

BEFORE THE CORPORATION COMMISSION OF OKLAHOMA
COURT CLERK'S OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA

APPLICATION OF PUBLIC SERVICE)
COMPANY OF OKLAHOMA, AN)
OKLAHOMA CORPORATION, FOR AN)
ADJUSTMENT IN ITS RATES AND)
CHARGES AND THE ELECTRIC)
SERVICE RULES, REGULATIONS AND)
CONDITIONS OF SERVICE FOR)
ELECTRIC SERVICE IN THE STATE OF)
OKLAHOMA)

CAUSE NO. PUD 201500208

**OKLAHOMA INDUSTRIAL ENERGY CONSUMERS' EXCEPTIONS TO
SUPPLEMENTAL REPORT RESPONSE OF THE ADMINISTRATIVE LAW JUDGE**

Oklahoma Industrial Energy Consumers ("OIEC") submits these exceptions to the Supplemental Report Response of the Administrative Law Judge ("ALJ") filed on August 8, 2016 ("Supplemental Report").

EXCEPTIONS TO SUPPLEMENTAL REPORT

The following exceptions are in addition to OIEC's Exceptions, filed on June 14, 2016, to the ALJ's Report and Recommendations filed in this cause on May 31, 2016 ("May 31 Report"). OIEC adopts and incorporates herein its Exceptions filed on June 14, 2016. In addition to its Exceptions filed on June 14, 2016, OIEC excepts to the Supplemental Report as follows:

1. The ALJ's recommendation that the Commission include in base rates costs, including estimated costs, of the Northeastern Unit 3 and Comanche environmental control costs, incurred or estimated to be incurred after the six months following test year end directly conflicts with the ALJ's findings, rationale and recommendations in her May 31 Report that no CWIP be included in the rate base because the Commission has adopted the utility Plant in service balance as of July 31, 2015, which is six months following test-year end. It also directly conflicts with the ALJ's finding at page 150 of the May 31 Report that: "The ALJ does not adopt PSO's proposal to recover the estimated \$44.2M annual costs associated with ECP assets that will not

be in service until later next year by either (1) extending the rate base out for an additional 17-month period beyond the test year end or (2) recovering the costs through the Environmental Compliance Rider ("ECR")."¹ It also conflicts with her finding at page 150 that: "The ALJ also does not adopt Staff's middle-ground position of including CWIP balances at July 31, 2015 for ECP assets. The ALJ finds that there is not sufficient evidence in this case to warrant a departure from the long-standing ratemaking policy." The ALJ did not acknowledge that she changed her position and recommendations. The record in this cause was not re-opened and no new evidence was presented that would justify the ALJ's reversal of her position on this point and the ALJ's recommendation is contrary to law, the Commission's long-standing practice, and the substantial evidence.

2. With respect to regulatory asset treatment for the ECP costs, the ALJ finds at paragraph no. 1 at page 7 of the Supplemental Report that Staff did not file the regulatory asset treatment in its responsive testimony and "[t]he ALJ has not recommended Staff's regulatory asset proposal it for inclusion." In the next sentence, though, the ALJ acknowledges "consideration of the proposal" in her Supplemental Report. Indeed, at page 52, the ALJ states: "Further, regulatory asset accounting should be used to accumulate the additional costs of the environmental controls not recovered in base rates in this case with the recovery of the regulatory asset being determined in a subsequent base rate proceeding." Therefore, it appears that the ALJ did not recommend inclusion of the regulatory asset for ECP investments in her May 31 Report, but does recommend regulatory asset treatment in her Supplemental Report. If

¹ The \$44.2M is the annual revenue requirement associated with the Northeastern 3 and Comanche environmental control upgrades that the ALJ proposes to include in rates in her Supplemental Report.

that is correct, then OIEC excepts to any such recommendation for the same reasons as stated in the preceding paragraph.

3. The ALJ's findings at pages 10-47 of the Supplemental Report are outside the scope of the Commission's Remand Order of July 1, 2016 and should be stricken or rejected. Those findings relate to the prudence of PSO's Environmental Compliance Plan ("Settlement Agreement ECP"). No party sought a clarification or correction of the ALJ's May 31 Report relating to the prudence of PSO's Settlement Agreement ECP, although some parties disagreed with the ALJ's recommendation that the Commission find that the PSO's Settlement Agreement ECP is prudent.

4. In the alternative, the ALJ's findings at pages 10-47 of her report should be rejected because they are contrary to the substantial evidence, as specifically discussed below.

5. In discussing depreciation expense, the ALJ states at page 8 of the Supplemental Report that OIEC should advise the Commission regarding the information OIEC provided relating to depreciation expenses. OIEC advises that the \$30,576,729 the ALJ quantifies as the depreciation expense adjustment is based on her recommended depreciation rates applied to plant balances as of December 31, 2014. Those recommended rates should be applied to actual plant balances as of July 31, 2015, which is the end of six months following test-year end. The application of the recommended rates to the July 31, 2015 plant balances should be part of an updated accounting exhibit that quantifies the impact of all of the ALJ's recommendations.

