BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF OKLAHOMA GAS AND ELECTRIC COMPANY FOR AN ORDER OF THE COMMISSION AUTHORIZING APPLICANT TO MODIFY ITS RATES, CHARGES, AND TARIFFS FOR RETAIL ELECTRIC SERVICE IN OKLAHOMA	)	CAUSE NO. PUD 201700496

Direct Testimony

of

Donald R. Rowlett

on behalf of

Oklahoma Gas and Electric Company

January 16, 2018

Donald R. Rowlett
Direct Testimony

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

A. My name is Donald R. Rowlett. I am the Managing Director of Regulatory Affairs for Oklahoma Gas and Electric Company ("OG&E"). My business address is 321 N. Harvey Avenue, Oklahoma City, Oklahoma 73102.

Q. **Please state your educational qualifications and employment history.**

A. I earned a Bachelor of Science degree in Business with an accounting emphasis (1980) and a Master's in Business Administration (1992), from Oklahoma City University. I have also completed all work, except for the dissertation, on a Ph.D. from Oklahoma State University in Business Administration. I joined OG&E in 1989. I currently serve as Managing Director of Regulatory Affairs where I am responsible for overseeing the Company's economic regulatory activities with the Oklahoma Corporation Commission, the Arkansas Public Service Commission and the Federal Energy Regulatory Commission. I have served in various financial roles in the Company including ten years as Vice President, Controller and Chief Accountant. As the Company's Controller I was responsible for financial and operations accounting, federal, state and local income and property taxes and budgeting. I have also made investor presentations and participated in numerous public equity and debt offerings. Prior to joining OG&E, I was employed by Arthur Andersen & Co. as a financial consultant and audit manager. During my employment, I performed audits of financial statements in a variety of industries. Additionally, I prepared filings with the Securities and Exchange Commission ("SEC") and provided clients with guidance on the financial reporting requirements of the SEC and Generally Accepted Accounting Principles ("GAAP").

OG&E's books. OG&E recommends amortizing this regulatory liability over 5-years. Pension expenses have decreased over the last several years, in large part, due to a declining number of participants in the defined benefit plan. The reduction resulted in an over-recovery. The annual amortization would reduce OG&E's annual jurisdictional revenue requirement by approximately $8 million. Combined with the annual pension expense reduction of approximately $23 million and the elimination of the previous pension liability amortization of approximately $5 million, the overall reduction in revenue requirement due to pension savings is approximately $27 million. The Pension Tracker is further discussed by OG&E witness Thenmadathil.

Income Tax Treatment

Q. **How has OG&E addressed the Tax and Jobs Act of 2017 ("TCJA" or the "Act"))?**

A. OG&E has incorporated the changes in federal income tax rates and other provisions of the Act in determining its revenue requirement as shown on Schedule A. The TCJA creates three opportunities to reduce customer rates.

