

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

COURT CLERK'S OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF)
OKLAHOMA GAS AND ELECTRIC COMPANY)
FOR AN ORDER OF THE COMMISSION)
GRANTING PREAPPROVAL TO CONSTRUCT)
RED ROCK GENERATING FACILITY AND)
AUTHORIZING A RECOVERY RIDER)

CAUSE NO. PUD 200700012

Direct Testimony

of

Howard W. Motley

On behalf of

Oklahoma Gas and Electric Company

January 17, 2007

Howard W. Motley
Direct Testimony

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

3 A. My name is Howard W. Motley. I am Vice President, Regulatory Affairs of Oklahoma
4 Gas and Electric Company (OG&E or Company). My business address is 321 N. Harvey,
5 Oklahoma City, Oklahoma 73101.
6

7 Q. **Briefly summarize your education and professional qualifications.**

8 A. I am a graduate of Oklahoma City University, where I received a Bachelor of Science
9 degree in Business. My career in public utility regulation has spanned 32 years beginning
10 April 15, 1974 when I accepted an auditing position with the Oklahoma Corporation
11 Commission (Commission). As an auditor for the Commission, I performed over 30
12 audits of public utilities. On August 1, 1979, I was appointed Director of the Public
13 Utility Division and served for over 10 years in that position until January 1990. During
14 the next 11 years, I provided professional consulting services in the area of public utility
15 regulation. I began my employment with OG&E in August 2001 as Manager, Rate
16 Strategies. I later was promoted to Director, Regulatory Affairs and Strategy. I was
17 appointed Vice President, Regulatory Affairs on November 15, 2006 by the OGE Energy
18 Corp. Board of Directors.
19

20 Q. **Has the Commission previously accepted your qualifications as an expert witness?**

21 A. Yes.

1 Q. **What is the purpose of your testimony in this proceeding?**

2 A. The primary purpose of my testimony is to support the approval of the Red Rock
3 Construction Rider (RRCR). I will also discuss the implementation of the proposed
4 RRCR along with quarterly reporting and annual true-up requirements.

5
6 Q. **Please identify the three cost recovery alternatives or approaches discussed in the
7 testimony of OG&E's witnesses James Hatfield and Frank Graves.**

8 A. OG&E's three cost recovery options are (i) wait until Red Rock is "plant in service" to
9 file a rate increase, (ii) include Red Rock construction work in progress in rate base as
10 part of a general rate review or (iii) implement a construction financing cost recovery
11 rider at the beginning of the construction cycle to recover Red Rock's financing cost on a
12 current basis.

13
14 Q. **Why did OG&E select the recovery rider option?**

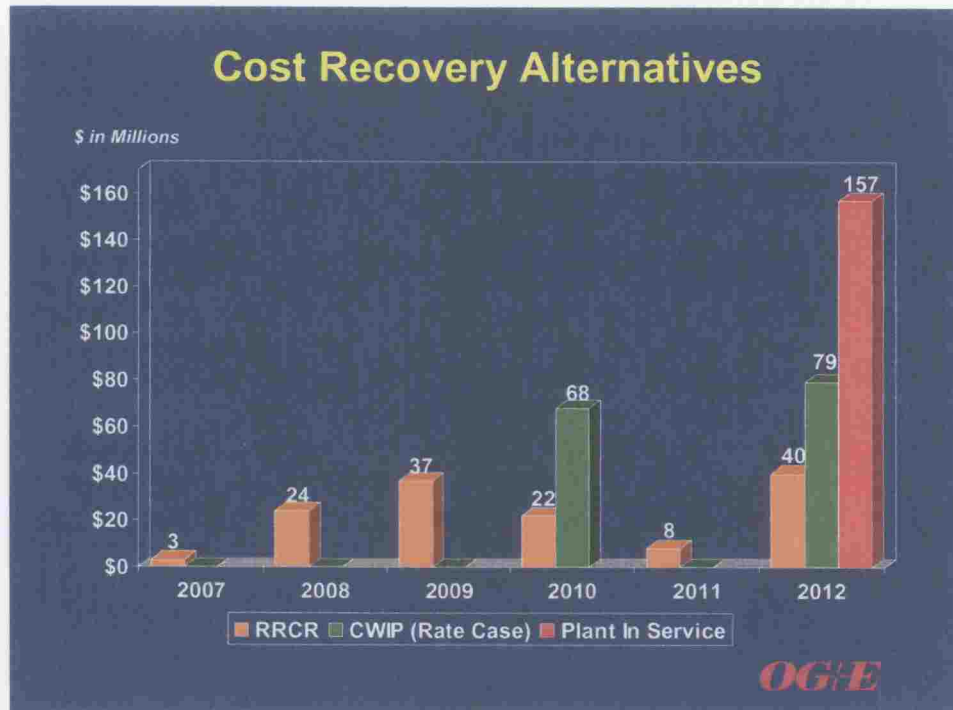
15 A. The RRCR provides a phase-in recovery of Red Rock construction financing costs that
16 will minimize customer impact at the end of the six-year construction cycle. The RRCR
17 will also support OG&E's ability to access the capital markets and provide the Company
18 a better 'quality of earnings' than the AFUDC approach. Better positioning in the capital
19 market produces lower debt costs and is beneficial to shareowners and customers.

