FILE

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to RC §4928.143 in the Form of an Electric Security Plan.	:	Case No. 08-935-EL-SSO

- - -

DEPOSITION

of Frank C. Graves, taken before me, Maria DiPaolo Jones, a Notary Public in and for the State of Ohio, at the offices of FirstEnergy, 76 South Main Street, Akron, Ohio, on Tuesday, September 23, 2008, at 9:09 a.m.

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1 APPEARANCE:

2 Mr. Mark A. Hayden
FirstEnergy
3 76 South Main Street
Akron, Ohio 44308
4
On behalf of the FirstEnergy companies.
5

6 APPEARANCES VIA SPEAKERPHONE:

7 Janine L. Migden-Ostrander
Ohio Consumers' Counsel
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Assistant Consumers' Counsel
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On behalf of the Residential Customers
11 of the FirstEnergy companies.

12 Chester, Willcox & Saxbe, LLP
By Mr. Mark S. Yurick
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On behalf of The Kroger Company.
15

Schottenstein, Zox & Dunn Co., LPA
16 By Mr. Andre T. Porter
250 West Street, Suite 700
17 Columbus, Ohio 43215

18 On behalf of the city of Cleveland.

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1 Tuesday Morning Session,
2 September 23, 2008.
3 - - -
4 STIPULATIONS
5 It is stipulated by and among counsel for the
6 respective parties that the deposition of Frank C.
7 Graves, a witness called by the Ohio Office of
8 Consumers' Counsel under the applicable Rules of
9 Civil Procedure, may be reduced to writing in
10 stenotypy by the Notary, whose notes thereafter may
11 be transcribed out of the presence of the witness;
12 and that proof of the official character and
13 qualification of the Notary is waived.
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1 Tuesday Morning Session,
2 September 23, 2008.
3 - - -
4 MR. SMALL: This is case 08-935 regarding
5 FirstEnergy's electric security plan; it was noticed
6 by multiple parties and agreed to by FirstEnergy
7 counsel as far as date and time and method of taking
8 the deposition.
9 We have a few counsel on the phone. If
10 there are any objections to the court reporter's
11 credentials, OCC arranged for the court reporter
12 today, if there are any objections to her
13 credentials, please make yourself heard at this time,
14 otherwise, I will assume that the matter is
15 stipulated.
16 Mark?
17 MR. HAYDEN: Yes.
18 MR. SMALL: Do you agree to the
19 credentials?
20 MR. HAYDEN: I'm sorry?
21 MR. SMALL: No problems with the method
22 of taking deposition?
23 MR. HAYDEN: Oh, no. No. No.
24 MR. SMALL: All right. Can we have the

witness sworn in, please.

- - -

FRANK C. GRAVES

being by me first duly sworn, as hereinafter certified, deposes and says as follows:

EXAMINATION

By Mr. Small:

Q. Mr. Graves, my name is Jeff Small. I represent the residential customers of the FirstEnergy companies. Well, let me go through a few formalities first.

A. Okay.

MR. SMALL: Why don't we take abbreviated appearances. Again, this is Jeff Small representing the office of the Ohio Consumers' Counsel.

THE WITNESS: Okay, nice to meet you.

MR. HAYDEN: Mark Hayden on behalf of the companies.

MR. SMALL: I think we have a couple counsel on the phone.

MR. PORTER: Andre Porter for the city of Cleveland.

MR. YURICK: Mark Yurick, Chester, Willcox & Saxbe for The Kroger Company.

1 Q. (By Mr. Small) Mr. Graves, you will be
2 asked questions by me and perhaps by other attorneys
3 who are on the phone today. The normal instructions
4 are for the witness to speak audibly so that the
5 court reporter can take down your responses; this is
6 especially important since we're doing it
7 telephonically, I can't see your nods and so forth,
8 so we're going to have to be audible. Do you
9 understand?
10 A. I do.
11 Q. Thank you very much.
12 Please ask the attorney asking the
13 question if you don't understand. And let us know if
14 you need anything, a break or something like that
15 today as we progress. Again, we're on the phones
16 and, therefore, a little bit difficult to see these
17 things, so just let us know if you need something as
18 we go along.
19 A. Okay. Thank you.
20 Q. You stated that you have your testimony
21 before you?
22 A. I do.
23 Q. All right. I'm going to ask a few
24 questions and basically I'm going to go through

1 portions of your testimony, so would you please start
2 off by turning to page 3 of your testimony?
3 A. Okay, I'm on it.
4 Q. All right. Your testimony has many
5 similar elements -- subject matter as other prefiled
6 testimony in this case by Mr. Scott Jones. Have you
7 read Mr. Jones' testimony?
8 A. Yes.
9 Q. Have you discussed your work with
10 Mr. Jones?
11 A. Not prior to filing my report. I did
12 discuss it some yesterday with him.
13 Q. Okay. So that was the first -- was that
14 the first contact between the two of you regarding
15 this case?
16 A. Yes, sir.
17 Q. All right. Would you please turn to page
18 7 of your testimony.
19 A. Okay, I'm on it.
20 Q. Around line 8 on page 7 you discuss
21 customer switching and mitigation of risk. Do you
22 see that?
23 A. Yes.
24 Q. Now, the risk that you assess in your

1 testimony is based on FirstEnergy's proposal in this
2 case or their -- it appears to be based on the MRO
3 proposal that FirstEnergy has; is that correct? Do
4 you know what I mean?
5 A. I think so. It is generally based on
6 the -- is it addressing the question of what kind of
7 price one might expect from the MRO. It's not
8 narrowly designed to be tied to their exact method of
9 procurement, but rather to the broader question of
10 what would a full-requirements outsourcing of the SSO
11 obligation probably cost at this time.
12 Q. Okay. Now, the risk that you assess in
13 your testimony, that risk would be different if we
14 had, for instance, modified the rules upon which
15 customers could switch to alternative suppliers,
16 wouldn't it?
17 A. Yes. I am assuming that customers are
18 allowed to switch and, therefore, I have included
19 risk premiums that were observed in other situations
20 where customers were also allowed to switch, and if
21 that were not the case, then there would be different
22 methods required to estimate the cost.
23 Q. Are you familiar with the discussions in
24 proceedings before the Public Utilities Commission

1 concerning minimum stays where individuals would not
2 be, at least not completely free to switch back and
3 forth between suppliers?
4 A. Only very generally. I don't know the
5 details of what's being considered or how likely such
6 decisions might be.
7 Q. And changing those rules for switching
8 could have an effect on the risk and, therefore, on
9 the price for the bids; is that correct?
10 A. In principle, certainly. It matters
11 considerably what the degree of change is and how
12 much it differs from the modest restrictions that
13 were also in place in some of the other venues where
14 I derived my data from.
15 Q. And in fact, that is the subject matter
16 on page 17 of your testimony where you discuss I
17 believe at line 9 a charge that would be applied to
18 customers who wish to leave standard service offer.
19 That is a switching rule that changes the switching
20 risk, correct?
21 A. Yes, that is a -- I understand that
22 particular rule to be one that discourages prodigal
23 customers from returning unless they're willing to
24 pay a stand-by charge, and that somewhat discourages

1 the switching behavior which I incorporate in my
2 recommendation for choosing the medium level of risk
3 in the adjustments.
4 Q. Now, currently the tariffs of the
5 FirstEnergy companies have tariffs [sic] in them in
6 which essentially customers enter into contracts for
7 specific terms. Are you aware of those provisions in
8 the existing tariffs of the company?
9 A. No, I have not studied those.
10 Q. Couldn't there also be contracts under
11 the standard service offer so that -- which again
12 would limit for periods of time, as an example you
13 have a two-year contract, it would limit the
14 switching during that two-year period; wouldn't that
15 type of arrangement also reduce the switching risk?
16 A. Yes. Again, in principle that certainly
17 could reduce risk. It matters when customers have to
18 make their notification surrounding those kinds of
19 restrictions and whether their interest in switching
20 or the contract under which they're being served
21 would be in place and clear before the MRO process
22 began, but the more it's definitive as to who will or
23 will not switch the easier it is to figure out what a
24 risk premium is, and the fewer customers who can

1 switch, the lower.

