do you have any opening**  
16 **observations?**

17 A. Yes. OG&E has requested approval of the RRCR in this cause to facilitate construction  
18 of the Red Rock Generation Facility (Red Rock). Red Rock offers the benefits of  
19 economies of scale through a partnership with PSO and OMPA. The members of that  
20 partnership serve approximately 95% of Oklahomans. However, certain parties fail to  
21 understand that the Company will not proceed with the Red Rock construction unless the  
22 Commission approves the RRCR because the financial risk to the Company is otherwise

1 too great. While reducing financial risk to the Company, the RRCR also benefits  
2 customers through lower financing costs. This lower cost of capital benefit also extends  
3 to the substantial additional capital spending the Company has planned through 2012.  
4

5 Q. **Do the opponents of Red Rock preapproval and the RRCR acknowledge the**  
6 **benefits of the Company's proposal?**

7 A. No. I believe the opponents of the RRCR ignore the benefits of a preapproval process as  
8 recognized by this Commission in previous cases and in current Commission rules. The  
9 benefit of the preapproval process is that it allows the Commission to determine the  
10 prudence of critical construction projects contemporaneously with management's  
11 decision making process. Said another way, the preapproval process allows the  
12 Commission to make a decision on Red Rock today rather than wait to make a decision in  
13 2012 based on the information available to the Company in 2007. This preapproval  
14 approach benefits all stakeholders. Some parties to this proceeding have complained that  
15 it is difficult to challenge the prudence of a construction process after the facility is  
16 completed. Preapproval addresses that concern by providing an opportunity to address  
17 prudence concerns before a project is actually constructed. All of the parties to this  
18 proceeding have had the opportunity to present the Commission additional evidence or  
19 rebut evidence presented by the Company. This is a very transparent process insuring that  
20 the Commission has all of the known evidence before it as it evaluates OG&E's  
21 requested relief. In addition, the Commission's preapproval of Red Rock and of the  
22 RRCR protects the financial integrity of the Company by demonstrating to the investment

1 community that the Commission recognizes the necessity for protecting the Company's  
2 cash flow during an unprecedented construction cycle.

3  
4 **Q. Others have said that the financial pressure that you have claimed the Company**  
5 **will face during the next six years is overstated. Do you agree with this assertion?**

6 **A.** No. The evidence presented in our application clearly demonstrated that a construction  
7 program as significant as OG&E's will result in significant erosion of the financial  
8 metrics used by the rating agencies to evaluate OG&E's credit risk. More importantly  
9 approval of the RRCR sends a strong message to the rating agencies and investment  
10 community of the integrity of Oklahoma's regulatory climate. The financial community  
11 considers the regulatory environment in which a company operates as one of the major  
12 risk factors when evaluating the risk of an investment. For example, Lehman Brothers  
13 Global Equity Research in its May 22, 2007 report on the power and utility sector  
14 concluded:

15 "We are recommending companies that we believe are cheap, but also have well  
16 established recovery mechanisms for rate base additions, do business in the most  
17 investment friendly jurisdictions, have strong financial flexibility, and have managements  
18 better equipped to deal with execution risks. As a result, we recommend purchase of  
19 AEP, DPL, DUK, and ITC.

20 Other names in our group, though currently fairly valued in our view, also enjoy the  
21 structural, regional, and regulatory advantages that we believe will accrue to our favorites  
22 above. Therefore, we view the following as core holdings for income-focused investors:  
23 OGE, PCG and WEC—all rated 2-Equal weight." (Emphasis added.)

1 I believe that the investment community, and most particularly the credit rating agencies,  
2 see the preapproval process guidelines enunciated in HB 1910 as offering significant  
3 mitigation of the regulatory risk that an Oklahoma utility would otherwise face when  
4 undertaking a major construction project like Red Rock.