6. The ALJ states at page 9 of her Supplemental Report: "Adjustments accepted make up \$58,132,537" This amount represents Staff's initial filed position. However, the ALJ did not adopt all of the Staff's suggested adjustments. Therefore, this amount is not correct. The revenue requirement increase that results from the recommendations in the ALJ's May 31

Report less than \$1 million, as evidenced by the Attorney General's updated accounting exhibit, which is Attachment 1 to the Attorney General's exceptions to the supplemental report filed this date.

7. OIEC continues to except to the ALJ's recommendation regarding rate case expense as unclear. OIEC does not object to recovery of rate case expense incurred by the Staff and the AG. However, it is not clear whether the ALJ is recommending recovery of any rate case expense incurred by PSO. To the extent that the ALJ recommends such recovery, OIEC objects for the reasons, and based upon the arguments and authorities, set forth in OIEC's Exceptions filed on June 14, 2016, at pp. 3-4 and 13-16.

8. OIEC could not find any discussion in the Supplemental Report of items four through six listed at the top of page 48 of the Supplemental Report, which the ALJ states "are addressed in subsequent sections".² It is not clear whether the ALJ actually intended to include supplemental findings on these points. OIEC reserves the right to except to any further findings that may be made on these points.

OIEC'S FURTHER RESPONSE TO SUPPLEMENTAL REPORT

1. The ALJ states at page 3 of her Supplemental Report, in response to the AG's Exceptions, that she did not recommend a specific, calculated refund to customers of excessive interim rates charged by PSO during the pendency of this cause because an actual interim rate number was not provided. OIEC had also requested and still requests that the Commission direct PSO to refund to ratepayers, with interest and within 90 days of the Commission's final order in

² Items four through six are described as recovery through depreciation rates of remaining un-depreciated book value of Northeastern Units 3 and 4 by 2026; an amendment to the FCA to include air quality control system consumables; and recovery of Independent Evaluator expenses over a two-year period. (Supplemental Report, p. 48).

this cause, the excessive interim rates that PSO unilaterally implemented on January 15, 2016. (OIEC's Exceptions to May 31 Report, pp. 4, 16-19).

2. The ALJ, at pages 2-3 of her Supplemental Report, responded to OIEC's exception to the ALJ's failure to include a summary of the testimony presented at the evidentiary hearing held in this cause. OIEC included this exception because it is required to be raised by OAC 165:5-13-5(b). OIEC specifically incorporated in its Exceptions to the May 31 Report, OIEC's summary of the testimony presented at the evidentiary hearing that was included at pages 7-48 of OIEC's Proposed Report of the ALJ filed on January 20, 2016. (OIEC's Exceptions to May 31 Report, p. 4, ¶ 7).

3. The ALJ, in her Supplemental Report, stated that it was not necessary for her to attach an updated accounting exhibit, which is contrary to the Commission's Remand Order, which provided that "the ALJ shall attach an updated accounting exhibit." It is not known whether there are issues pertaining to any such accounting and, therefore, OIEC reserves its right to supplement its exceptions, if necessary, once an updated accounting exhibit is provided.³

ARGUMENTS AND AUTHORITIES IN SUPPORT OF EXCEPTIONS TO SUPPLEMENTAL REPORT

- I. **The ALJ's new recommendation that the Commission include in base rates actual costs of the Northeastern Unit 3 and Comanche as of January 31, 2016, and the estimated costs of Comanche through its in service date of June 2016 is in conflict with the findings in her May 31 Report and is contrary to law.**

In her Supplemental Report, the ALJ recommends that the Commission "adopt the base rate approach and take the actual costs of the Northeastern Unit 3 and Comanche environmental

³ OIEC, at pages 19-20 of its Exceptions to the May 31 Report, noted that PSO had failed to comply with the ALJ's direction that PSO provide a revised costs of service that incorporated each of the adjustments and recommendations set forth in the ALJ's Report so that an accurate revenue requirement could be determined. OIEC reserved its right to supplement its exceptions when such revised cost of service information was provided.

controls as of January 31, 2016, as well as estimates of the Comanche cost to be incurred through its in service date in June 2016, to formulate the base rates.” Supplemental Report, p. 52 (emphasis added). The test year ended on January 31, 2015, and the six-month post test year period ended on July 31, 2015. Thus, the ALJ is recommending cost recovery, including estimated costs, of facilities that were not in service within six months following test-year end.