2 On the other hand, if you -- being able

3 to switch once over a two- to three-year period might

4 be enough to still be a significant source of risk

5 because power prices tend to move in -- somewhat tend

6 to move in waves of boom/bust cycles or periods of a

7 bit of overcapacity then undercapacity, and it's

8 certainly possible that over a couple of year cycle

9 you could be mostly in the money or mostly out of the

10 money relative to those terms.

11 Q. Okay. On a related matter, and I'm still

12 on page 17 -- I'm sorry, still on page 7 of your

13 testimony --

14 A. Okay.

15 Q. -- and specifically lines 12 and 13, you

16 refer to the Ohio companies have experienced larger

17 amounts of customer switching. Do you see that?

18 A. Yes, I do.

19 Q. And do you understand that those

20 switching statistics were arrived at after incentives

21 for switching were built into stipulations as part of

22 cases that launched competition in the state of Ohio?

23 A. I understand that there were such

24 incentives at the time.

1 Q. Is there -- to your knowledge, is there
2 anything in the FirstEnergy proposal that would tend
3 to repeat that experience? Is there anything -- any
4 similar type of incentives that would drive customer
5 switching up again the way they happened in the past?
6 A. I'm not aware of an incentive mechanism
7 comparable to the earlier period, but I think the
8 risk of switching is still considerable in Ohio both
9 because circumstances are such that prices could
10 change a lot over the next few years and that could
11 cause a lot of customer interest in alternative
12 suppliers, and also customers have become somewhat
13 familiar with the process of how to shop and there
14 are retail providers who are in place to try to
15 entice them.
16 Q. But wouldn't you agree that the specific
17 force that drove switching statistics higher in Ohio
18 than elsewhere are unlikely to be repeated?
19 A. You know, I don't really have an opinion
20 on the political likelihood of that sort of thing.
21 I'm unaware of any movement in that direction.
22 Q. Okay. Let's move on to page 8 of your
23 testimony.
24 A. Okay.

1 Q. You mentioned New Jersey and Illinois
2 full-requirements standard-offer service auctions
3 right at the bottom of Page 8 and the top of page 9.
4 A. I see that.
5 Q. Now, in this portion of your testimony
6 you're using these auctions to come up with
7 comparable prices from an auction that would be held
8 in Ohio; is that correct?
9 A. Yes.
10 Q. Okay. And if the auction process was
11 different in Ohio than in New Jersey and Illinois, we
12 could experience different results, correct?
13 A. I need a little clarification about what
14 you mean by the auction process being different.
15 Q. Well, let's take a step back. Isn't it
16 implicit in your analysis in this portion of your
17 testimony that the results would be similar or that
18 we could learn from the results from New Jersey and
19 Illinois because and directly tied to the fact that
20 the auction proposed in Ohio by the FirstEnergy
21 companies is very similar to the auctions that were
22 held in New Jersey and Illinois?
23 A. I certainly agree that there is a strong
24 similarity in the auction designs. My analysis is

1 really agnostic, though, as to the way in which the
2 full-requirements SSO service is outsourced.
3 I'm assuming there would be some sort of
4 competitive broad procurement in which the suppliers
5 would have to provide all of the energy and related
6 products that it takes to create a retail service;
7 that doesn't have to be done through a descending
8 clock auction, although that is a pretty efficient
9 way of doing it, but, for instance, Maryland has used
10 an RFP process for a similar result.
11 Q. So you believe that the results would be
12 essentially the same regardless of the methods used
13 in Ohio for that auction as long as it was for full
14 requirements?
15 A. The key thing that I'm depending on is
16 the fact that it would be a full-requirements
17 vertical-tranche obligation for the winners. I think
18 it would be a very secondary influence as to exactly
19 what the auction mechanism was.
20 Q. Just a moment ago you mentioned an RFP
21 process through Maryland. Why is there no mention of
22 Maryland or its results as part of your testimony?
23 A. It really has to do with data
24 limitations. I have worked on Maryland matters on

1 behalf of those utilities in their standard service
2 offer proceedings, but the only data that I was able
3 to use for those was proprietary, whereas there's
4 public data available on New Jersey and Illinois.
5 Just a quick clarification. I believe in
6 my Figure 7 I do discuss the results of the Maryland
7 auctions and the Delaware auctions as well, but I
8 can't go through the restructuring of those costs in
9 the same way because of the proprietary load-shape
10 data in those settings.
11 Q. I don't want to jump too much ahead, but
12 so we understand a little bit about Exhibit 7, were
13 the results from Maryland as far as risk premium used
14 in your work in this case?
15 A. Yes, insofar as the 25th, 50th, and
16 75th percentile average risk premium was derived
17 from those -- from the sample of firms that are in
18 Exhibit 7 and those became the basis for Exhibits 4
19 and 6.
20 Q. Okay. I see New Jersey -- I'm sticking
21 with Exhibit 7 for a little bit here.
22 A. Okay.
23 Q. I see New Jersey at the top.
24 A. Correct.

1 Q. Illinois at the bottom. There are a
2 large number of rows that appear to be labeled
3 "Maryland."
4 A. Correct.
5 Q. Do we have Delaware here? Is that what
6 the second set of numbers starting with --
7 A. Yes, there's a block in the first column
8 that has the label "DE."
9 Q. I think it's the 11th row, it starts
10 there.
11 A. That looks about right, yeah.
12 Q. That says "DE"?
13 A. Yes. That's Delaware, and it's the
14 Delmarva Power & Light RFP.
15 Q. How was Delmarva's bidding process
16 conducted?
17 A. I can't say with certainty that I
18 remember that exactly, but I believe it is also an
19 RFP process.
20 Q. So we have an auction at the top for New
21 Jersey, Illinois on the bottom, and then RFPs for
22 Delaware and Maryland in between; does that pretty
23 much summarize it?
24 A. That's my recollection.