5  
6 **Q. Are you aware of any communications by the Commission with the investment**  
7 **community regarding the pre-approval guidelines in HB 1910?**

8 A. Yes. In OG&E's most recent rate case, Cause No. PUD 200500151, OG&E witness  
9 Susan Abbott presented testimony describing the credit agencies' perception of risk.  
10 During her cross-examination, an OIEC attorney asked Ms. Abbot if she were aware of  
11 what Regulatory Research Associates had said about HB 1910. She responded that she  
12 did not. Vice Chairman Denise Bode then stated:

13 "It's a statute and I worked on it to provide OG&E regulatory certainty and you should  
14 know about it because I talked to Wall Street and it about three or four weeks ago and I  
15 was unhappy because I felt like the investment community of Wall Street was not  
16 focusing on anybody but the coast.

17 ..." it may not be in your direct testimony but I would encourage you if you haven't read  
18 about it to go back if you're advising companies on what we are doing in this part of the  
19 country because I think it was absolutely something that was very important and I felt  
20 real good about, you know, how everybody came together, both the consumers, the  
21 Attorney General, the Commission and the industry to try to put some certainty in place  
22 so that the company would feel good about making investments. So I just share that with  
23 you. So I do hope you go back and look at it."<sup>1</sup>

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<sup>1</sup> Transcript, October 10, 2005, page 120.

1 Q. **OIEC witness J. Randall Woolridge states in his testimony that “....there is no**  
2 **empirical evidence presented by the Company which indicates that using a more**  
3 **traditional AFUDC to recover these expenses will lead to a credit rating downgrade**  
4 **at OG&E or result in any other significant negative financial outcomes.” Do you**  
5 **agree with this assessment?**

6 A. Absolutely not. In fact, I believe the Company provided Mr. Woolridge an abundance of  
7 information that shows OG&E’s credit metrics will be pressured even if the Commission  
8 authorizes use of the RRCR. Additionally, the credit rating agencies used qualitative  
9 measures to support their quantitative analyses. As S&P pointed out in its April 27, 2007  
10 report, a copy of which was provided to Mr. Woolridge:

11 “Regulatory preapproval would reduce uncertainty regarding future recovery of  
12 preapproved costs. Access to a CWIP rider during construction would enhance  
13 cash flow stability, lower external financing needs, and reduce the likelihood of  
14 rate shock once Red Rock is in service. OG&E has a three-year recovery rider in  
15 place for its Centennial wind project.

16 Despite the various regulatory protections, the capital plan still exposes the  
17 company to construction risk. The company will need to manage costs and  
18 potential construction delays or risk financial deterioration.”

19

20 Q. **Please describe the evidence presented by the Company to Mr. Woolridge.**

21 A. My Direct Testimony, filed on January 17, 2007, explains that the Company expects  
22 Funds from Operations (FFO) to decrease by 15% at the peak of the construction cycle.  
23 That level of erosion places significant pressure on the Company’s financial ratios. The

1 Company also provided all credit rating agency reports for the past three years. Those  
2 reports emphasize the importance of regulatory treatment supporting the credit metrics  
3 for OG&E. Finally, the Company, in response to Wal-Mart Data Request 1.4, presented  
4 to all parties an analysis that indicated the high probability of a ratings downgrade  
5 without the RRCR.

6  
7 **Q. Does Mr. Woolridge acknowledge that he received and reviewed the Company's**  
8 **response to Wal-Mart Data Request 1.4?**

9 A. Yes. Unfortunately, he clearly misinterpreted the information provided in the response.  
10 Mr. Woolridge apparently recognizes that OG&E's financial ratios deteriorate during the  
11 construction period as shown in JRW-1, but incorrectly assumes that the Company's  
12 credit ratings will be maintained despite this deterioration. What he fails to acknowledge  
13 is that S&P's BBB credit ratio guidelines range from BBB- to BBB+ and Moody's A  
14 credit ratio guidelines range from A3 to Aaa. Thus, a drop from BBB+ to BBB, even  
15 though it remains in the BBB range, is a ratings downgrade that will result in higher debt  
16 costs to be borne ultimately by customers.