The ALJ recommended, in her May 31 Report, that no CWIP be included in the rate base because the Commission has adopted the utility Plant in service balance as of July 31, 2015, which is six months following test-year end. The ALJ further found that it was not appropriate or necessary to extend CWIP for any portion of the ECP costs because approximately \$44 million of environmental investments will not be in service at the end of the six-month, post-test year period. The ALJ's findings in her May 31 Report on this point are very clear. Specifically, the ALJ recommended:

- “Second, the ALJ recommends that the Commission find that PSO should not be allowed to recover any costs for its Comanche Dry Low NOx burners until the investments are in service. This condition also includes rejection of the test-year waiver.” (May 31 Report, p. 148) (emphasis added).
- “Since the Commission has adopted the Utility Plant in service balance as of July 31, 2015, the ALJ finds that no CWIP should be included in the rate base of PSO. No adjustment is necessary to reflect this decision, since the booked utility plant in service as of July 31, 2015, captures all CWIP requested for those plants that were actually in service as of July 31, 2015.” (May 31 Report, p. 149).
- “However, the Commission has consistently held that projects still in CWIP accounts at the date of the six-month cut-off have been excluded. . . . In short, this treatment has been consistently adopted because it has the effect of including in rate base all projects actually complete and in service within the 6-month post test year period.” (Emphasis added) (May 31 Report, p. 149).
- “Under the evidence presented by PSO, neither the Northeastern Unit 3 nor the Comanche plant has a completion date that was imminent on July 31, 2015, the conclusion of the 6-month cut-off. Both plants have estimated completion dates in 2016, and it is clear from PSO's application that the Comanche plant will not be placed in service until at least June 2016, which is 17 months beyond test-year

end. . . . The Commission finds that these estimated completion dates do not justify CWIP recovery. (Emphasis added). (May 31 Report, pp. 149-150).

- The ALJ does not adopt PSO's proposals to recover the estimated \$44.2M annual costs associated with ECP assets that will not be in service until later next year (May 31 Report, p. 150).

As further found by the ALJ in her May 31 Report: "PSO may, if necessary and if it so chooses, bring a general rate proceeding to recover the ECP costs once the facilities have been placed in service, if the utility believes it is earning an insufficient return at that time." (May 31 Report, p. 150).

OIEC pointed out in its exceptions that the ALJ's recommendation that the Commission include \$135,075,111 in environmental control investment in rate base at page 154 of her Report was inconsistent with the above findings. The ALJ, in her Supplemental Report, does not acknowledge the inconsistency, but, instead, makes new findings, without explaining why she changed her mind.

The ALJ's new findings are contrary to law and the evidence in this cause. PSO witness Sartin admitted that the environmental investments that were not in service, even as of the date of the hearing in this cause, were not currently used and useful. Sartin Cross, 12/8/15 Tr. at 105. Mr. Sartin also testified that PSO intentionally filed this proceeding before the facilities were placed in service. (12/8/15 Tr. at 175-176). Mr. Sartin further testified that he did not know of any instance where the Commission has authorized investments in rate base when the plant was not used and useful and in service until after the six-month, post-test year end. (12/8/15 Tr. at 148).

Staff witness Roach testified that Staff was opposed to recovery of costs of the Comanche plant until it was actually placed in service. (12/10/15 partial Tr. at 28). Mr. Roach further

testified that Staff was against recovery of costs incurred beyond six months after test year-end.

Id.

Authorizing inclusion in rate base of costs of facilities that are not yet in service is contrary to the Commission's long-standing practice, as acknowledged by PSO witness Sartin, and it is contrary to law. Generally, Oklahoma law allows utilities to recover prudently incurred investments that are placed in service during the test year, but recovery is not allowed for expenditures for facilities that will not be placed in service within the test year or within six months after the end of the test year. 17 Okla. Stat. § 284; *Turpen v. Oklahoma Corporation Commission*, 1988 OK 126, 769 P.2d 1309, 1316 n. 7; *Southwestern Public Service Co. v. State*, 1981 OK 136, ¶ 13, 637 P.2d 92, 97; *Arkansas Louisiana Gas Co. v. Sun Oil Co.*, 1976 OK 89, 554 P.2d 14, 15; *Public Service Co. v. Oklahoma Corporation Commission*, 1983 OK 124, 688 P.2d 1274, 1276. This rule exists for public policy reasons. Oklahoma ratepayers should only be required to pay rates based upon the value of a public utility's investments that are used and useful in providing service to the public at the time the rates are set. *Turpen v. Oklahoma Corporation Commission*, 1988 OK 126, 769 P.2d 1309, 1316 n. 7 (A public utility's rate base is "based upon the value of the property used and useful in [the utility's] public service business at the time the inquiry was made.") (emphasis added), quoting *Southwestern Public Service Co. v. State*, 1981 OK 136, 637 P.2d 92, 97.

The Legislature modified the above principles only to the extent of requiring the Commission to give effect to all known and measurable changes that occur or are reasonably likely to occur within six months of the end of the test year. 17 O.S. § 284. Section 284 provides:

In its review and examination of an application by a utility to change its rates and charges pursuant to Sections 137, 152 or

158.27 of Title 17 of the Oklahoma Statutes, and in any order resulting therefrom, *the Corporation Commission shall give effect to known and measurable changes occurring or reasonably certain to occur within six (6) months of the end of the test period upon which the rate review is based.* (Emphasis added).

Therefore, OIEC respectfully submits that the ALJ's Supplemental Report is in error and OIEC requests that the Commission find that PSO may not recover in this proceeding any costs attributable to facilities that were not in service by July 31, 2015, which is within six months after the end of the test year.