1 Q. Okay. That was a journey into Exhibit 7.
2 We'll probably get back to the exhibits a little bit
3 later. I'm back on page 9 of your testimony.
4 A. Okay. I've got it.
5 Q. And on page 9, lines 7 through 11 --
6 A. Yes.
7 Q. -- you stated that you adjusted prices
8 from other places to reflect Ohio by using weighted
9 LMPs relevant to the designated New Jersey utility
10 and the Ohio Companies' service territories. Do you
11 see that?
12 A. Yes, I do.
13 Q. Where did you get the historical Ohio LMP
14 data?
15 A. It's MISO data since, as I recall,
16 September 2005 to 2007, about two years worth of data
17 and, you know, to be honest, I don't know exactly
18 what our source -- what our original source was, but
19 it's published by MISO. We may have gotten it from
20 Energy Velocity, which is a data service that
21 compiles some of that data.
22 Q. Was it day-ahead or same-day data?
23 A. It's day-ahead.
24 Q. What locations or designations in Ohio

1 did you use?

2 A. As I recall, although I'll have to check

3 this for you, we did a weighted average of the

4 companies' zones.

5 Q. Do you know what those zones are?

6 A. I don't remember how MISO designates

7 them, but -- no, I don't know the MISO designations,

8 exactly what they call them.

9 Q. How many zones are there?

10 A. There are three companies.

11 Q. Okay.

12 A. And I'm not positive that MISO treats

13 them all separately, but it is a weighted average or

14 it reflects all three companies to the extent there's

15 a data set for that, which I can investigate for you.

16 Q. Now, how much did the values vary from

17 one location to another?

18 A. In terms of congestion?

19 Q. In terms of the values listed by MISO.

20 A. Sure. In terms of -- that's a -- I don't

21 know off the top of my head. I couldn't tell you.

22 But I don't expect it to be a very big difference

23 because I don't think there's a lot of congestion

24 across them.

1 Q. Now, you mentioned New Jersey in your
2 answer. What source of data was used for New Jersey?
3 A. For the LMPs?
4 Q. Yes.
5 A. PJM website for the specific zones of the
6 utility holding the auction.
7 Q. Okay. I'm going to -- keep your finger
8 sort of at that part of your testimony, I'd like to
9 go back to Exhibit 2 which you mention on line 15 of
10 page 9, and I'd like to go back to Exhibit 2 for a
11 little bit.
12 A. Okay.
13 Q. I just want to understand how this
14 table's put together. First of all, in Exhibit 2 the
15 third line, we have -- what is EDC? Electric
16 distribution company, right?
17 A. Correct.
18 Q. And ACE, what company is that?
19 A. Atlantic City Electric.
20 Q. Okay. And there we have in New Jersey a
21 contract goes on line 3 here --
22 A. Yes.
23 Q. -- from June 2007 through May 2010,
24 correct?

1 A. Yes. That's right.
2 Q. And on line 7 down below there we have
3 ACE designated again, correct?
4 A. Yes.
5 Q. We have a contract date from June 2008
6 through May 2011, correct?
7 A. Right. This occurred at a different
8 auction.
9 Q. Okay. And the different auction -- could
10 you describe the relationship between rows 3 and 7?
11 A. Sure. New Jersey holds what they call
12 their basic generation service auctions every year
13 for at that time three years ahead purchasing, and so
14 they held one in 2007 and they held another one in
15 2008. The date in column 2 tells you when the
16 auction occurred, the dates in 4 and 5 tell you when
17 the service obligation extended, and so one of those
18 is the 2007 auction results and one is the 2008
19 auction results.
20 Q. And this happens throughout the table for
21 New Jersey, so all these things that repeat one
22 another, the companies repeated is a designation that
23 an auction for another third of the load was taken at
24 that time, correct?

A. That's correct.

Q. I'm going to stick with this ACE as an example.

A. Okay.

Q. How does the price for the ACE reflect the LMP that you have for the ACE area in New Jersey?

A. Which price are you referring to? Column 6 or somewhere else? Column 14. Which one?

Q. We're having a little -- okay. I was wondering what the pulsing was on the phone.

A. There's some construction behind us and somebody's backing up I think.

Q. I think we want column 6.

A. Okay. So column 6 is the actual price that resulted in the auction, so it reflects the LMPs to the extent that the bidders in that auction themselves were concerned about the local LMPs. I don't know specifically what motivated their decision to offer their services at that price, but I would expect it had something to do with the local LMPs.

Q. And with these LMPs have you investigated how the LMPs differ between New Jersey and the FirstEnergy portions of Ohio?

A. Yes, I have.

1 Q. And how have you done that? And where
2 have you done that? Is that in your testimony
3 somewhere?
4 A. Yes. That's one of the several
5 adjustments that take you from the value in column 6
6 to the value in column 14, and it's done by way of
7 column 9, which is the congestion adjustment, and
8 that compares the price differences between
9 contemporaneous LMPs in the place where the auction
10 was originally held and the LMPs in FirstEnergy and
11 scales up or down according to whether FirstEnergy
12 has higher or lower LMPs in that historical period.
13 And those are simply all-hours LMPs with
14 no load weighting, so that's a flat adjustment for
15 congestion. And what you see is generally the
16 congestion or the LMP effect is considerably lower
17 contemporaneously in Ohio than in New Jersey and the
18 eastern PJM generally because there's a lot of
19 congestion in PJM and -- into eastern PJM. So you
20 have to reduce the prices that prevailed in those
21 auctions by some 20 percent or so, 26 or more percent
22 generally, to make them Ohio equivalent.
23 Q. And so because of this difference, over
24 20 percent that I think you just said in your

1 response, you would expect bidding to reflect the
2 anticipated LMP over the time frame of the contract
3 for the bidding.
4 A. Well, there's more than one component to
5 the LMP so maybe I should just back up a little bit
6 here and give you a short walk through what's going
7 on here.
8 Q. Just as a summary, again, there's more
9 than one element happening in column 9 here on
10 Exhibit 2?
11 A. No. Column 9 is only adjusting for the
12 historical all-hours congestion differences
13 between -- that is LMP differences between one
14 location and the other. It does not adjust for the
15 fact that the forward curve has changed since then
16 and it does not adjust for the fact that the load
17 shapes are different which are further influences on
18 the LMPs that are ultimately incurred by FirstEnergy
19 customers. So it only adjusts for the congestion
20 effect.
21 Q. Okay. I didn't want to interrupt you.
22 You were talking about -- or, was that with the
23 different factors that you were talking about
24 earlier?

1 A. That's sort of a short version of it, but
2 it might be helpful to give you the very high level
3 tour if you don't mind.
4 Q. Go ahead.
5 A. So what I basically have done in this
6 table is take the results of the auctioning as shown
7 in column 6, I then determined at the time what the
8 capacity prices were and subtracted that out for the
9 portion of load -- for the portion of the total cost
10 they would have to pay for capacity. So that's
11 anywhere from 99 down to 83 or so percent of the load
12 and that's the energy component.
13 Then I say, well, what's different about
14 energy in Ohio versus in, say, New Jersey. Well, for
15 one, there's the timing of the event. And since the
16 prior auctions the forward curves have moved up or
17 down, generally they've moved up. So you see in
18 column 8 now prices are on the order of 12 to 30
19 percent higher than they were in the -- at the time
20 of those previous auctions.
21 Q. I'm sorry, just to clarify as we go
22 along, does it make a difference whether we're
23 talking about, with those forward curves, does it
24 make a difference whether we're talking about New

1 Jersey or Ohio?

2 A. Sure. Yes, it does. The forward

3 adjustment adjusts for the differences in forwards

4 then at the auction place to forwards now in Ohio.