17  
18 **Q. Did the credit rating agency reports you mentioned earlier weigh in on this subject?**

19 A. Yes. I would like to especially reference two of the most current reports. S&P issued a  
20 report on the Company on April 24, 2007 and stated in the Outlook section:

21 "The stable outlook on the OGE family of companies reflects Standard & Poor's  
22 expectations that OG&E will proceed with its \$3.3 billion capital plan only if regulatory  
23 preapproval and various riders, including a CWIP rider for Red Rock, are secured and in

1 place throughout the construction cycle.” ...“An outlook revision to positive is highly  
2 unlikely, given OG&E's impending capital plan.”

3 In addition, the Moody's report on OG&E issued December 27, 2006 stated:

4 “Degradation to OG&E's credit metrics from circumstances such as adverse outcomes in  
5 rate case filings, greater than expected capital expenditures and/or environmental  
6 compliance costs could place downward pressure on the ratings of OG&E.”

7  
8 **Q. Mr. Garrett also referenced Mr. Woolridge's conclusions when he testified**  
9 **“However, as discussed in more detail in the testimony of Mr. Woolridge, the**  
10 **evidence provided by the Company does not indicate that such a downgrade would**  
11 **occur under the AFUDC approach. As such, the one claimed benefit for ratepayers**  
12 **appears to be an illusory benefit at best, given the current financial condition of the**  
13 **utility.” Do you agree with his assessment?**

14 **A.** No I do not. It would appear Mr. Garrett failed to independently review Mr. Woolridge's  
15 conclusions and relied on Mr. Woolridge's erroneous interpretation of information  
16 contained in the credit rating agency reports and the information provided by OG&E as  
17 reflected in Exhibit JRW-1.

18  
19 **Q. Does this mean that without the RRCR, OG&E will not go forward with the plant?**

20 **A.** Yes it does. First of all, we must recognize the magnitude of the investment. The \$789  
21 million investment in Red Rock is greater than the \$709 million net book value of all of  
22 OG&E's existing 6,079 MW of generation. The investment in Red Rock is equivalent to  
23 the capital cost of approximately one and a half ice storms of the magnitude of the one  
24 we experienced in 2002 in each of the next six years. This is a very large investment.

1           However, we are not alone in the industry. Most utilities our size face a similar situation.  
2           It is not prudent from a financial point of view to proceed with the construction of a plant  
3           of this magnitude relative to the size of the Company while facing the uncertainty of cost  
4           recovery. For example, AG witness Smith proposed that the increase could be phased-in  
5           over a two to three year period. In the late 70's and 80's companies that did not have full  
6           cost recovery of generation build faced the reduction or elimination of dividends, credit  
7           downgrades to minimum or non-investment grade and other financial stress. It took these  
8           companies a decade or more to recover. It is simply not reasonable to expect the  
9           Company to subject itself to this type of situation. Of course, the clear purpose of HB  
10          1910 was to alleviate such concerns.

11  
12    **Q.    Do you have additional concerns with Mr. Garrett's testimony?**

13    A.    Yes. Mr. Garrett states in his testimony, "Furthermore, if OG&E is truly incapable of  
14          financing the Red Rock project—in other words, if the cost of the project would cause  
15          OG&E to fall below investment grade—OG&E probably should not have participated as  
16          a bidder in the PSO request for proposal for base-load capacity ("RFP"), offering to build  
17          a plant it could not afford to build without ratepayer help."

18  
19    **Q.    Has Mr. Garrett misinterpreted OG&E's intent?**

20    A.    Yes. First, OG&E and PSO have provided an abundance of documentation regarding the  
21          benefits to ratepayers due to the economies of scale for this project. Second, OG&E has  
22          been clear throughout the process that our plan was premised on the regulatory treatment  
23          requested in this proceeding.

1 I think the more appropriate question is why OG&E would not have submitted a bid.  
2 Circumstances presented OG&E with a unique opportunity to partner with PSO to add an  
3 efficient base load generating plant that utilizes a much less price volatile fuel source to  
4 its electricity supply portfolio. By partnering with PSO, and subsequently OMPA, each  
5 provider was able to take advantage of the economies of scale made possible by building  
6 a plant larger than the needs of each alone. OG&E was able to incorporate elements of its  
7 existing Sooner infrastructure (land, cooling lake, rail facilities etc.) into its bid further  
8 reducing the cost to OG&E customers. The preapproval process set out in HB 1910 made  
9 OG&E's submitting a proposal to satisfy PSO's need for power with the Red Rock  
10 facility an attractive alternative for OG&E and its customers.