II. To the extent the ALJ recommends use of a regulatory asset for ECP investments, the ALJ's recommendation is contrary to the substantial evidence and the law.

The ALJ did not approve the use of a regulatory asset or deferred accounting in her May 31 Report. At page 7 of her Supplemental Report, the ALJ states that Staff witness Thompson did not file the regulatory asset proposal in Staff's Responsive Testimony. The ALJ further found: "The ALJ has not recommended it for inclusion." Thus, it appears that the ALJ is not recommending use of a regulatory asset for PSO's ECP. However, the ALJ follows the quoted sentence with the following statement, which renders her recommendation unclear: "The ALJ is acknowledging consideration of the proposal with the exception of the recovery." (Supplemental Report, p. 7).

Denial of the use of a regulatory asset is consistent with ALJ's findings in her May 31 Report is consistent with the authorities discussed in Proposition I above. It is also consistent with testimony of OIEC witness Mark Garrett, who recommended application of strict application of the six-month post-test year cut-off. (12/21/Tr. at 143-144, 147, 150).

III. The ALJ's findings addressing the prudence of PSO's Settlement Agreement ECP is beyond the scope of the Remand Order and should be Stricken.

PSO filed a Motion to Remand, arguing that certain portions of the ALJ's Report should be clarified and corrected. The Commission, in its Remand Order entered on July 1, 2016, found that other parties made similar assertions. The Commission remanded the cause to the ALJ "to review the clarifications and corrections asserted in the motion" and to issue a supplement, as appropriate. (Order No. 653915, p. 2).

No party sought clarification or correction of the ALJ's findings and recommendation that the Commission find that PSO's ECP is prudent, although exceptions to the finding were filed by the AG. Nevertheless, the ALJ spent 38 pages of her Supplemental Report discussing the prudence of PSO's Settlement Agreement ECP. The ALJ's Supplemental Report, insofar as it discusses the prudence of PSO's ECP is outside the scope of the Remand Order and should be stricken and disregarded.

IV. Alternatively, the findings of the ALJ in the Supplemental Report relating to prudence of the ECP should be rejected.

Many of the ALJ's findings and statements at pages 10-47 of the Supplemental Report are in error, and OIEC takes exception thereto.

A. The Coal Retrofit Option is the least cost option by a significant margin.

OIEC advocated at the hearing for the least cost option for environmental compliance, which was the coal retrofit option. The ALJ found at page 32, ¶ d) of the Supplemental Report that retrofitting both units was only "marginally" the least cost option and that there was no material, significant difference among the base case analyses. The ALJ further found that there was only a 1% to 4% difference between the various options. Those findings are contrary to the substantial evidence in this cause.

The evidence, as found by the ALJ, was that retrofitting both coal units with scrubbers was the least cost option. That option, based on PSO's own calculations, was \$1.86 billion less costly over the life of the option than was the Settlement Agreement ECP chosen by PSO and recommended by the ALJ. (Norwood Surrebuttal, 12/18/15 a.m. Tr. at 18, lines 11-15). An amount of nearly \$2 billion over the life of the units (the "nominal" basis); which is \$278 million on a present value basis, is clearly material and significant. (Norwood Surrebuttal, 12/18/15 a.m. Tr. at 30). As stated by OIEC witness Norwood:

I hope we're not getting to the point in Oklahoma where the idea that \$2 billion in nominal savings, or several hundred million dollars, on a present-value basis . . . is not something to consider, you know, when you're evaluating a major investment.

Id.

With respect to the percentage difference between the coal retrofit option and the Settlement Agreement ECP, PSO's evidence was that there was a 3.3% difference between those options. The 3.3% number is incorrect under the evidence. PSO calculated the percentage savings by including all system costs, including costs that have nothing to do with environmental compliance and are not affected by any environmental compliance plan. (Norwood Surrebuttal, 12/18/15 a.m. Tr. at 33). This approach is similar to a utility understating the impact of base rate change by including fuel costs, which are not collected through base rates, in the rate increase calculation. The proper comparison is to compare savings due to the difference in the plans, divided by the costs incurred for those plans; which will provide the difference in the costs incurred as a result of each plan (such as fuel costs, capital costs, operating costs). *Id.* at 35.

When properly calculated, the difference in costs to ratepayers between the coal retrofit option and the EPA Settlement Agreement ECP is approximately 14%. (Norwood Rebuttal Testimony, pp. 14-15). This is clearly a material and significant difference. *Id.*

B. The use of nominal values, which are the actual costs over the life of the project, is proper.

The ALJ faults OIEC witness Norwood for using nominal costs. (Supplemental Report, p. 33, ¶ 5.a). Both the ALJ and PSO ignore the fact that Mr. Norwood used both nominal and present-value costs and that in most cases, according to PSO's own analysis, the coal retrofit option was the lowest reasonable cost alternative for ratepayers, both on a nominal and present value basis. (Norwood Responsive Testimony filed Oct. 14, 2015, p. 4; Norwood Surrebuttal, 12/18/15 a.m. Tr. at 16).