5 So it takes both into -- we only care about how it

6 affects you when you get to Ohio.

7 Q. Right. All right.

8 A. Okay? So on average prices are higher by

9 varying degrees as shown in column 8. On the other

10 hand, on average there's a lot less congestion into

11 the region of Ohio than there is into eastern PJM and

12 so that tends to mean we can subtract quite a bit.

13 It turns out also FirstEnergy's companies

14 tend to have flatter loads than these companies on

15 the eastern PJM so column 10 further reduces the

16 number you would have expected moving from PJM to

17 FirstEnergy by a few percent for the fact that the

18 load is flatter.

19 And then that is the extent of the energy

20 adjustments. All those factors are combined and

21 multiplied by column 6 to get the energy adjustment.

22 And then the capacity component is

23 saying, well, that's whatever wasn't included in

24 column 7 so some up to 20 percent or so of the cost

is probably capacity related, and how have capacity prices changed? Well, in some places they've gone way up, in some places they've gone way down, so I adjust for that. Then I put those together in column 13 as a joint effect, and the net overall result is column 14.

I should point out that in this exhibit here at the time we filed this exhibit we had made a mistake in the way we calculated the forward adjustment because we used the wrong reference point as the percentage change, that is it wasn't done relative to FE as a denominator but as -- that is FirstEnergy -- instead it was done relative to the utility that had sponsored the original auction.

So we had to reverse that out, and in my OCC set 3 question No. 29 I filed an adjusted Exhibit 2 which has exactly the same mechanics but a slightly different column 8 and the result is numbers that are about $7 higher on average in column 14.

Q. All right. Let's take that a little bit more slowly. You're saying that the column that I'm looking at for Exhibit 2, Exhibit 2 column 8, has incorrect numbers in it.

A. As originally filed, correct. Those --

1 you are correct that those are incorrect.
2 Q. And the only location right now with the
3 correct answers are in response to an OCC
4 interrogatory and I think you said 29?
5 A. OCC set 3, question 29.
6 Q. And the result in the column 14 is the
7 added $7?
8 A. Yes. The corrected result is about
9 $7 higher on average than the previous result.
10 Q. All right. Now, these are procurement
11 results from Illinois, New Jersey, and Pennsylvania,
12 correct?
13 A. Yes. That's right.
14 Q. Are you aware that the FirstEnergy EDUs
15 have conducted one auction in Ohio and that a second
16 process was begun in Ohio for the FirstEnergy
17 companies?
18 A. Generally, yes.
19 Q. And were you aware that FirstEnergy --
20 A. I'm sorry?
21 Q. Why didn't you use information from that
22 bidding process in your testimony and your Exhibit 2?
23 A. It was not really a very conscious
24 decision. I didn't study that auction closely and I

1 didn't collect data on it, and I had studied and
2 collected data on these other auctions.
3 Q. Wouldn't the FirstEnergy EDU experience
4 in Ohio be the, perhaps the best data for, or at
5 least important data for determining what the Ohio
6 experience would be if we went out for auction again?
7 You wouldn't have to do all the adjustments that you
8 do in Exhibit 2.
9 A. Certainly some of them wouldn't be
10 required. You'd have to do adjustments for where the
11 forward curves were now, and capacity prices have
12 probably changed. And I don't know if the product
13 was the same either, so if the load shapes were
14 different -- so you might have to do several of them,
15 but probably you could get away without doing the
16 congestion adjustment.
17 Q. I don't know what you mean by -- what do
18 you mean by the product, you're not sure if the
19 products would be different? Again, is that a
20 reference to the full-requirements hundred megawatt
21 tranches?
22 A. No, not so much the size of the tranches,
23 but the scope of the service. I don't recall whether
24 the prior auctions were for all customers or whether

1 they were for residential only. If they weren't for
2 the same broad group of SSO customers, then you'd
3 have to adjust for the difference in the composition.
4 Q. Okay. So what you're saying is that they
5 were limited in some respect. You'd have to do a
6 load shape adjustment and that sort of thing.
7 A. Correct.
8 Q. But you didn't investigate the Ohio
9 experience.
10 A. That's correct.
11 Q. Excuse me for just a moment here.
12 I'm back on page 9.
13 A. Okay.
14 Q. These are related questions having to do
15 with this table. Especially on line 12 there's a
16 reference to July 15th, 2008. Do you see that?
17 A. Yes, I do.
18 Q. You adjusted for differences in forward
19 energy prices prevailing as of July 15th, 2008,
20 correct?
21 A. That is correct.
22 Q. How did you do your calculations -- that
23 calculation?
24 A. Well, that calculation is the one I just

1 described, the relevance to July 15th is that that's
2 the date from which I took forward prices and then
3 found the ratio of them in, say, New Jersey versus --
4 or the difference between them in New Jersey at the
5 time of the auction and Ohio at the time as of July
6 15th.
7 Q. Maybe I should be a little bit more
8 clear. Yes, you did discuss that at least
9 conceptually, but what I was looking for in my
10 question was more mechanically how the calculations
11 were done.
12 A. Okay.
13 Q. You know, use ratios or a formula type of
14 thing as opposed to the concept that you were trying
15 to get at.
16 A. Okay. Well, I don't have the actual
17 spreadsheet in front of me to take you through it
18 explicitly, but basically the idea is this: Suppose
19 power forward prices were $80 on, and we'll just talk
20 about a simplified case, let's say $80 on peak in New
21 Jersey in 2007 and now they're a hundred dollars in
22 Ohio, okay?
23 Then the hundred dollars as -- as of July
24 15th. Then they would be 25 percent higher in Ohio

1 and in order to get -- to convert the New Jersey
2 number to a likely Ohio number I need to scale up the
3 energy component by 25 percent, which is the type of
4 number you see in column 8, to get the Ohio update
5 for -- as if in a sense everything else in New Jersey
6 was still the same, but we now had Ohio's level of
7 forward prices.
8 Q. Is there any special significance to July
9 15th? Why was that selected?
10 A. No, it's not an especially more important
11 date than any other. You just have to choose a date
12 to do the calculations, and that was about the time
13 when we were completing this portion of the analysis
14 so we took a date that was contemporaneous with the
15 analysis.
16 Q. In preparing for this testimony did you
17 work with any other dates besides July 15th?
18 A. No, that's the only one for which we
19 prepared these calculations.
20 Q. How much do these market prices vary from
21 day to day?
22 A. I don't have a simple way of describing
23 that, but it is certainly true that forward prices do
24 change from time to time and sometimes it's a few

1 percent per day I suppose. They move back and forth
2 also over time, so there's a fairly complicated
3 process.
4 Q. Well, if they're moving from day to day,
5 wouldn't it be good procedure to look at several
6 points rather than -- or many points rather than --
7 over time rather than one specific time period?
8 A. Well, you would still end up getting one
9 estimate for whatever averaging period you used, and
10 the market will still move some relative to that
11 point no matter how you calculate it.
12 What you want to do is take market data
13 and describe how the -- what I was trying to do is
14 take market data and describe how, under those
15 conditions, what might full requirements service cost
16 in Ohio. If I used an average of other conditions, I
17 would still be doing it for one fixed number
18 ultimately as that average and then that average
19 isn't necessarily what prevailed on any one day and
20 it isn't any more likely to be indicative of where
21 things will stay than any given snapshot.
22 Q. Well, couldn't the particular snapshot
23 that you have been affected by, for instance, say
24 severe weather on that particular day?