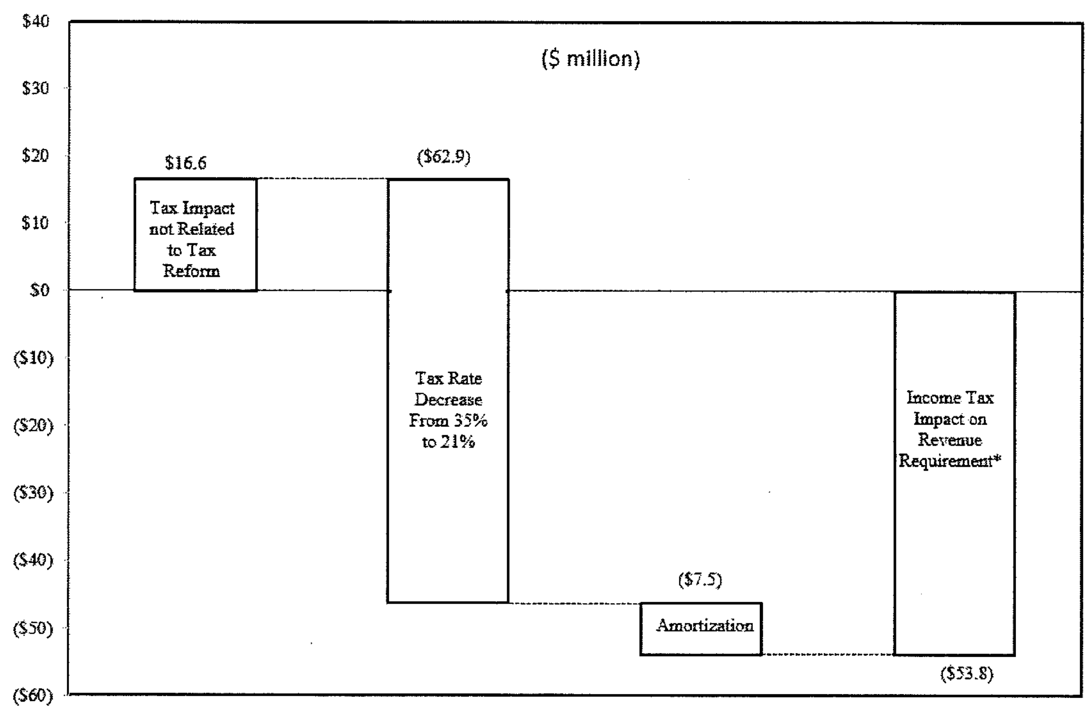
First, the federal corporate income tax rate has been reduced from 35% to 21%, resulting in an approximate $63 million reduction in OG&E's annual revenue requirement. The new federal income tax rate is reflected in this application on the schedules in Section J of the MFR package.

Second, OG&E's current rates for electric service reflect a 35% federal income tax rate. Beginning January 1, 2018, OG&E's federal income tax rate dropped to 21%. OG&E began recording a regulatory liability for the difference in the provision for income taxes based on the 35% federal income tax rate and the amount that would have been provided had rates been based on a 21% federal rate. In accordance with Commission Order No. 671982 in Cause No. 201700569, the Company will accrue a carrying charge on that liability at the 7.0667% weighted cost of capital. OG&E proposes that the amount accumulated in the regulatory liability be returned to customers through an income tax rider.

Third, OG&E has recorded accumulated deferred income taxes ("ADIT") for temporary differences between book and tax income. These accumulated income taxes are currently based on a 35% federal corporate income tax rate. With the passage of the

TCJA, the deferred income tax liability must be remeasured at the 21% income tax rate. OG&E has previously included the provision for deferred income taxes in determining its revenue requirement. The difference between the ADIT balance previously recorded and the remeasured amount should be recorded as a regulatory liability. OG&E's billed revenues will be lower in the future as a result of returning excess deferred income taxes to customers. The regulatory liability should be grossed up for the income tax benefit that OG&E will realize. This regulatory liability, when grossed up for income taxes, is approximately $1 billion. The current year turnaround of the excess deferred income taxes results in a reduction to OG&E's revenue requirement of approximately $7 million.

Chart 2: Income Tax Impact on Revenue Requirement



* Excludes income taxes and Investment Tax Credits related to Mustang combustion turbines

Q. **How will this regulatory liability for excess deferred income taxes be returned to OG&E's customers?**

A. OG&E will follow the normalization provisions of Section 203 (e)(2)(B) of the 1986 Tax Reform Act that prescribes the Company use the Average Rate Assumption Method ("ARAM"). OG&E's revenue requirement will be reduced in the year that the temporary differences that gave rise to the accumulated deferred income taxes turnaround. Revenues will decrease by the difference between the rate used to accrue them (35%) and the tax rate used to determine how much will be paid (21%).

Q. **Does the level of book/tax differences turning around stay constant?**

A. No. The level of temporary differences turning around will slowly increase over time. As more vintage year additions reach the point where book depreciation expense exceeds tax depreciation.

Q. **How does OG&E propose handle this increase in the turnaround of excess deferred income taxes?**

A. OG&E proposes to record the difference between the level of turnaround of excess deferred income taxes included in rates and actual level that occurs in subsequent years as a regulatory liability. OG&E further proposes that the amount accumulated in the regulatory liability be returned to customers monthly using the proposed Federal Tax Change and Production Tax Credit ("FTCPTC") Rider, which is discussed more fully by OG&E witness Cash.