Moreover, use of nominal costs (in addition to present-value costs) is proper because those are the costs that the ratepayers actually pay; ratepayers do not have the option of paying present value rates. (Norwood Surrebuttal, 12/18/15 a.m. Tr. at 16). The nominal, \$1.86 billion difference in costs between the coal retrofit option and the EPA Settlement Agreement ECP are the additional costs that ratepayers will actually pay over time. *Id.* PSO itself has recognized that nominal costs are relevant as shown by the fact that PSO itself used both nominal and present-value calculations in its own 2015 IRP. *Id.*

C. The analysis of cost difference must be done over the life of the plans to determine the impact of the plans on ratepayers.

The ALJ found it notable that Mr. Becker, in his analysis using present values, found that PSO's ECP was lower cost than the retrofit option during the first 13 years of the plan. (Supplemental Report, p. 34). The ALJ ignored the evidence that PSO's ECP plan costs were significantly higher than the coal retrofit option during the last 15 years of the plan, even though the future savings were heavily discounted through PSO's present value calculations. The ALJ clearly erred by ignoring the entire life of the plan in determining the true cost differences between the environmental compliance options. As testified to by Mr. Norwood:

And I just point out one thing is when you do a study of this sort, when you're looking at a long-term resource, you don't look at the first 10 years, the first 13 years of the resource, you look over the full life of the resource. And when you do that in this case, by the Company's own calculations, you come up with a \$1.86 billion advantage of the coal retrofit option over this settlement. And I don't think you can de-emphasize that or say that's not a significant number; it's a very significant number.

(12/18/15 a.m. Tr. at 17-18).

The ALJ also erred in finding, on page 34 of her Supplemental Report, that PSO showed that the full retrofit plan would have increased PSO's compliance plan annual customer rate impact by \$75 million, compared to PSO's ECP. This testimony took into account only the first-year impacts. (Norwood Surrebuttal, 12/18/15 a.m. Tr. at 10-11; Norwood Responsive Testimony, Ex. SN-4). PSO acknowledged that it did not calculate customer rate impacts for the remaining 30 years of the EPA Settlement Agreement. *Id.* at 11. It is clearly misleading to look at only first-year impact, particularly when the major impacts of the EPA Settlement plan were anticipated to occur when the second coal unit was retired in 2026. *Id.* The evidence established that the impact of PSO's EPA Settlement Agreement ECP over time will be a large increase in fuel expense--amounting to nearly \$2 billion--when compared to the coal retrofit alternative, and the bulk of those additional fuel costs will be disproportionately allocated to PSO's large customers, who use high amounts of energy. *Id.* at 11-12.

D. The ALJ's finding that the coal retrofit option is too risky due to potential environmental regulations is contrary to the substantial evidence and to the Commission's recent order approving a similar coal retrofit option.

The ALJ made findings in several places that the coal retrofit option was too risky because of the early retirement of coal units and the possible economic obsolescence of coal units due to environmental regulations. Her findings included findings that OIEC witness Norwood ignored these risks in recommending the least cost option, which is the coal retrofit

option and that the fuel diversity provided by the coal unit was outweighed by these risks. (Supplemental Report, pp, 35-40). The ALJ's findings are based upon the testimony of Dr. Roach that future regulations may force early retirement of PSO's Northeastern coal units. However, Dr. Roach admitted that it is not possible to accurately predict the nature or compliance cost of future environmental regulations on PSO's coal plants at this time and, therefore, he has performed no quantitative analysis to support his opinion that future regulations would likely lead to early retirement of PSO's coal units. (Norwood Rebuttal, p. 8; Ex. SN-R1). Dr. Roach also testified that he had not done an analysis to determine whether proposed or potential environmental regulations would be passed and whether they would impact scrubber retrofits. (12/10/15 partial Tr. at 19). Therefore, Dr. Roach's opinion is mere speculation.

Further, Dr. Roach's opinion (and, thus the ALJ's finding in this regard) are contrary to the testimony of PSO's parent and affiliate companies in other proceedings. During the same time frame that PSO was evaluating the coal retrofit option, AEP witnesses presented testimony in regulatory cases in Arkansas and Virginia that coal plants similar in size and vintage to the Northeastern coal units are likely to be able to operate for 60 years or more if equipped with scrubbers. (Norwood Rebuttal Testimony, p. 9; Ex. SNR-2). Also in this same general time frame, PSO's affiliate, Southwestern Electric Power Company, obtained approval from Texas regulators to construct the new \$2 billion Turk coal-fired generating unit. (Norwood Rebuttal Testimony, p. 9). If AEP truly felt that coal plants were at jeopardy for early forced shutdown due to increasing future environmental regulations, it hardly seems likely that it would have invested \$2 billion for a new coal plant, and certainly such environmental risks are no greater in Oklahoma than they are in Arkansas, Texas or Virginia.