20
21 Q. **How does the RRCR phase-in the costs related to Red Rock?**

22 A. Chart 1 illustrates the cost recovery timing under each of the three regulatory options
23 previously identified. The amounts utilized in Chart 1 are total company values. The

1 Oklahoma jurisdiction is the source of approximately 85 percent of the Company's
2 revenues.

3 **Chart 1**



4
5 **Q. Please compare the results under the “plant in service” option to the CWIP Rate**
6 **Case option.**

7 **A.** If OG&E waits until Red Rock is “plant in service” before increasing rates, a \$157
8 million rate increase would be required in 2012. This large rate increase could be reduced
9 to a \$79 million rate increase in 2012 by selecting the CWIP Rate Case regulatory option.
10 Under the CWIP Rate Case option, electric rates would increase \$68 million in 2010.
11 This earlier increase would reduce the increase required in 2012 to \$79 million. This
12 represents a 50% reduction in customer impact in 2012 for Red Rock. Additionally, as
13 illustrated in Chart 1, the overall revenue requirement going forward is approximately

1 \$10 million less. The CWIP Rate Case option would result in a \$147 million Red Rock
2 revenue requirement beginning in 2012 as compared to \$157 million for the "plant in
3 service" option. The lower revenue requirement results from a reduced amount of
4 AFUDC being charged to the final construction cost of Red Rock under the CWIP Rate
5 Case option. OG&E witness Frank Graves discusses in detail the advantage to customers
6 of avoiding substantial amounts of AFUDC being charged on a large, multi-year
7 construction project such as Red Rock.

8
9 **Q. Does the RRCR reduce the Red Rock rate increase needed in 2012 even more than**
10 **the CWIP Rate Case approach?**

11 A. Definitely. The RRCR is a phase-in proposal over a six year period. As demonstrated by
12 Chart 1, the RRCR phase-in approach reduces the \$157 million rate increase in 2012 to
13 around \$40 million. This is a 75% reduction of the customer impact in 2012 compared to
14 the "plant in service" option. In addition, the annual Red Rock revenue requirement for
15 2012 and beyond is \$134 million or \$23 million less than the annual revenue requirement
16 associated with the "plant in service" approach.

17
18 **Q. Is the Company's objective to minimize the rate increase related to Red Rock?**

19 A. Although in this cause the Company is proposing a cost recovery mechanism designed to
20 minimize the impact of Red Rock plant cost on rates after the plant is placed in service,
21 the Company's overriding long-term goal is to minimize the rate increase customers will
22 be facing in 2012. At the end of the Company's six year construction cycle, which is
23 described by Mr. Hatfield in more detail, the RRCR phase-in proposal will help offset the

1 ultimate rate increase necessary to cover not only the \$789 million Red Rock investment
2 but the additional \$ 2.5 billion capital expenditures to replace aging infrastructure and
3 update environmental controls.
4

5 **Q. Has OG&E estimated the amount rates will need to increase in 2012 to recognize the**
6 **\$3.3 billion construction expenditures OG&E will make over the next six years?**