11  
12 **Q. Do you have any additional comments regarding criticism of the need for the**  
13 **RRCR?**

14 **A.** Yes. It seems to me the opponents of the RRCR fail properly to weigh the consequences  
15 if the Company is correct. If ratepayers are indifferent from a net present value  
16 perspective, as described by OG&E witness Frank Graves and apparently acknowledged  
17 by Mr. Garrett on page 9 of his responsive testimony, why should the Commission take  
18 the chance on increased financing costs as a result of a ratings downgrade. This question  
19 is particularly important when you consider that the increased cost of funds resulting  
20 from a credit ratings downgrade would apply to more than just the proposed investment  
21 in Red Rock. A ratings downgrade would increase the cost of refinancing the debt for  
22 existing rate base as well as increasing the cost of future rate base additions.

23

1 Q. **Does the RRCR produce other benefits?**

2 A. Yes. The RRCR mechanism provides a smoother path towards the ultimate level of  
3 customer impact required to recover the investment in Red Rock. OG&E witness Howard  
4 Motley explains in greater detail how the ratepayer benefits from a “pay-as-you-go”  
5 approach.

6  
7 Q. **How do you respond to claims that the RRCR shifts the risk from investors to**  
8 **customers?**

9 A. I think a more appropriate way of looking at the RRCR is that it reduces risk for all  
10 parties rather than transfers risk. There is no question the RRCR reduces regulatory risk  
11 by providing the Company some certainty of recovery and provides current cash flow on  
12 the financing costs. However, customers also benefit from avoiding the increased cost of  
13 capital associated with rating downgrades.

14  
15 Q. **Since OG&E is requesting customers to begin paying the financing costs of Red**  
16 **Rock before it is in service, what provisions are in place to protect the customers**  
17 **from an adverse financial event at OG&E’s parent company or its affiliates?**

18 A. OG&E is governed by statutes, rules and other agreements that are intended to “ring  
19 fence” the utility and protect the interests of ratepayers. OG&E is structurally separate  
20 from its parent company and all of its affiliates and there are Commission rules in place  
21 to oversee affiliate and financial transactions. OG&E is a separate corporate legal entity.  
22 It issues its own debt and is a separate SEC registered public company even though it no

1 longer has any publicly traded equity. None of OG&E's utility assets are pledged to  
2 secure its or any other entity's debt.

3 Commission rules are in place to oversee affiliate and financial transactions. They are  
4 found at 165:35-31-1:

5 Purpose, scope and application of Subchapter

6 (a) The affiliate transactions and financial transactions (such as stock, bond,  
7 derivatives, and any financing instrument issuance) rules are promulgated to  
8 establish enforcement, reporting and monitoring provisions of utilities as to  
9 these transactions.

10 (b) The intention of this Subchapter includes [but is not limited to]:

- 11 1. The establishment of standards for transactions between utilities and their  
12 affiliates for purposes of determining fair, just and reasonable rates and  
13 charges;
- 14 2. The prevention of subsidization of an affiliate by a utility
- 15 3. The support of fair and clear cost allocations; and
- 16 4. The protection of the customers of a utility from being subjected to any  
17 unreasonable financial obligation or cost of an affiliate.

18 The sale or disposal of utility facilities is governed by 165:35-1-5:

19  
20 Except upon order of the Commission made upon application, notice and hearing,  
21 no utility shall discontinue or abandon any segment of its jurisdictional  
22 distribution system or sell, transfer, or dispose to another any portion of its  
23 jurisdictional plant or property them consisting of an integrated operating system,  
24 or major fractional part thereof, unless the following criteria are satisfied:

25  
26 Oklahoma law grants the Commission broad powers over acquisition, change of control  
27 or mergers.<sup>2</sup> 17 O. S. § 181 et seq authorizes the Commission to regulate the issuance of  
28 securities by public utilities and prescribes procedures and regulations for creation of

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<sup>2</sup> 17 O.S. § 191.1 et seq.