Also in the same general time frame, OG&E filed an application in Cause No. PUD 201400229, seeking permission to retrofit two of its five coal-fired generating units with scrubbers and to continue operating a third coal unit that does not require a scrubber as part of OG&E's proposed ECP. The coal-fired units involved in Cause PUD 201400229 are similar in size and vintage to PSO's Northeastern coal units. (Norwood Rebuttal Testimony, p. 9). OG&E's economic studies indicated that retrofitting coal units was the lowest reasonable cost compliance option for its customers, as PSO's economic studies also showed in this case. Dr. Roach filed testimony on behalf of the OCC Staff in OG&E's Cause No. PUD 2014000229 in which he recommended approval of OG&E's ECP. In his testimony, Dr. Roach noted that OG&E's compliance plan appropriately offered a diversified portfolio of actions in the face of uncertainty that exists with regard to future environmental regulations and natural gas prices. (Norwood Rebuttal Testimony, p. 10, citing Dr. Roach's Responsive Testimony, pp. 8, 11, in Cause No. PUD 201400229). The environmental risk faced by OG&E's decision to retrofit and continue operations of three coal fired plants is no greater than the environmental risk PSO faced if it had retrofitted and continued operating its two coal plants.

Finally, the Commission's findings pertaining to the risk of early retirement of the Northeastern Units is in conflict with the Commission's findings in Order No. 652208 entered in Cause No. PUD 201600059 on April 28, 2016. OG&E requested the Commission in Cause PUD 201600059 to approve OG&E's request to install dry scrubbers at OG&E's Sooner Generating Facility. The Commission granted OG&E's application by a final order, Order No. 652208. The Commission found that the retrofit and continued operations of three of OG&E's coal-fired generating units, two equipped with scrubbers, would provide continued fuel diversity. The Commission further found: "Finally, the plans that include replacement of coal with new gas-

fired combined cycle plants are consistently the highest cost cases and also expose the Company to high and volatile natural gas prices.” Order No. 652208, p. 11, ¶ 2.

The ALJ's findings in the last paragraph that PSO has addressed concerns about fuel diversity are not supported by the evidence. The ALJ relies on Mr. Fate's testimony that PSO will supply 20% of its energy requirements with wind energy. However, PSO had already planned to do that, and the Company's acquisition of additional wind energy is not affected by its decision to retrofit or retire its coal units. Under the ALJ's recommendation, PSO will lose the diversity provided by coal generation. Under PSO's EPA Settlement Agreement ECP, by 2017, the first year following retirement of the Northeastern Unit 4, coal fired generation is forecasted to drop from the current level of approximately 40% to approximately 20% of PSO's total system energy supply. (Norwood Responsive Testimony, p. 18). By 2027, the first year after the second Northeastern Unit is to be retired, PSO forecasts that coal-fired generation will represent only approximately 3% of the total system energy supply, while natural gas-fired generation and PSO market energy purchases will increase to approximately 73% of total system energy. *Id.*

Fuel diversity lowers and stabilizes energy costs to customers. (Norwood Responsive Testimony, p. 19). Further, fuel diversity, through the inclusion of coal, provides a hedge in case gas prices go up in the future. (Norwood Surrebuttal, 12/18/15 a.m. Tr. at 40). In fact, PSO's position in this cause conflicts with PSO's own explanation of the importance and value of fuel diversity in its 2014 Fuel Supply Portfolio and Risk Management Plan. (Norwood Responsive Testimony, p. 19).

OIEC's evidence was that the value of maintaining PSO's Northeastern coal units would be approximately \$1 billion for each \$1 per MMBtu increase in the price of natural gas over the

next 25 years. (Norwood Responsive Testimony, pp. 19-20). Even PSO's witness, Mr. Smead, acknowledged that the diversity provided by coal provides a significant benefit, which he claims is \$500 million, rather than \$1 billion. (Norwood Surrebuttal, 12/18/15 a.m. Tr. at 38).

E. The ALJ's finding that PSO analyzed compliance alternatives is not supported by substantial evidence.

The ALJ's finding at page 40 of the Supplemental Report that PSO analyzed compliance alternatives including cost of replacement power for the new load, is contrary to the evidence. The evidence demonstrated that although PSO's actual peak demand increased by 621 MW from 2002 to 2011; for the EPA Settlement analysis, PSO assumed that the peak demand of PSO's system in the year 2031 would be approximately 150 MW lower than the actual peak demand in the summer of 2012. (Norwood Responsive Testimony, p. 40; Ex. SCW-1). By using such an extreme low peak demand forecast for its EPA Settlement analysis, PSO unreasonably understated the need for replacement capacity resulting from the retirement of the Northeastern coal units in 2016 and 2026 under the Settlement. (Norwood Responsive Testimony, p. 41).

F. The ALJ's findings regarding the inclusion of the carbon tax in modeling and the impact of the Clean Power Plan are contrary to the evidence.