1 A. That's unlikely unless it was a really
2 national scale and extraordinarily disruptive type of
3 severity. So Hurricane Katrina could do that, but
4 one thing I've done is study extensively the
5 volatility properties of forward markets and those of
6 the things that cause short-term volatility don't
7 have a long persistence of influence on the market.
8 So things that are happening in one day change the
9 near-term prices, but they don't really affect your
10 expectations for the future very much as a rule.
11 Q. I realize that you probably, I think you
12 probably responded that you wanted to take something
13 close to the period where you were, you know,
14 completing your testimony, but would these
15 calculations be different if we took something, a
16 period of time that was not in the middle of the peak
17 summer electricity use?
18 A. I tend to doubt it, to be honest.
19 Because I'm not just looking at the August price of
20 power here, I'm adjusting for the full strip of power
21 going forward at the time for many months, and the
22 overall seasonal pattern you would expect doesn't
23 really change whether or not you are observing it in
24 the summer or observing it in the fall. It's still a

1 year's worth of overall seasonality that has to be
2 taken into account in these adjustments.
3 It's possible it would show a little bit
4 of a bump for the current month if the current month
5 was -- or for the near month if the near month was
6 being influenced by some local disturbance that went
7 away, but there could be another disturbance later on
8 that would be of the same character. So there's
9 never a perfect moment when the world is exactly
10 normal.
11 Q. In response to my last question or
12 recently you said something about August. Did you
13 mean July?
14 A. No. I did mean August because I was
15 meaning you'd be -- in July you start looking ahead
16 at subsequent months.
17 Q. Okay.
18 A. And also August is one of the, typically
19 one of the more high-cost months. But I wasn't
20 really picking on August. I was just using it as an
21 example.
22 Q. Let's go back here for a moment to
23 Exhibit 2.
24 A. Okay.

1 Q. It's still the portion that you're
2 discussing in this testimony. And I appreciate the
3 high level path through Exhibit 2, but I'd like to
4 explore column 7 a little bit.
5 A. Okay.
6 Q. There I believe you said you took out
7 capacity or the portion attributed to capacity.
8 Could you describe how you did that?
9 A. Sure. As of the auction date shown in
10 column 2 there were often in PJM prevailing market
11 prices for capacity; they instituted their so-called
12 reliability pricing method or model and by the 2007
13 auctions there were already prices that had resulted
14 from that process of setting future capacity prices,
15 and every load-serving entity in PJM incurs those
16 costs and they are a multiple of the peak load that
17 you expect to -- that you're obligated to serve.
18 So we knew the load shapes and peak loads
19 for the auctions involved, and that tells us how much
20 capacity costs ultimately has to be devoted to
21 serving the New Jersey loads.
22 You can subtract that from the auction
23 cost itself and get what is the noncapacity part
24 which is what is in column 7 as a percent.

1 Q. Could you give me the date of that
2 development that you said took place in PJM? I
3 believe you said that there was a change in the way
4 PJM operated.
5 A. Yes. They instituted this RPM capacity
6 pricing method I believe in late-2006 and held the
7 first auctions for it in I think October of 2006 for
8 probably 2008 through '11. Or 2008. I forget
9 exactly when it started but before 2007, before the
10 auctions in New Jersey, they had instituted RPM
11 pricing and had a couple of auctions to set the
12 prices for the future.
13 Q. I notice quite a bit of variability in
14 column 7 as far as, it went from 99.67, which is the
15 first row, down to --
16 A. Right, 79 or so.
17 Q. -- 77.1 and so forth.
18 A. Yes. And the reason for that is that
19 prior to that they did not have this RPM method and
20 they had only traded UCAP, as they called it, and it
21 traded on daily and monthly markets and at the time
22 was trading at extremely low prices because PJM was
23 in excess supply especially the eastern -- I mean the
24 western side where ComEd and Ameren are, and so PJM

had very little capacity at that time. But on the eastern side by -- later on by a year or so later capacity was quite valuable.

Q. I guess what I'm a little bit confused by is I'm expecting to see the later auctions have lower percentages in column 7 and yet that doesn't really occur. The low numbers are some of the -- in terms of percentages are some of the earlier auctions. Wouldn't the effect that you're talking about drive down the percentages in later auctions because you're taking out the capacity component?

A. Well, it depends on what the price was at the time. It's a little easier to see if you go to column 11 which is the other side of -- which is 1 minus column 7.

Q. Right.

A. So that tells you how much of the bid we estimated to be capacity related. It was a very small portion in the ComEd auctions in 2006, it was 22 percent or so of the first New Jersey auction, dropped down a little bit in 2008 because the subsequent RPM auctions had lower prices than the first one. But it was still pretty material. So it changes over time. And it changes by location in PJM

1 also.

2 Q. Okay. That's the discussion of what's

3 happening as far as capacity in PJM. How are these

4 capacity adjustments made for MISO? I believe you

5 described it as taking out the capacity then putting

6 it back in later on in the columns, that would be

7 column 12; is that correct? I'm sorry.

8 A. No; that is correct. Column 12 is the

9 effect of taking out the capacity that prevailed in

10 PJM and putting in the -- a factor to scale that for

11 the difference in capacity prices at FirstEnergy, and

12 for that purpose we got what we understood to be

13 quotes from FirstEnergy related to capacity that they

14 had observed in early-July which were around $2.10 or

15 20 cents, I forget the number but something like

16 that, per kilowatt month and they actually I think

17 arose from primarily capacity prices in the summer

18 with virtually no price in the off-peak months.

19 But on average over the course of a year

20 it was about $2.10 or 20 cents per kilowatt month.

21 So quite a bit less generally than the capacity

22 prices in PJM except for those very early ComEd and

23 Ameren prices which were really low.

24 Q. I guess I'm a little bit, well, there are

1 a couple of things in that answer. You used that
2 $2.20 elsewhere in your testimony.
3 A. Yes, I think I used it in Exhibit 3 also.
4 Q. You said something about over the course
5 of the year, but you said the quotes that you
6 received from FirstEnergy were in July, could you
7 just explain that a little bit?
8 A. Yes. My understanding is that the DNR
9 prices that FirstEnergy observed were really prices
10 for I believe July and August of the year and that
11 there were either nothing trading or virtually zero
12 cost DNR capacity in the other months. And those
13 were, I forget the dollars, the amounts that were
14 involved, but we did convert them to an annual
15 equivalent because that's simply -- we need to price
16 these contracts on a per megawatt-hour basis based on
17 the average annual energy requirement. So when we
18 did that, it came out to be $2.10 per kilowatt month.
19 Q. And when you say "quotes," are these
20 actual transactions?
21 A. That's a question you should direct to
22 FirstEnergy. I don't recall. I believe so, but I'm
23 not positive.
24 Q. So you accepted their representation that

1 these are the numbers and --

2 A. Well, yes. There's not a public data

3 source that I'm aware of on capacity pricing in MISO.