7 A. The Company has developed a rough estimate of the rate increase required utilizing the
8 “plant in service” recovery approach. The estimate is based on the following
9 assumptions: (i) a \$3.3 billion construction initiative which does not include AFUDC; (ii)
10 forecasted accumulated depreciation and deferred income taxes; (iii) last approved rate of
11 return; (iv) current income tax rates; and (v) estimated operating expenses for Red Rock
12 and environmental controls. Our estimate is that the rates in the Oklahoma jurisdiction
13 would need to increase approximately \$304 million. Additionally, customer growth,
14 variances in other O&M costs and increased construction costs associated with the
15 accrual of AFUDC would impact the final revenue requirement needed in 2012.
16 However, the 2012 jurisdictional increase would be offset by an estimated \$55 million of
17 fuel savings created by Red Rock. Based on these estimates, the net increase to
18 customers’ bills would be around \$249 million.
19

20 **Q. Please quantify the customer impact in 2012 based on the 6-Year Construction**
21 **Initiative.**

22 A While \$3.3 billion is projected to be spent over the next six years, the costs will be spread
23 over all customers, current and future, over the next several decades. Based on the \$249

1 million estimated increase, the average residential customer's bill would increase 18.7%
2 or \$18.30 per month over what customers paid in 2006, if the RRCR is not used to phase-
3 in the increase. The RRCR phase-in would reduce the \$18.30 per month increase in 2012
4 to \$11.78. The Company believes that gradual adjustments made over a period of years
5 are easier for consumers to accommodate than a larger, one-time increase.

6
7 **Q. Please provide an estimate of the increase in an average residential customer**
8 **monthly bill over the construction period under the RRCR tariff.**

9 **A.** An average residential customer's monthly bill is estimated to increase initially 34¢ in
10 2007 and up to a cumulative total of \$4.66 per month in 2011. The incremental increases
11 are reflected in Chart 2. In 2012, the incremental increase is \$1.80 per month, but the
12 customer will experience a \$2.30 monthly reduction in fuel costs because of Red Rock.

13
Chart 2



1 Q. **Under OG&E's phase-in recovery proposal, when will OG&E's customers begin**
2 **paying the financing costs of Red Rock?**

3 A. As explained by Mr. Langston, OG&E needs an order in this cause by July 20, 2007 in
4 order to lock down a cost-saving EPC contract for the Red Rock plant. If that order is
5 issued, the RRCR would be implemented the first billing cycle in August 2007.

6

7 Q. **Does the Red Rock annual revenue requirement include an equity return for the**
8 **shareowner?**

9 A. Yes. The annual revenue requirement is determined in the same manner as a general rate
10 review. The Company includes an overall return (debt and equity) on the capital
11 investment for Red Rock and related income taxes. In calculating the financing costs, the
12 rate of return on equity approved by the Commission in OG&E's last general rate review
13 will be utilized. The Company's Security Rider return requirement component is
14 calculated in the same manner. During the construction period, depreciation, O&M
15 expense and ad valorem taxes are not included in the RRCR revenue requirement,
16 although these costs are recovered in the Security Rider and Centennial Wind Energy
17 Project Rider.

18

19 Q. **How will Red Rock costs be allocated between OG&E's multiple regulatory**
20 **jurisdictions to ensure that only the appropriate amount is charged to Oklahoma**
21 **customers?**

22 A. Historical cost of service procedures, as approved by the Commission, are applied in the
23 allocation process. There are two steps to allocate Red Rock costs to Oklahoma

1 customers. The *first step* is to determine to which FERC account the project should be
2 charged. Historical cost of service procedures allocate costs (by each FERC account)
3 between regulatory jurisdictions. Once the costs are assigned to the Oklahoma
4 jurisdiction, the *second step* is to allocate the Oklahoma portion to each customer class.
5 OG&E witness Roger Walkingstick discusses the development of the charges to
6 Oklahoma customers.

7
8 **Q. Will the Company file quarterly reports?**

9 A. Yes. OG&E will submit, within 60 days of the end of each quarter, Quarterly Reports to
10 the Director of Public Utilities summarizing the monthly financing costs for Red Rock
11 and the RRCR revenue actually collected during each month.