The ALJ's findings at page 36 of the Supplement Report that inclusion of a carbon tax in modeling is appropriate are contrary to the substantial evidence. PSO did not model a scenario without a carbon tax. (Norwood Rebuttal, pp. 10-13). AEP has access to models that would have allowed PSO to model a scenario without carbon and, in fact, AEP regularly, in other cases similar to this cause, has modeled alternatives under scenarios without carbon taxes and has shown what the economic effect of including no carbon taxes is. (Norwood Surrebuttal, 12/18/16 a.m. Tr. at 20). That effect is that it greatly increases the value of retrofitting and retaining operations of coal assets relative to the other alternatives. *Id.* Without a carbon tax,

there is a \$1.7 billion present value difference; i.e., the EPA settlement is \$1.7 billion more expensive than what PSO has suggested on a present-value basis. *Id.* at 20-21.

The ALJ's findings that the Clean Power Plan ("CPP") may contribute to early retirement of the coal-fired generating units likewise are not supported by the substantial evidence. Dr. Roach did not consider whether PSO could meet the mass-based carbon compliance goals of the CPP, which require a 23% reduction in total CO₂ mass emissions by 2030; instead he focused on the CO₂ rate-based compliance goals. (Norwood Rebuttal, p. 10). The evidence established that the cost of compliance with the final CPP's mass-based carbon emission goals appears to be far lower than the cost implied by the carbon tax proxy included in PSO's economic analysis of the coal retrofit alternative. In other words, the final CPP reflects a significantly lower cost of compliance with carbon emissions regulations than assumed by PSO's economic analysis of the coal retrofit option and, therefore, decreases the chances that the Northeastern coal units would be forced into early retirement. (Norwood Rebuttal, pp. 10-11). PSO's own information demonstrated that PSO would achieve a 35% reduction in CO₂ emissions from the 2012 base year emissions level for its Oklahoma system by 2030, if PSO implemented the coal retrofit compliance plan. (Norwood Rebuttal, pp. 12-13). This also means that there is no justification for the \$3.3 billion of carbon taxes that PSO included in its analysis of the coal retrofit alternative as a proxy for the cost of compliance with future carbon regulations. (Norwood Rebuttal, p. 13).

PSO, unlike OIEC witness Norwood, did not run an analysis showing the removal of carbon costs in its analysis of the coal retrofit and other ECP options. Instead, the only information provided on this topic is the analysis provided by OIEC witness Norwood. PSO's carbon tax assumption overstates the cost of complying with carbon standards under the final

CPP. For example, under the final CPP, the EPA's carbon emissions standards for Oklahoma indicate that coal-fired generation would need to be reduced by approximately 50% from the level produced in 2012. Under this requirement, coal-fired energy would drop from approximately 50% of total energy generated in Oklahoma in 2012 to approximately 25% of total energy supply by 2030. However, under the EPA Settlement, PSO has agreed to reduce coal-fired generation to approximately 3% of the forecasted energy supply on the Company's system by 2026, which far exceeds the CPP requirement.

PSO witness Ground testified that he is PSO's regulatory and environmental expert. However, Mr. Ground did not provide testimony in response to OIEC's testimony regarding the impact of the clean power plant on the environmental compliance options, nor did he do an analysis of potential environmental regulations affecting natural gas or wind generating facilities. While Mr. Ground did do an analysis of environmental regulations regarding coal, he did not do an analysis of potential environmental regulations impacting natural gas or natural gas generating units.

G. The ALJ's Finding that the timing of PSO's Settlement saved ratepayers money is not supported by the evidence.

The ALJ found that Mr. Norwood incorrectly asserts that PSO's decision to enter into the Settlement Agreement was premature. (Supplemental Report, p. 36). The ALJ further found that PSO's actions resulted in cost savings. *Id.*, p. 37. However, as demonstrated above, the record shows that the PSO settlement is more costly than the scrub retrofit plan both on a nominal cost basis and on a present value basis.

According to PSO's own analyses immediately before entering into the EPA Settlement Agreement ECP and thereafter, the EPA Settlement Agreement ECP was and continues to be forecasted to be much more costly and risky than the coal retrofit option over a wide range of

scenarios evaluated by PSO. Under PSO's August 2012 base case analysis just prior to execution of the EPA Settlement, the nominal cost of the EPA Settlement was forecasted to be approximately \$1.9 billion higher (\$278 million higher on a present value basis) than the Coal Retrofit alternative.

V. **The ALJ's recommendation regarding depreciation expense should be applied to plant balances as of July 31, 2015, which is the end of six months following test year end.**

At paragraph 5 of its motion for remand, PSO raises questions regarding the depreciation expense finding in the ALJ's May 31 Report. Specifically, PSO asserts that the depreciation findings at page 150 of the ALJ's May 31 Report are inconsistent with the depreciation findings at pages 164-166. PSO states:

On page 150 of the Report "the ALJ recommends that the Commission find an adjustment of \$23,014,546 to reduce PSO's proposed depreciation expense." This finding conflicts with the statement found on page 166 of the Report that "the combined impact of the various above noted issues results in \$30,576,729 reduction in annual depreciation expense based on the plant as of December 31, 2014, as set forth on the applicable portions of Exhibit JP-1 and Exhibit DG-D-1 thru DG-D-4 and DG-G-14." In addition depreciation expense is annualized using approved depreciation rates and approved plant in service. It appears the ALJ recommended using December 31, 2014, plant in service balances rather than July 31, 2015, plant in service balances. This would be a departure from the past Commission practice of going six-months post test year.