1 liens on property. Additionally, it establishes procedures for filing applications, hearing  
2 and appeals before the Commission in the State by any public utility.

3 Agreements between OG&E and the Commission are reflected in OG&E's Holding  
4 Company Order No. 399818. The Order accepts the Memorandum of Understanding that  
5 outlines OG&E's agreement and considerations offered in forming its holding company  
6 structure. The Memorandum of Understanding establishes specific notice requirements,  
7 reporting requirements and accounting procedures including provisions in regard to:

- 8 • Transfer or Sale of Assets
- 9 • Reports, Notices and Approval Requirements Related to the Transfer or Sale of  
10 Assets
- 11 • Gain on Transfers or Sale of Utility Assets
- 12 • Goods or Services Provided Between the Utility and Holding Company or  
13 Subsidiaries
- 14 • Access to Books and Records of OG&E and its Affiliates
- 15 • Separation of Costs
- 16 • Restriction on Pledging Utility Assets or Income

17 As can be seen, many provisions currently exist that ring fence the utility and provide  
18 security to OG&E's ratepayers. However, we must acknowledge that OG&E is currently  
19 benefiting from the corporate structure. This is due to the fact that its non-regulated  
20 affiliate is providing significant cash to its corporate parent which is, in turn, being used  
21 to support the utility's capital expenditures.

22  
23 **Q. Attorney General witness Lee Smith stated in her testimony that OG&E may have**  
24 **over stated its future capital expenditures. She relies on a report by KEMA, titled**  
25 **“Reliability Versus Cost at Oklahoma Gas & Electric”. Do you agree with her**  
26 **reliance on this report?**

1 A. No. The KEMA report cited by Ms. Smith, dated March 2, 2005, studied 180 distribution  
2 circuits and only investigated reliability improvement opportunities. The main focus of  
3 this report was reliability improvement strategies and options. The study recommended  
4 expenditures to improve system reliability but did not include capital expenditures for  
5 normal system aging and typical system wear and tear.

6 To understand the magnitude of the aging infrastructure issue, Ms. Smith would have  
7 been better served to review the ABB & KEMA report titled. "Asset Management  
8 Roadmap" dated September 13, 2005. This report projected a 2 to 3% annual decrease in  
9 reliability over the next decade at the current spending levels unless steps are taken to  
10 address our aging infrastructure issue.

11  
12 Q. **Does the Company's 6-Year Construction Initiative address the aging infrastructure**  
13 **issue?**

14 A. Yes. In addition to the expenditures to address aging infrastructure, our capital spending  
15 includes both routine and non-routine spending. Some examples of routine spending are  
16 the ongoing investment in expanding infrastructure, including infrastructure to serve new  
17 customers. An example of non-routine spending would be the average cost of restoring  
18 customer outages.

19  
20 Q. **Is there any basis for a suggestion that OG&E intentionally exaggerated the level of**  
21 **its capital investment?**

22 A. Absolutely not. The magnitude of capital investment presented in this case is the level of  
23 capital investment around which all of our operating plans are based. The 2007-2012

1 planned capital expenditures have been provided to the OG&E Board of Directors. The  
2 projected capital expenditures have been reported to investors, analysts and to the  
3 Securities and Exchange Commission. The Company described these levels of  
4 investment in its Annual Report. I certainly hope that Ms. Smith is not suggesting that  
5 OG&E or as its Chief Financial Officer I would file false reports.

6  
7 **Q. Ms. Smith observed that OG&E's projected capital expenditures decreased from**  
8 **the \$3.3 billion reported in your direct testimony to \$3.0 billion reported in a**  
9 **subsequent data request, why does the level of capital expenditure decrease?**

10 **A.** Subsequent to OG&E's filing of testimony in this cause, OG&E filed its Regional Haze  
11 compliance plan with the Oklahoma Department of Environmental Quality (DEQ). The  
12 revised level of capital expenditures shown in Table 1 almost exclusively reflects the  
13 lower cost of implementing the alternate compliance plan submitted to DEQ.