4 They don't have a formal market for capacity at this

5 time, and so DNR is traded so that companies can

6 satisfy their reliability obligations, but it's

7 traded bilaterally and the data is not public, so we

8 had to rely on FirstEnergy for that.

9 Q. So this is coming from FirstEnergy's, I

10 don't know exactly how to describe it, dealings

11 concerning bilateral contracts.

12 A. Well, that's reading a little more into

13 it than I can tell you. It came from FirstEnergy. I

14 don't know whether it's a transaction they were

15 actually in or they're just aware of the transaction.

16 Q. You used the word "quotes." Why did you

17 use the word "quotes"? That suggested to me that you

18 understood that it was, well, there were

19 representations made to you about what it was by

20 FirstEnergy.

21 A. You're reading too much into my choice of

22 words.

23 Q. Okay.

24 A. I don't know whether it was a quote or a

1 transaction. It's the number that was given to us as
2 their understanding of the current capacity pricing.
3 Q. All right. I'm kind of done with Exhibit
4 2 so I've got to recalibrate here.
5 Okay, I have just a little bit at the end
6 here. Did you say that you've read Mr. Jones'
7 testimony?
8 A. I have.
9 Q. Did you note that as far as the direction
10 of prices over time, that Mr. Jones has inclining
11 prices over the three-year period whereas you have
12 declining prices? I'm at about page 15 and 16 of
13 your testimony.
14 A. Okay, hold on.
15 Okay. I have it.
16 Q. Why are the prices declining over the
17 three-year period in your work?
18 A. Basically it's because the forward curve
19 is declining slightly over the future right now.
20 It's pointing downwards a little bit. And I'm using
21 a constant risk premium throughout the entire time
22 while Dr. Jones is using a risk premium that becomes
23 steeper or larger as you go further out.
24 Q. Have you discussed that factor, that

1 difference between your testimony, with Mr. Jones?
2 A. Generally, yes.
3 Q. And which is the better assumption to
4 make for -- over time? Why did you select the
5 constant risk premium?
6 A. Well, the main reason was that the data
7 I'm relying on is pretty noisy and not such a huge
8 sample that I felt like I could really pick out very
9 detailed patterns inside of it, so I didn't attempt
10 to do so, and to be conservative just said let's look
11 at the 25th, 50th, or 75th percentile of the
12 overall range of risk premiums I observed, think
13 about whether it's more likely that we be at the high
14 end of that or the low end, and ended up concluding
15 there are reasons that there's more risk than average
16 in Ohio than in those other settings but there are
17 some offsetting factors and I'm going to go with the
18 middle.
19 I certainly agree with Dr. Jones that
20 there is in principle an upward sloping risk premium
21 for a couple of reasons in this setting, one is just
22 the right to switch is a call option which is granted
23 to customers, and call options are more valuable the
24 longer their horizon. Future years involve much more

1 volatility in percentage terms than near-term years
2 and so there's more likelihood of switching as you go
3 out farther.
4 So that's definitely correct conceptually
5 and I think Dr. Jones also feels it's likely that
6 switching could increase over time for other reasons
7 as well just because of the process building
8 momentum.
9 So I don't disagree with the direction of
10 his adjustments. I was just being conservative in
11 mine and not building that factor in.
12 Q. I'm over on page 17 of your testimony and
13 you have a market reference price for the ESP of
14 around 92 to 90 dollars per megawatt-hour over the
15 next three years. Do you see that?
16 A. I do; line 17.
17 Q. But the adjustment you mention -- well,
18 first off, how did you arrive at the 90 to 92? Quite
19 frankly, I've looked at the numbers that you have on
20 page 15 and 16 and don't see any way of coming up
21 with 90 to 92 dollars. Could you describe how you
22 come up with those numbers? Was there some kind of
23 averaging process that you used?
24 A. Yes, there is.

1 Q. Okay. Could you describe that averaging
2 process?
3 A. Sure. On -- let's see, where is that?
4 Okay. It's probably a little easier to
5 go to Exhibit 4 and Exhibit 6 to see what's going on
6 because then we can look at the numbers
7 simultaneously.
8 Q. Okay, I'm there.
9 A. So in my discussion of risks I concluded
10 that the mid -- the 50th percentile risk premium
11 was the one I would elect to use.
12 Q. So on Exhibit 4 and Exhibit 6 you're
13 going to be using the one called Estimated
14 50th Percentile Risk Premium, right? That set of
15 rows.
16 A. That's correct, in rows 10 and 11.
17 Q. Okay.
18 A. And you see those on Exhibit 4 started
19 around $96.68 and dropped down to 92.44 by 2011, and
20 when you go to Exhibit 6, they start at 87.94 and go
21 to 88.05.
22 Q. Okay.
23 A. If you average those two --
24 Q. If you average all six numbers?

1 A. Well, year by year, yes. If you average
2 PJM and Cinergy in the first year you get about a 92
3 average of the midpoint between 96.68 and 87.94, and
4 if you average, say, 2011 you've got a 92.44 and an
5 88.05 and so 90 is about in the middle.
6 Q. Okay.
7 A. So these aren't precise averages and, you
8 know, the decimal places are obviously not relevant
9 to this proceeding, so that's why I said 90 to 92.
10 Q. So those numbers come from at least
11 rounding from Exhibits 4 and 6 exclusively; is that
12 right?
13 A. Correct.
14 Q. And what about the --
15 A. They're corroborated, as I state on line
16 18, by Exhibit 2 where if you look at the range of
17 those numbers, they went from the -- mostly around 80
18 to mostly -- as a low, to in the upper 90s, and the
19 revised calculation is a bit higher than that.
20 Q. You don't actually use, in arriving at
21 your 90 to 92 dollars, you don't actually use the
22 comparables method that you laid out earlier in your
23 testimony.
24 A. I don't use an explicit value out of it.

1 I do check that the results of my construction
2 cost -- constructed cost calculations are
3 qualitatively similar to Exhibit 2 by observing that
4 the 50th percentile is right in the middle of the
5 adjusted comparables that I found. And as I discuss
6 on page 15 at line 10, I also mention that, you know,
7 I saw that range of 76 to 93 dollars. As I mention,
8 that's about $7 higher on average now, not every
9 number moves up 7 but the new range is more like 77
10 to 106 dollars now, and again, 90 to 92 is right in
11 the middle of that range.
12 Q. I'm not completely following you and that
13 was going to be my next question. When you made
14 those adjustments that you mentioned to the column,
15 that was an err?
16 A. Yes.
17 Q. How does that effect your ultimate
18 results on page 17?
19 A. Go back to page 15 first, that's the
20 first place you're going to see it.
21 Q. Okay.
22 A. So the row -- I mean line 11 has a
23 statement saying that the prices range from 76.35 to
24 93.80.

1 Q. All right.

2 A. And those should be higher. They should

3 be 77.55 to 106.59 for the -- okay? They don't

4 change anything other than Exhibit 2, so all the

5 other analyses and numbers are unaffected, all right?