In her Supplemental Report, the ALJ states that OIEC should advise the Commission on the information provided in her report on depreciation issues. (Supplemental Report, p. 8). While it may be unclear what the depreciation language at page 150 means, the ALJ's comprehensive findings on depreciation expense issues are set forth in her May 31 Report starting at the bottom of page 164 and continuing through the top of page 166. The comprehensive findings on depreciation issues in the May 31 Report are both clear and accurate.

The ALJ makes specific findings as to Production Plant, Transmission Plant, Distribution Plant and General Plant. With respect to Production Plant issues, she adopts the recommendations of OIEC witness Mr. Jacob Pous. Her Production Plant findings for (1) Northeastern Units 3&4 Life Spans, (2) Production Plant Net Salvage, (3) Interim Retirements and (4) Production Plant Interim Net Salvage are each taken directly from the recommendations of Mr. Pous in his Summary Testimony. With respect to Transmission Plant she also adopts the recommendations of Mr. Pous. With respect to Distribution Plant she adopts the recommendations of Staff witness David Garrett. With respect to General Plant, she adopts the recommendations of Mr. Garrett for life spans and Mr. Pous for salvage value.

The ALJ quantifies the impacts of her recommendations as \$30,576,729 based on plant balances at December 31, 2014. However, PSO is correct that the depreciation rates the ALJ adopts in her report for Production, Transmission, Distribution and General plant will have to be applied to actual plant balances at July 31, 2015, the 6-month cutoff date. OIEC recommends that Staff include a depreciation schedule that applies the ALJ's recommended depreciation rates to July 31, 2015 plant balances as part of its Compliance Accounting Exhibit that calculates the impacts of all of the ALJ's recommendations on the Company's revenue requirement.

VI. The ALJ's finding of a revenue requirement of \$58,132,537 is in error.

The ALJ recommended at page 155 of the May 31 Report that "the Commission find that based on the results of PUD's inputs to PSO's COSS, retail customers would be allocated an increase of \$58,132,537, excluding miscellaneous revenue, while the federal jurisdiction will be allocated a total \$1,235,810. At paragraph 9 of its motion for remand, PSO raised questions regarding language in the May 31 Report that seems to indicate that the impact of the ALJ's recommendations would result in a revenue requirement increase of \$58,132,537.

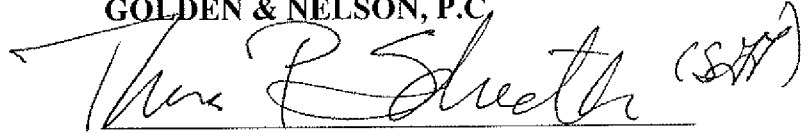
In response, the ALJ states at page 9 of her Supplemental Report: "Adjustments accepted make up \$58,132,537." This statement is incorrect. The \$58,132,537 number comes from Mr. Schwartz's direct rate design testimony and it reflects the revenue requirement increase that results from Staff's adjustments in Staff's Accounting Exhibit of \$31,543,351, a change in other revenues of \$4,511,027, and the increase in base rates that results from transferring the System Reliability Rider costs from rider recovery into base rates of \$22,078,159. However, the ALJ did not recommend all of Staff's adjustments. The \$58,132,537 does not represent the results of the ALJ's recommendation in her May 31 Report. In fact, the revenue requirement increase that results from the recommendations contained in the ALJ's May 31 Report is less than a \$1 million increase in rates, not a \$58 million increase. The Commission was correct in requesting, in its Remand Order, that the ALJ file an updated Accounting Exhibit that quantifies the impacts of the ALJ recommendations. This exhibit is still needed.

CONCLUSION

OIEC requests that the Commission not adopt those findings and recommendations in the May 31 Report and in the Supplemental Report to which OIEC has excepted, and that the Commission adopt the recommendations of OIEC with respect to such findings. OIEC requests that all other findings and recommendations of the ALJ be confirmed and adopted. OIEC further requests that the Commission clarify that PSO's rate case expenses are not recoverable in this cause. OIEC further requests that the Commission order a refund of interim rates collected by PSO in excess of the revenue requirement ultimately ordered by this Commission, with interest, with such refund to occur within 90 days of the Commission's issuance of a final order in this cause.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that on August 16, 2016, a true and correct copy of the above and foregoing was mailed, postage prepaid, faxed, e-mailed or hand-delivered to:

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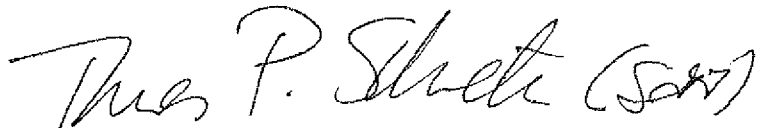
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A handwritten signature in black ink that reads "Thomas P. Schroedter (S&W)". The signature is written in a cursive style and is positioned above a horizontal line.

Thomas P. Schroedter