14 At the time OG&E filed its application in this cause its preliminary plan to comply with  
15 the Regional Haze standard was to install scrubbers. Subsequent to the time the  
16 application was filed OG&E developed an alternative compliance plan. The elements of  
17 the revised plan that result in substantial saving over the original plan were only  
18 identified after extensive modeling of OG&E's emission profile that was completed in  
19 March 2007, well after the application was filed in this cause. If approved, the alternative  
20 plan achieves required reductions in sulfur dioxide (SO<sub>2</sub>) and oxides of nitrogen (NO<sub>x</sub>)  
21 emissions at a lower cost.

1 As Ms. Smith acknowledged in her testimony, a revised level of capital expenditures and  
 2 projected revenue requirement was provided to the parties in response to Attorney  
 3 General Data Request 5-4 Revised.

4  
 5 **Q. Has OG&E's alternative plan been approved by the DEQ and EPA?**

6 A. No. The DEQ is incorporating OG&E's proposed alternative compliance plan into the  
 7 Oklahoma State Implementation Plan which will be submitted to EPA for approval. The  
 8 Company hopes to have feedback from DEQ by mid July 2007. If the EPA does not  
 9 approve the alternative plan, OG&E would have to revert to the original compliance plan  
 10 requiring earlier implementation and higher level of capital expenditure. Of course, the  
 11 Company's SEC disclosures will be revised if approval is granted.

12  
 13 **Q. Please describe the revised capital expenditure requirements if the Company's DEQ  
 14 proposal is approved.**

15 A. Table 1 shows the major components of OG&E's revised \$3.0 billion 6-Year  
 16 Construction Initiative.

17 **Table 1**

<b>Capital Expenditures</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>Total</b>
Base Plan	\$304.8	\$305.1	\$299.7	\$310.1	\$325.2	\$325.3	\$1,870.2
Centennial Wind Project	26.0	-	-	-	-	-	26.0
Environmental	-	12.0	22.5	83.0	97.3	93.8	308.6
Red Rock	92.7	278.8	285.7	97.7	34.1	-	789.0
Total Cap-X	\$423.5	\$595.9	\$607.9	\$490.8	\$456.6	\$419.1	\$2,993.8

18  
 19 **Q. Can you provide detail on the \$1.87 billion Base Plan?**

1 A. The Base Plan is divided into several sub-categories including New Business, System  
2 Growth, Maintain System Integrity, Restoration of Customer Power and General  
3 Plant/Fleet.

4

5 **Q. The category labeled New Business is a significant category. Please explain how the**  
6 **necessary level of capital expenditures was developed.**

7 A. The New Business budget is based upon an analysis that included a review of the 2001-  
8 2005 actual spending on New Business. During this time, spending grew 14.2% annually,  
9 and residential new business spending doubled, reflecting a period of economic growth in  
10 Oklahoma and western Arkansas. Recognizing that the economy may be slowing down  
11 over the next five years, the growth factor for New Business was reduced to 9.2% for the  
12 initial long-term budget. The budget for 2007 showed a one-time increase to recognize  
13 known large industrial projects that were likely to take place. The 2008-2012 budgets  
14 resumed the growth trend at the lower level.

15

16 **Q. How was the System Growth budget developed?**

17 A. The System Growth budget was based on spending levels needed to support the current  
18 average load growth. The Project Management group reviewed load growth from 1995 to  
19 2005, evaluating peak load changes and capacity added during this time frame.  
20 Consideration was given to the levels of reliability needed to maintain system reliability  
21 at current levels, as well as the probability of equipment failures that could occur if we do  
22 not relieve equipment overloads caused by system growth. Cost of the infrastructure was  
23 planned to be added based on a cost per megavolt ampere using the average cost of recent

1 “typical” projects (non-typical outlier jobs that would have increased the estimate were  
2 removed from the cost average). Inflation for materials and contract labor were based on  
3 current experience and contract negotiations with suppliers, and recognition that we are  
4 competing for materials and labor that are in demand by other utilities that are also  
5 upgrading their infrastructures.