6 And so it is still true on lines 17 and 18 of page 17

7 that a number of 90 to 92 is in the middle of the

8 range of comparables.

9 Q. Okay. And so because the figures on page

10 15 and 16 are not coming from Exhibit 2, those

11 numbers do not change.

12 A. Correct. The ones that are from the

13 constructed cost approach do not change, only the

14 ones from the comparables change.

15 Q. All right. So the only thing that's

16 changing at the tail end of your testimony are the

17 portion of the testimony on lines 10 through 14 on

18 page 15 because that's where the comparables --

19 A. That's correct.

20 Q. Okay. And since you didn't explicitly

21 use that number, the number on page 17 doesn't change

22 and you just have a different number as far as what

23 you call the corroboration.

24 A. Yes. But I guess I don't quite agree

1 that I didn't use it. If I had not found there was
2 corroboration, I would have had to investigate what's
3 going on and decide whether I'd give the same weight
4 to the constructed cost method. So I think I am
5 using it, but I'm not taking an explicit value from
6 it.
7 I actually think -- and one of the
8 reasons for that is that, you know, there's quite a
9 bit of subjectivity involved that bidders will bring
10 to the process in assessing what the risk premium or
11 other kinds of premiums might be, and even the number
12 90 to 92 that I describe is itself uncertain because,
13 as you refer back to Exhibit 4 and Exhibit 6,
14 remember I also had 25th and 75th percentile
15 prices as well which would be higher or lower, and I
16 think realistically we can't predict the results of
17 these auctions to within, you know, more than a few
18 percent. That would be a pretty big conceit.
19 Q. That's all I meant. Thank you for the
20 explanation. I only meant in a mechanical sense of
21 coming up with the numbers that you didn't use it. I
22 understand your responses and I have no further
23 questions. Thank you very much. Other attorneys on
24 the phone may have their own questions.

A. Okay. Thank you.

MR. YURICK: This is Mark Yurick on behalf of The Kroger Company. I actually have a couple of questions, but I don't need to go first.

THE WITNESS: Can I just ask a quick question about do you have a lot of questions? Because I might take a short break if you do. If you don't have too many, we can keep plowing on.

MR. YURICK: Unfortunately, some of that depends on your answers, but I wouldn't assume that it would be more than 15 or 20 minutes.

MR. HAYDEN: Can we just take a real brief five-minute break?

MR. YURICK: I'm okay with it.

MR. HAYDEN: Okay. Let's take a five-minute break.

MR. SMALL: How about 10:30 so everybody has a landmark, all right?

MR. HAYDEN: Okay, sure.

THE WITNESS: That would be fine.

MR. HAYDEN: Thank you.

(Recess taken.)

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1 EXAMINATION

2 By Mr. Yurick:

3 Q. Mr. Graves, my name is Mark Yurick, and I
4 represent The Kroger Company. How are you doing this
5 morning?

6 A. Fine, thank you. Nice day today.

7 Q. Yeah, it is.

8 I'm going to ask you a few questions.
9 Your testimony starting on page 5, and this is kind
10 of a general question, you indicate or seem to
11 indicate that one of the larger risks faced by a
12 utility company in providing standard service offer
13 is customer switching; is that right?

14 A. Yes, I think that's one of the important
15 risks.

16 Q. Right. I'm just saying it is a risk or
17 one of a number of risks; is that right?

18 A. Yes, I agree with that.

19 Q. I know you testify a little bit about the
20 effects of government aggregation and the effect that
21 government aggregation has on residential switching
22 risks; is that right?

23 A. Yes, sir.

24 Q. I'm not going to ask you about that.

1 What I want to know is are there ways that a company
2 can hedge against the risk of industrial or
3 commercial clients, are there ways to hedge against
4 those types of customers from switching?
5 A. So just to make sure I understand your
6 question, are you -- you're imagining a
7 full-requirements supplier worried about switching
8 and trying to decide what he could do with his
9 portfolio to immunize himself against that?
10 Q. Right. Are there ways to mitigate that
11 risk?
12 A. Sure. There is a little bit you can do.
13 The best things that can be done at the regulatory
14 level which are not within the scope of the supplier,
15 so, you know, restrictions on switching and different
16 ways of pricing the service can help mitigate that
17 risk, but I'm assuming those are off the table.
18 So I think you're saying if I have to
19 offer a fixed price with given flexibilities for
20 customers, what can I do.
21 Q. Well, let me ask it maybe a little
22 different way. The risk factor of a customer, an
23 industrial or commercial customer, switching, I think
24 your testimony is that that risk increases the

1 potential cost to a full-service supplier, correct?
2 A. That is correct.
3 Q. That risk, in other words, translates
4 into a monetary cost. Am I saying that correctly?
5 A. Yes, that is correct.
6 Q. What if I as a full service requirements
7 utility entered into a special contract with a
8 commercial organization or an industrial customer,
9 would that mitigate my risk?
10 A. Certainly contracts can allocate risk and
11 responsibilities and so there's no reason that in
12 principle a contract couldn't reduce that risk, but I
13 guess I want to make sure we're talking about the
14 same thing which is if I am a full-requirements
15 supplier for a slice of system on FirstEnergy's
16 territory, I don't know that there's any authority to
17 subdivide the way that's provided to particular
18 customers so that they sign contracts saying they
19 won't switch or saying that they'll only -- so if you
20 are faced with just the general risk of their
21 behavior, of their rational economic behavior given a
22 fixed-price contract, a fixed price SSO, contracting
23 doesn't seem to me to be a remedy.
24 Q. Okay. Well, really I'm not asking that

it's going to eliminate it entirely or whatever. All I'm saying is let's say you're, I'm trying to take it one step at a time. Obviously, you know, I'm trying to make it as simple as I can. So I'm just kind of asking you if I'm a utility company and I have to provide standard service offer and I enter into a special arrangement, a special contract with one of my large industrial customers, to some extent that mitigates my risk, correct?

A. If I -- I think I understand your question. And I guess the answer is yes, if you're able to do that and it restricts the way the customer can elect to move to and from the full requirements fixed price service, so if once the fixed price service is in place you can then go out and say "Well, here's what I'm offering, but before I set the price for it I'd like to know if anybody is willing to sign a nonswitching contract." If I can get that information before the price is set, then that could be helpful.

Q. Okay. Again, just -- I'm really just asking about a hypothetical utility company serving full requirements. If I have a contract with a large industrial customer, okay, and that contract provides

1 that they're going to buy their electricity, their
2 energy and power, at a certain price for a certain
3 period of time and there's no switching allowed,
4 that's going to mitigate my risk, right?
5 A. Sure, that does, but again, the contract
6 has to be in place before you -- for you to
7 incorporate it in the way you would price a
8 full-requirements service. You have to know that
9 that's there before you can set the price.
10 Otherwise, I don't know that I have that and I need
11 to put in a risk premium for it.
12 Q. Right. But I guess what I'm saying is
13 again, in a vacuum, and I apologize I'm probably
14 talking way beneath your level, all right, but just
15 as a simple proposition I'm a company providing
16 energy and power to an industrial and I'm worried or
17 I'm trying to reduce the risk of them switching. I
18 can essentially lock them up with a special contract.
19 I mean it's possible, assuming the PUCO and so forth
20 approves it, I can lock that industrial up for a
21 certain specific period of time thereby mitigating my
22 risk, correct?
23 A. Subject to your hypothetical, sure, I
24 agree that those kinds of contracts can reduce risk.