12
13 **Q. Will the RRCR have a true-up measure?**

14 A. Yes. As described by OG&E witness Roger Walkingstick, the Staff will conduct an audit
15 to ensure that customers pay only the actual financing costs of Red Rock.

16
17 **Q. Has the Commission approved recovery riders in conjunction with the preapproval
18 of construction projects?**

19 A. Yes. The most recent is the Centennial Wind Energy Project Rider. Subsequent to the
20 Commission issuing OG&E's last general rate review order, the Company developed a
21 wind project that would benefit our customers. OG&E needed a rider to recover financing
22 costs, depreciation and operating costs in order to move forward with the project. The
23 Commission issued an order approving the wind project and the recovery rider. The

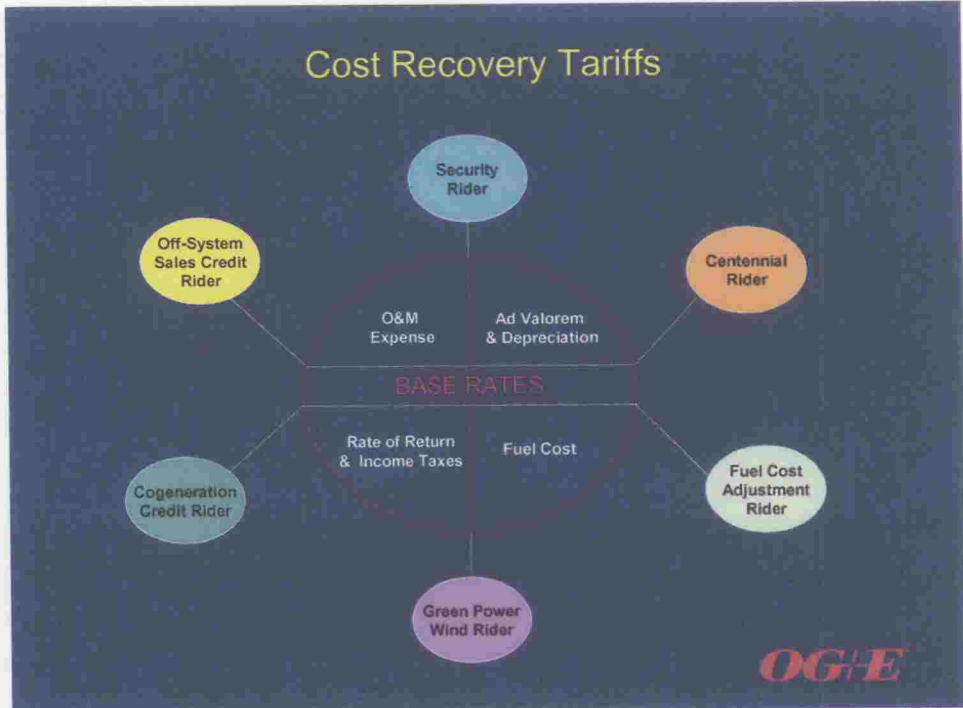
1 Centennial rider requires an annual true-up to ensure that OG&E’s customers are not
2 overcharged. The Centennial rider allowed the Company to move forward with a
3 renewable energy project that will benefit customers for many years.

4 Prior to the approval of the Centennial rider, OG&E’s Security Rider was approved by
5 the Commission. In the Commission order approving the rider, OG&E was allowed to
6 recover the costs for specific security projects associated with the Company’s Homeland
7 Security and Critical Infrastructure Plan. These projects were preapproved up to a
8 “capped” amount.

9
10 Q. Please identify OG&E’s current riders authorized by the Commission.

11 A. Chart 4 illustrates the six riders that work in concert with the Company’s filed base rate
12 tariffs approved in the last general rate review.