6  
7 **Q. What process was used to determine the needed investment for Maintain System**  
8 **Integrity?**

9 A. The Maintain System Integrity (including “Aging Infrastructure”) budget was based on a  
10 coordinated effort of the engineering, construction, planning, and project management  
11 groups within Electric Services. Resources from procurement, finance, and other groups  
12 were brought in as needed to provide assistance, and a business case was prepared for  
13 increasing investment to replace higher-risk aging infrastructure. The Company had  
14 previously recognized potential risks associated with our expansive aging infrastructure,  
15 and commissioned two successive studies in 2004-2005 by KEMA and ABB to evaluate  
16 the condition of our system and perform a risk analysis around our existing investment  
17 and maintenance practices. These studies indicated that the average age of our system  
18 was 27 years old, and that we were facing increased risks of equipment failures and loss  
19 of reliability. The System Integrity group used existing asset management and equipment  
20 failure records, as well as data compiled for the two studies, to identify specific high risk  
21 portions of the system that should be replaced over a five year period.

22 It should be noted that the increased spending of just over \$200 million for “Aging  
23 Infrastructure” is significantly lower than the \$1 billion estimated by ABB/KEMA if all

1 aging assets were replaced. The lower spending is based on management's risk analysis  
2 of system assets. Certain items, such as wood poles, are considered to have additional  
3 useful life in them, and valuable budget dollars were reserved for only the highest risk-of-  
4 failure portions of the system.

5  
6 **Q. What are the remaining items in the Base Plan?**

7 A. There are two smaller portions of the budget related to Restoration of Customer Power,  
8 largely driven by weather/storm damage, and General Plant/Fleet costs. These were  
9 individually estimated based on historical trends and aging plant/fleet assets that were  
10 due for replacement. Analysis on the fleet budget indicated that some of our trucks were  
11 costing more to maintain than it would cost to purchase new vehicles. New  
12 EPA/emissions rules were also taken into consideration for the five year fleet budget to  
13 comply with new regulations as they become effective.

14  
15 **Q. How was the budget approved?**

16 A. The overall capital budget was consolidated into one business case for Electric Services  
17 and Transmission that was presented to both operational and executive management.  
18 Several iterations of the business case were prepared to address questions and concerns,  
19 particularly about the increased level of spending and the ability to execute this plan with  
20 internal and external labor resources. An Implementation Plan was presented to executive  
21 management in August 2006, and included an analysis of execution risks and the actions  
22 that would be taken to mitigate these risks. Discussions were held with outside  
23 contractors such as GE to assure that specialized/skilled workers would be available to

1 perform the needed work at the levels the spending plan contemplates. Deliveries for long  
2 lead-time items were also coordinated in late 2006 to insure that needed equipment and  
3 other material would be available in 2007 and later. The five-year capital spending plan  
4 was provided to the Board of Directors.

5  
6 **Q. Is it possible that capital expenditures at OG&E could be greater than \$3.0 billion**  
7 **during this timeframe?**

8 A. Yes. First of all, as I discussed earlier, the DEQ/EPA may require a more costly  
9 environmental solution than proposed in our March filing. Also, the Company is actively  
10 looking at adding more wind generation to its generating portfolio. Additionally, the SPP  
11 is analyzing alternatives that could require new transmission construction due to  
12 proposed wind projects in the Texas Panhandle and potential new projects in western  
13 Oklahoma in the next five years. Finally, as Jesse Langston explains in his rebuttal  
14 testimony, OG&E is investigating the merits of expanded energy efficiency programs that  
15 could also require substantial expenditures beginning as early as next year.

16  
17 **Q. Do you have any concluding comments regarding the RRCCR?**

18 A. Yes. OG&E has requested in this cause the RRCCR to facilitate construction of the Red  
19 Rock Generation Facility in partnership with PSO and OMPA. This least cost option will  
20 benefit approximately 95% of Oklahomans. However, unless the Commission approves  
21 the RRCCR, the Company will not proceed because the financial risk to the Company  
22 would be too great. While reducing financial risk to the Company, the RRCCR would

1 benefit customers through lower financing costs. This lower cost of capital benefit also  
2 applies to the additional capital spending the Company has planned through 2012.

3

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

5 A. Yes.