Q. **Will the Company retain any benefits from the tax changes and are customers harmed by your treatment?**

A. No. The Company's approach to incorporating the tax changes into our filing preserve for our customers all the benefits of the federal tax rate reduction beginning on January 1, 2018, the effective date of the new law.

Q. **When will customers begin to recognize the benefits of the tax changes?**

A. The Company will begin tracking the benefits of lower tax rates effective January 1, 2018. Customers will begin to recognize the benefits of the lower tax rates when new rates are implemented in this Cause.

Q. **What will be included in the FTCPTC rider?**

A. The Rider will include three factors, which are:

1. Federal Tax Change ("FTC") factor,
2. Amortization of the Regulatory Liability ("ARL") factor, and
3. Production Tax Credit ("PTC") factor.

The mechanics and a copy of the proposed FTCPTC rider are attached and discussed in detail in the direct testimony of OG&E witness Cash.

Q. **What is a PTC?**

A. A PTC is a tax credit which reduces the income taxes of qualified tax-paying owners of renewable energy projects based on the electrical output (measured in kilowatt-hours, or kWh) of grid-connected renewable energy facilities. The PTC is an incentive that provides financial support for development of renewable energy facilities. Companies, like OG&E, that generate electricity from wind, or other renewables are eligible for a federal PTC for the first ten years of renewable energy facility's operation. Currently, this PTC incentive is $0.024 per kWh. The Oklahoma state PTC provides a $0.0025 per kWh incentive for facilities placed in service prior to January 1, 2007 and a $0.005 per kWh incentive for facilities placed in service after January 1, 2007. PTCs have been used to reduce the income tax expense component of the Company's cost of service and the PTC's have been used to reduce the cost recovered through individual project riders.

Q. **Were PTCs addressed in OG&E's last rate case?**

A. Yes. In Cause No. 201500273, Final Order 662059, the Commission allowed recovery through the Fuel Clause Adjustment for those PTCs associated with Centennial Wind Farm, expiring in 2017. However, the Commission found that the ratemaking treatment for all subsequently expiring PTCs should be addressed in a subsequent rate case or some other proceeding.

Q. **What treatment is OG&E requesting for Production Tax Credits ("PTCs")?**

A. OG&E is requesting that a rider be established to track the difference between the PTCs customers are receiving in base rates versus the actual PTCs received from the OU Spirit and Crossroads wind farms operations. The purpose of this rider is to account for the variability of PTCs due to the fluctuating wind generation and plan for the scheduled expiration of the PTCs associated with OU Spirit and Crossroads facilities.

Q. **Are there any other reasons for this change?**

A. Yes. As mentioned above, the PTCs are available for the first ten years of production from the facility. Beginning in the eleventh year, the PTCs are no longer available. By implementing this PTC rider, the level of PTCs credited to customers can be adjusted to reflect the actual level of credits being generated.

Q. **Does this change impact the revenue requirement requested in this Cause?**

A. No. There is no impact to revenue requirement in this Cause.

Q. **When do the PTCs for OU Spirit and Crossroads expire?**

A. OU Spirit PTCs expire in December of 2019, while the last of the Crossroads PTCs will expire in March of 2022. By establishing a rider now, the Company can accurately reflect the PTCs being earned each month. If the current treatment of PTCs is left unchanged, once the credits begin to expire, customers will be receiving the benefit, while the Company no longer receives the tax credit. The mechanics of the proposed FTCPTC Rider is fully discussed by OG&E witness Cash.

Q. **Will customers benefit from this change?**

A. Although the intent of this rider is to capture the impact of the expiration of PTCs associated with OU Spirit and Crossroads, customers could benefit, in the short term, when the level of PTCs generated each year are greater than the level estimated in base rates.

<u>Environmental Compliance</u>

Q. **Is OG&E recommending a regulatory asset for Environmental Compliance?**

A. Yes. In Cause No. PUD 201600059, Final Order No. 652208, OG&E's plan to comply with the requirements of Regional Haze by installing dry scrubbers, at Sooner Units 1