13 **Chart 4**



1 The most familiar rider is the Fuel Cost Adjustment (FCA) Rider that balances the over
2 and under recoveries of fuel cost from our customers. Commission rules prohibit the
3 Company from enhancing profits through the FCA Rider. The other riders have been
4 approved over the last decade.
5

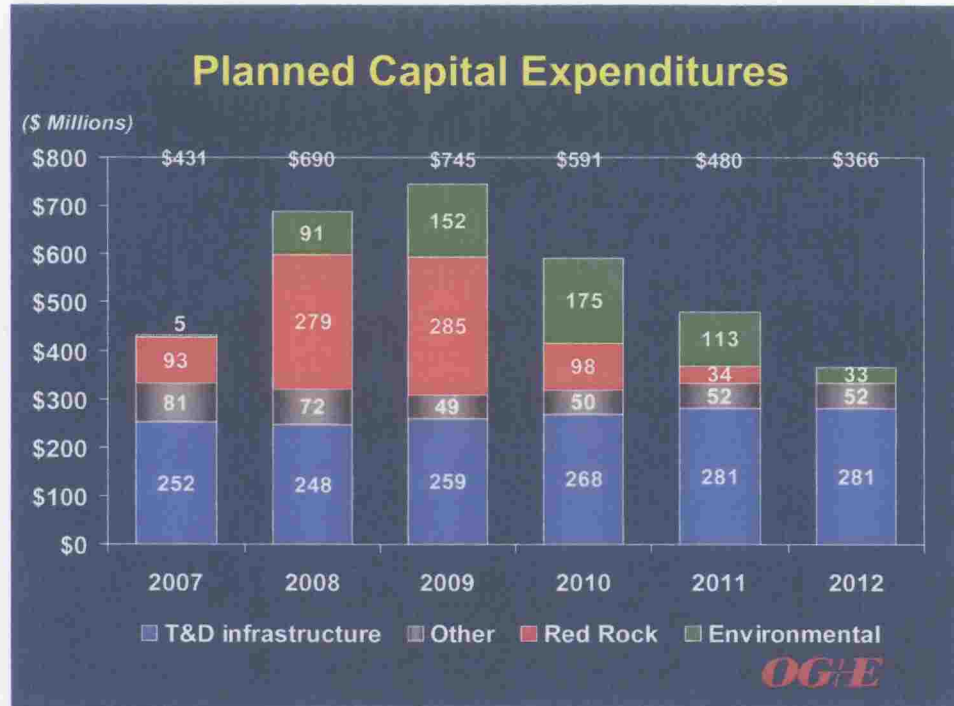
6 **Q. From your experience, why would there be opposition to a recovery rider?**

7 A. The concern is whether the utility's earnings will be increased unfairly because of the
8 additional revenues produced by a recovery rider. This concern is generally reflected in
9 an argument that a recovery rider constitutes "piecemeal ratemaking". The concern of
10 "piecemeal ratemaking" is that if a full rate case review of all other company costs and
11 revenues were conducted, the need for the recovery rider could be mitigated or
12 eliminated.
13

14 **Q. Are these arguments valid as applied to this Application?**

15 A. No. The arguments are not valid based on the circumstances the Company is presenting
16 to the Commission. If OG&E's operating costs and capital expenditures were in a
17 declining mode or the Commission had not performed an OG&E general rate review one
18 year ago, an in-depth review could be justified. However, OG&E is in a major
19 construction cycle as demonstrated in Chart 3 and even with the RRRCR will experience
20 significant regulatory lag. The \$3.3 billion planned capital expenditures substantially
21 exceed the increase in accumulated depreciation over the six year construction cycle. A
22 rider will mitigate but will not eliminate the financial impact of regulatory lag during this
23 six year period.

Chart 3



2 During this six year period, the Company will experience approximately a \$1 billion
 3 increase to accumulated depreciation on the rate base established in OG&E's last general
 4 rate review. Because of the Company's \$3.3 billion construction initiative, the increase to
 5 rate base during the six year period, after deducting the accumulated depreciation, will be
 6 over \$2 billion. This level of new capital investment would require an annual rate
 7 increase of over \$200 million. The RRCR is projected to produce annual revenue ranging
 8 from \$3 million (2007) to \$94 million (2011). The RRCR will mitigate but not eliminate
 9 the financial impact of regulatory lag during this six year construction cycle.

10

11 Q. Does this conclude your testimony?

12 A. Yes.