1 Q. And since the risk of customer switching
2 has the effect of increasing cost or price to
3 compensate for that risk, then decreasing the risk by
4 entering into a special contract, that would also
5 lessen my costs. It would have the converse effect,
6 theoretically anyway; isn't that right?
7 A. Yes, that is correct. To the extent I
8 don't have to worry about a customer
9 opportunistically and perfectly reasonably choosing
10 to leave my service and take a better offer, then I
11 don't need to build in a premium for the cost of
12 either -- potentially dumping supplies at a loss
13 because I don't have to worry about the loss.
14 Q. Right. And again, I apologize for the
15 simplicity of my questions. I'm just trying to be
16 certain that we're on the same page here.
17 A. And conversely, I'm not trying to answer
18 them in too complicated a way. I just want to make
19 sure whether we know we're talking about a generic
20 contract or we're talking about a full-requirements
21 SSO where we have to know whether those things are in
22 place first, so that's all I'm trying to clarify.
23 Q. Now, let me ask you this: In coming up
24 with your pricing forecast, did you look at how many

1 or did you look at the special arrangements or
2 special contracts that the FirstEnergy companies had
3 where their supply or their sales were more or less
4 locked in? Was that information that you took into
5 consideration?
6 A. No, it is not. I don't know how many
7 such contracts they have or what their terms are or
8 whether they would even survive this process.
9 Q. I understand, and perhaps you weren't
10 asked to look at those, but to the extent that those
11 special contracts exist or are locked in, that would
12 mitigate the risk of customer switching; isn't that
13 right?
14 A. Within the limits of what I understand of
15 the situation it sounds like the answer is yes, that
16 is if a full-requirements service were offered and it
17 became the price that prevailed under the contracts,
18 and the contracts continued to limit the switching of
19 the customers, then there wouldn't need to be a risk
20 premium for the potential departure of those -- of
21 that group of customers.
22 Q. Let me ask you another question along
23 those same lines. If I was looking at a cost
24 difference between a special contract price and a

1 standard service offer price and I was trying to
2 determine whether I'm making money or losing money on
3 that special contract, wouldn't it be prudent to take
4 into consideration the fact that those sales are
5 locked in, that the -- in other words, that there's
6 no risk of customers switching?
7 A. Whose point of view are we looking at
8 here? Is this the seller, the supplier of power
9 wondering if --
10 Q. Yeah. I'm a seller, okay, I've got a
11 special contract, I'm trying to determine whether or
12 not I want to enter into it, okay? I'm a
13 hypothetical utility company, and I'm trying to
14 determine is this a good special contract for me or
15 is this something that I should not want to enter
16 into. I've got a price from a special contract, I've
17 got a standard service offer price, okay, and I'm
18 trying to determine now at what level am I losing
19 money. Doesn't the risk of switching enter into
20 that?
21 MR. HAYDEN: Hey, Mark, this is Mark
22 Hayden. Just for clarification, I think I heard two
23 different things. I thought I heard you say seller
24 or supplier perspective and then I thought I heard

you say from the utility's perspective, and I just want to understand which perspective.

MR. YURICK: Oh, I'm sorry.

Q. Yeah, I mean from the utility's perspective. Not necessarily generator's perspective. I mean from the standpoint of the utility who's entering into the special contract.

MR. HAYDEN: Okay.

A. Okay, so is the presumption these contracts exist or are at least being considered and you're trying to decide if it's a good deal to enter the special contract given that it doesn't involve -- that it restricts switching?

Q. Given that it restricts switching.

A. Yes. So --

Q. Is that something I have to take into consideration?

A. Oh, yes, you would want to take that into consideration, and of course it's not the only element, but you would conceivably be willing to sell it for a bit less given the lack of switching and then you'd have to see if the price difference was commensurate with the risk reductions.

Q. And there's some model or some way that

1 you can quantify or at least try to put -- try to
2 quantify the reduction in risk of customers switching
3 into that number; isn't that right?
4 A. Yes. It's a fairly difficult analytic
5 exercise, but it basically boils down to saying
6 what's the behavior of the customer likely to be
7 under the status quo or the normal situation versus
8 how much more restricted are they under the contract,
9 and to what extent does that eliminate the likelihood
10 of them choosing some other kind of service or making
11 other kinds of demands on my service, and putting a
12 price tag on those.
13 It can be done with call-option based
14 models, but they're complicated compared to normal
15 financial market call options because the quantities
16 involved are not certain.
17 Q. I understand. But you can attempt to do
18 that.
19 A. Yes.
20 Q. You should attempt to do it, otherwise
21 you don't know whether you're making money on the
22 contract or not, really, right?
23 A. Well, it might be necessary. It depends
24 on how -- there's some level at which you can be

1 pretty sure and then it gets gray as you get close
2 to, you know, exactly right prices.
3 Q. I understand.
4 MR. YURICK: I don't have any more
5 questions for the witness at this point.
6 And I thank you for your patience, sir.
7 THE WITNESS: Sure. Not at all.
8 MR. HAYDEN: Does anybody else on the
9 phone have any more questions for Dr. Graves?
10 MR. PORTER: I do not. This is Andre.
11 MR. HAYDEN: Okay. Hearing none, I
12 believe we are done. Thank you very much.
13 (The deposition concluded at 10:49 a.m.)
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State of _____ :
: SS:
County of _____ :

I, Frank C. Graves, do hereby certify that I have read the foregoing transcript of my deposition given on Tuesday, September 23, 2008; that together with the correction page attached hereto noting changes in form or substance, if any, it is true and correct.

_____
Frank C. Graves

I do hereby certify that the foregoing transcript of the deposition of Frank C. Graves was submitted to the witness for reading and signing; that after he had stated to the undersigned Notary Public that he had read and examined his deposition, he signed the same in my presence on the _____ day of _____, 2008.

_____
Notary Public

My commission expires _____, _____.

- - -

1 CERTIFICATE

2 State of Ohio :
: SS:
3 County of Franklin :

4 I, Maria DiPaolo Jones, Notary Public in and for the State of Ohio, duly commissioned and
5 qualified, certify that the within named Frank C. Graves was by me duly sworn to testify to the whole
6 truth in the cause aforesaid; that the testimony was taken down by me in stenotypy in the presence of said
7 witness, afterwards transcribed upon a computer; that the foregoing is a true and correct transcript of the
8 testimony given by said witness taken at the time and place in the foregoing caption specified and
9 completed without adjournment.

10 I certify that I am not a relative, employee, or attorney of any of the parties hereto, or of any
11 attorney or counsel employed by the parties, or financially interested in the action.

12

IN WITNESS WHEREOF, I have hereunto set my
13 hand and affixed my seal of office at Columbus, Ohio, on this 25th day of September, 2008.

14

15 Maria DiPaolo Jones, Registered
16 Diplomate Reporter, CRR and Notary Public in and for the
17 State of Ohio.

18 My commission expires June 19, 2011.

19 (MDJ-3262A)

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